Relationships, Risk and Remuneration:

ASX200 Directors' practice of the ASX Corporate Governance Council Principles

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Abstract

Corporate governance has attracted significant focus both in both Australia and other countries, particularly in light of large corporate collapses over recent decades. With an increase in the focus on corporate governance, many countries have adopted voluntary codes of corporate governance and require corporations to explain deviations from best practice ('comply or explain').

The Australian Securities Exchange Corporate Governance Council (ASXCGC) was formed in August 2002, and released a set of best practice governance principles in 2003 containing the 'if not, why not' (comply or explain) provision. The best practice principles and recommendations are extensive, with the current (3^{rd}) version containing eight principles and 29 recommendations. However, in spite of over a decade of use, it is not currently understood how company directors make sense of and enact the 29 recommendations.

The effective practice of corporate governance of Australian Securities Exchange (ASX) top 200 companies (ASX200) is critical to the reputation and conduct of wealth and prosperity in the Australian economy. This thesis studies the ways in which ASX200 directors describe the practice of governance against the *ASXCGC Principles and Recommendations*. It highlights the dominant and the normalised factors for directors in the practice of the principles and recommendations and proposes an interpretative model of practice to assist directors to hone their governance practice. The model could also be useful for future and current company directors, governance practitioners and regulators of listed and unlisted companies in Australia.

Certification of Dissertation

I certify that the ideas, experimental work, results, analyses, software and conclusions reported in this dissertation are entirely my own effort, except where otherwise acknowledged. I also certify that the work is original and has not been previously submitted for any other award, except where otherwise acknowledged.

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CHAPTER 1: Introduction

1.1 Background

Corporate governance is the framework of rules, relationships, systems and processes within and by which authority is exercised and controlled in operations.[1] It is the mechanism through which companies are controlled and monitored by those responsible for its operations.

Corporate governance has attracted significant focus in both Australia and around the world, particularly in light of large corporate collapses over recent decades. With an increase in the focus on corporate governance, a number of countries have introduced various forms of corporate governance regulations.[2] Many countries, have also adopted voluntary codes of corporate governance with the requirement to explain deviations from best practice (‘comply or explain’). A prime reason for adopting such voluntary codes of best practice is that they provide a ‘softer form’ of regulation that provides companies with flexibility in how they comply.[3]

The Australian Securities Exchange Corporate Governance Council (ASXCGC) was formed in August 2002. This Council was designed to develop and deliver an industry-wide, supportable and supported framework for corporate governance which could provide a practical guide for listed companies, their investors, the wider market and the Australian community.[4] The initial 21 members of the ASXCGC included selected organisations with disparate business backgrounds carrying the varying aims and priorities of their constituencies. [5]

The ASXCGC released a set of best practice governance principles in 2003 that were designed to achieve good governance outcomes and meet the reasonable expectations of most investors in most situations.[6] The *ASXCGC Principles and Recommendations* adopted the ‘if not, why not’ (comply or explain) obligation,

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[1] Commonwealth of Australia, ‘The Failure of HIH Insurance: A Corporate Collapse and its Lessons (Report No. xxxiii, HIH Royal Commission, 2003) vol 1.
[2] Ruth V Aguilera and Alvaro Cuervo-Cazurra, 'Codes of Good Governance Worldwide: What is the Trigger?' (2004) 25(3) *Organization Studies* 415, 415.
[3] OECD, *OECD Principles of Good Governance* (1999) 11.
[4] ASX Corporate Governance Council (ASXCGC), *Principles of Good Governance and Best Practice Recommendations* (2003) 2.
[5] Ibid.
[6] ASXCGC, *Corporate Governance Principles and Recommendations* (3rd ed, 2014) 3.

introducing the obligation to explain deviations from the code's principles. Further, the Australian Securities Exchange (ASX) Listing Rule 3.1 required a statement to be included in the annual report of listed companies which discloses the extent to which they could be determined to have followed the *ASXCGC Principles and Recommendations*. The *ASXCGC Principles and Recommendations* noted that, because the size, complexity and operations of companies differ, flexibility that would optimise performance was allowed.[7] At the time, ASXCGC considered it 'a major evolution in corporate governance practice in Australia, the impact of which must not be underestimated'.[8]

Just prior to the establishment of the ASXCGC, the 'Howarth Corporate Governance Report' ('*Howarth Report*') was released, with research conducted by the Business School at the University of Newcastle. The collapse of Australian companies, such as Ansett, OneTel, and HIH, had heightened concern about the quality of corporate governance in Australia. The *Howarth Report* noted that, up until that time, the debate about standards of corporate governance had been largely based on anecdote and opinion.[9] The report analysed the top 250 listed companies and measured the independence of the board and oversight committees, and showed that there was room for improvement in demonstrating openness and accountability. The report further stated that in the 'current climate of corporate damage control, organisations need to reassure the community, investors and the government that business is conducted fairly and in the interests of all shareholders and stakeholders'.[10]

In 2007, the ASXCGC released a second edition of *Corporate Governance Principles and Recommendations*. The ASXCGC stated that the adoption of recommended practices and of the 'if not, why not' reporting had increased in each of the three years the code had been in operation.[11] The second edition revised the total number of principles down from ten to eight, however the key elements remained unchanged.

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[7] ASXCGC (2003), above n 4, 2.
[8] Ibid.
[9] Jim Psaros and Michael Seamer, 'Howarth 2002 Corporate Governance Report' (No. 2, University of Newcastle Business School, 2002) 3 ('*Howarth Report*').
[10] Ibid.
[11] ASXCGC, *Corporate Governance Principles and Recommendations*, (2nd ed, 2007) 2.

In 2007, the Global Financial Crisis (GFC) began to unfold and in 2009 the *Report of the High Level Group on Financial Supervision in the EU* examined the contributing causes of the GFC and found that corporate governance was one of the most important failures of the crisis.[12] The ASXCGC released amendments to its second edition in 2010. These amendments included a recommendation for increased board diversity which suggested the establishment of a diversity policy with measurable objectives for achieving gender diversity so that progress could be assessed annually.[13]

During 2014 the ASXCGC released the third, and current, edition of the code (included in Appendix A), which contains 29 recommendations underpinning eight Principles. The revised recommendations in the current edition include checks for directors prior to appointment, written agreements between directors and the company, the company secretary's accountability to the board, director inductions and professional development, external auditor attendance at the Annual General Meeting (AGM), information and communication to investors, disclosure on the internal audit function and risk exposure and management.[14] Other key changes included amendments to risk recommendations to reflect the lessons learnt from the GFC and greater flexibility in making disclosures on company websites (rather than only in annual reports).[15]

1.2 Statement of problem

Codes of good governance appear to have generally improved the governance of corporations in countries that have adopted them.[16] Like other codes of good governance, the ASXCGC principles and recommendations provide high level guidance on how governance could be practiced.[17] The fact that they are not mandatory suggests that there may be significant variation in how governance is practiced.[18]

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[12] The High Level Group on Financial Supervision in the EU, *The Report of the High Level Group on Financial Supervision in the EU* (2009) 29.
[13] ASXCGC, *Corporate Governance Principles and Recommendations with 2010 Amendments* (Ammendments to 2nd ed, 2010) 26.
[14] ASXCGC (3rd ed), above n 6, 3.
[15] Ibid.
[16] Ruth V Aguilera and Alvaro Cuervo-Cazurra, 'Codes of Good Governance' (2009) 17(3) *Corporate Governance: An International Review* 376, 1.
[17] ASXCGC (2014), above n 6, 3.
[18] Ibid 3.

The board is the governing body of the company, and as members of the governing body, the directors are responsible for directing the company.[19] In order to understand boards, it is critical to understand the directors who sit on them.[20] Company law requires that directors will act collectively as a board; but in carrying out functions as a member of the board, each director is individually subject to statutory and general law director's duties.[21] Director's duties exist to address the agency problem, which posits that the interests of directors may diverge from the interests of their shareholders.[22]

The S&P/ASX200 is regarded as Australia's primary share market index and measures market capitalisation and liquidity.[23] At present it is difficult to gain access to Australia's top 200 company (ASX200) directors (an elite group in society); consequently, there has been a distinct lack of research on how this elite group actually govern and meet their obligations as directors.

The ASXCGC principles and recommendations are fairly prescriptive in their nature, the current (3rd) edition containing eight principles and 29 supporting recommendations. Although the ASXCGC principles and recommendations have been in place for 15 years, and there is no research examining how ASX200 directors make sense of the eight principles and 29 recommendations in the ASXCGC code, and how they choose to focus their time and efforts in governing the ASX200 companies. Further, given they are not mandatory, but rather are best practice guidelines, this requires that there could be various ways of enacting these governance recommendations. It is not currently understood how directors of listed companies perceive their responsibilities or indeed enact them in governing within the Australian jurisdiction under the ASXCGC Principles and Recommendations.

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[19] Bob Tricker, *Corporate Governance Principles, Policies and Practices* (Oxford University Press, 2nd ed, 2012), 44.
[20] Renee Adams, 'Boards, and the Directors Who Sit on Them' (Finance Working Paper No 515/2017, ECGI, July 2017).
[21] Robert Austin and Ian Ramsay, *Ford, Austin and Ramsay's Principles of Corporations Law* (LexisNexis Butterworths, 16th ed, 2015) 419.
[22] Michael Jensen and William Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3 *Journal of Financial Economics* 305, 305; Jacqueline Christensen, Pamela Kent and Jenny Stewart, 'Corporate Governance and Company Performance in Australia' (Pt Wiley-Blackwell) (2010) 20(4) *Australian Accounting Review* 372, 373.
[23] *Market Index* <https://www.marketindex.com.au/methodology>.

The ASX200 directors arguably have the most complex responsibilities, and this research endeavours to understand how ASX200 directors reflect on their practice of the ASXCGC principles and recommendations (3rd edition), enabling a better understanding of how the *ASXCGC Principles and Recommendations* are actually being practiced.

The research results are intended to inform current directors, those considering a director career, policy makers such as the ASXCGC, and other parties interested in governance on how the ASXCGC Principles and Recommendations are being practiced by ASX200 directors. For those considering a director career, such insights would be particularly useful in assisting the transition into director roles where they are required to govern companies under the ASXCGC code. Further, developing an understanding of how governance is practiced by the ASX200 directors would provide a sense of what happens in the ASX200 boardrooms, a subject which is little understood and researched.

1.3 Research objective

The research objective for this study was to understand how ASX200 directors reflected on their practice of the ASXCGC principles and recommendations. This study sought to explore and advance knowledge on governing under good governance codes by investigating how the ASX200 directors reflect on their governance of the ASX200 companies.

To fulfil this objective, it was necessary to understand how ASX200 directors make sense of the eight principles and 29 recommendations, and how they choose to focus their time and efforts. It was also necessary to query the degree to which these non-mandatory principles and recommendations were embedded in the governance practices (as reflected on by the ASX200 directors). Further, it was necessary to study the degree to which there was commonality in the governance practices as reflected by the ASX200 directors. Finally, it was necessary to have a broader understanding of ASX200 director governance as reflected on by the directors.

These objectives were considered during the design phase of the research, as discussed in Chapter 3. The answer to the primary research question resulted in the development of an ASX200 director governance model which is presented in Chapter 6.

1.4 Research question

As already noted, the research objective for this study was to understand how ASX200 directors reflect on their practice of the ASXCGC principles and recommendations. The purpose of the research is to enable new and existing directors to better understand governance under the ASXCGC principles and recommendations and assist them to perform their roles. In order to explore how the ASX200 directors reflect on their governance of the ASX200 companies, the research sought to answer the following sub-questions:

1. Which of the ASXCGC principles and recommendations are embedded in the governance practices of ASX200 companies (as reflected on by the ASX200 directors)?
2. Which of the ASXCGC principles and recommendations have accepted practices as reflected by ASX200 directors?
3. How do the ASX200 directors reflect on their practice of each of the eight ASXCGC principles and associated recommendations?
4. What keeps ASX200 directors awake at night (what are their enduring concerns with respect to governing ASX200 companies)?
5. What makes governing ASX200 companies easier (as reflected by the ASX200 directors)?

In answering each of these five sub-questions, the study was designed to be able to answer the primary research question: ‘How are ASX200 directors reflecting on their practising of the ASXCGC principles and recommendations?’

1.5 Motivation for the study

The researcher is a professional board director and chair, currently serving on a number of Australian boards in the health, education, sport and charity sectors. Prior to a board career, senior and executive roles in various sectors with governance and managerial responsibilities had informed the researcher’s own practice. These experiences led to a strong interest in governance across Australian companies.

The study is motivated by a desire to understand how ASX200 directors (responsible for governing some of Australia's largest publicly listed companies) reflect on their practice of the ASXCGC principles and recommendations. Given the complexity and detail in the ASXCGC principles and recommendations, the researcher desired to understand how ASX200 directors made sense of the code, and where and how they chose to focus their time in addressing them.

Of all corporate directors, those from ASX200 companies have, arguably, the most complex responsibilities. The researcher sought to synthesise the lessons learnt by studying how ASX200 directors manage their time and effort when navigating the ASXCGC principles and recommendations.

1.6 Research methodology

The adoption of an interpretive approach was determined to be appropriate for this study, as interpretation follows the idea that reality is socially constructed rather than objectively determined.[24] Interpretivism supports a qualitative approach, which attempts to make sense of or interpret phenomena in terms of the meanings people bring to them.[25] Given that qualitative research is known to enable the researcher to get closer to an individual's perspectives (through methods such as interviewing),[26] it was determined that using qualitative research methods for this study would be the most appropriate strategy for researching how ASX200 directors reflect on their governance practices of the ASX200 companies. Because little is known about how directors practice the ASXCGC principles and recommendations, adopting a qualitative research methodology allowed for the use of a grounded theory methodology in which no up-front theory is proposed and no hypotheses are formulated for testing ahead of the research.[27]

The use of open-ended interview questions covering each principle was determined to be the most effective approach for studying how directors reflect on their

[24] Mark Easterby-Smith, Richard Thorpe and Andy Lowe, *Management Research: An Introduction* (London, Sage Publications, 1991) 24.
[25] Norman K Denzin and Yvonna S Lincoln, *The Sage Handbook of Qualitative Research* (Thousand Oaks, Sage, 4th ed, 2011) 3.
[26] Norman K Denzin and Yvonna S Lincoln, *The Handbook of Qualitative Research* (Thousand Oaks, Sage, 2nd ed, 2000) 10.
[27] Barney G Glaser and Anselm L Strauss, *The Discovery of Grounded Research: Strategies for Qualitative Research* (Weidenfeld and Nicolson, 1968) 6.

governance responsibilities in relation to the eight ASXCGC principles and associated recommendations. The researcher's insider status facilitated access to this elite group population, complemented by snowball sampling. Snowball or chain sampling is a design strategy that can be employed in purposeful sampling. It involves starting with one or a few relevant and information-rich interviewees and then asking them for additional relevant contacts.[28]

The data analysis and findings presented in Chapters 4, 5 and 6 documents the reflections of the ASX200 directors. The analysis used an iterative process to capture the key themes identified by directors as critical to their roles.

1.7 Outline of chapters

The study is presented in seven chapters. Chapter 1 states the research problem and question, and the motivation behind the desire to understand how ASX200 directors (responsible for governing some of Australia's largest publicly listed companies) reflect on their practising of the ASXCGC principles and recommendations.

Chapter 2 details the literature on corporate governance and non-mandatory codes of good governance. It considers the foundational corporate governance theories of agency, stakeholder, contingency, resource dependency, stewardship, social contract, hegemony, lifecycle and signalling theories. It then examines the current (3rd) edition of the ASXCGC principles and recommendations, and the Australian context.

Chapter 3 outlines the research design and methods adopted to address the research question. It establishes the reason for the use of a qualitative approach, grounded theory, and a snowball sampling method. It also describes the use of open-ended questions in interviews and the manner in which the data was gathered and analysed.

Chapters 4 and 5 describes the sample and data analysis. Chapter 4 describes how the directors chose to focus on some principles and recommendations more than others, and examines the degree to which there was common practice in the reflections of the ASX200 directors. Chapter 5 also describes what keeps directors awake at night and what makes governing the ASX200 companies easier.

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[28] Michael Quinn Patton, *Qualitative Research and Evaluation Methods* (Thousand Oaks, Sage, 4th ed, 2015) 270.

Chapter 6 presents the overall results, findings and implications of the study. It presents an ASX200 director governance model, which outlines how directors focus on three key areas in their reflections on governance: relationships, risk and remuneration. At the intersection of these three themes four factors are present: trust, values, judgement and rigour. The chapter also provides an examination of the results against foundational corporate governance theories.

In conclusion, Chapter 7 presents considerations for regulators and a discussion of the practical potential of the model. It also suggests opportunities for further research and provides a brief discussion on the Royal Commission into the financial services industry, which was underway as this study was being finalised.

1.8 Significance of the research

The effective practice of corporate governance of the ASX200 companies is critical to the reputation and conduct of wealth and prosperity in the Australian economy.

Since the original introduction of the ASXCGC principles and recommendations in 2003, there has been limited research on how ASX200 directors reflect on their governance practices in line with this non-mandatory ‘if not, why not’ good governance code.

Further, difficulties in accessing elite groups (such as boards and directors) have long been a source of constraint on researchers.[29] Boards of directors are inherently difficult to study directly,[30] and this research provides a critical examination of how ASX200 directors reflect on their governance practices when governing ASX200 companies. This study provides valuable insight for governance practitioners, regulators and other interested parties into the reflections of those responsible for governing some of Australia’s largest companies. Such insights are useful not only for listed Australian company directors but also for non-listed companies given that there is some guideline creep into non-listed companies who elect to use the

[29] Andrew M Pettigrew, 'On Studying Managerial Elites' in Morten Huse (Ed), *The Value Creating Board: Corporate Governance and Organizational Behaviour* (Routledge Taylor and Francis Group, 2008) 162.

[30] Richard Leblanc and Mark S Schwartz, 'The Black Box of Board Process: Gaining Access to a Difficult Subject' (2007) 15(5) *Corporate Governance* 843, 843.

ASXCGC principles and recommendations as best practice guidelines in their governance models.[31]

The research has current relevance, as the interviews were conducted prior to the announcement of the Royal Commission into the financial services industry in Australia, which was established in December 2017. The Royal Commission was established to inquire into whether any conduct of financial services entities amounted to misconduct, whether any conduct falls below community standards and expectations and whether the use of superannuation did not meet community standards or expectations or was not in the interest of those members.[32] In assessing these findings, the Royal Commission was also to inquire into whether misconduct might be attributable to the culture and governance practices of a financial entity, the industry or sub-sector, or other practices including risk management, recruitment and remuneration practices of the financial entity, the industry or sub-sector.[33] The interviews for this research were completed nine months before the establishment of the Royal Commission and were, therefore, not influenced by it. Further, had the research been conducted later (during the Royal Commission), the researcher potentially would have found it significantly more difficult to secure a sufficient sample size in this already hard to access elite group, as the additional scrutiny over governance practices may have discouraged some directors from participating.

1.9 Scope and limits of the research

The study examined the reflections of ASX200 directors on their governance practices, particularly relating to the ASXCGC principles and recommendations. The reason for narrowing the scope to the ASX200 directors was that these directors, among company directors, are the most influential because they are responsible for governing some of the largest companies in Australia. Additionally, it was hoped to appeal to this elite group by narrowing the scope and, in turn, improving the chances of gaining access to them. Despite the significance of the findings from the research, the study had a number of limitations.

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[31] Martin Laverty, *One Board for Mission, Another Board for Margin: Exploring Two-Tiered Boards and Links to Not-For-Profit Organizational Performance* (University of New England, 2017) 6.
[32] Elizabeth the Second Queen of Australia and Head of the Commonwealth, 'Letters Patent – Financial Services Commission' (2017) 2.
[33] Ibid.

Systematic error from non-response is a function of both the number of non-respondents and the degree to which those who cannot be contacted or refuse to be interviewed differ in traits or attitudes from those who are successfully contacted or interviewed.[34] The consequences of non-response in elite group interviewing depends on the goals of the interviewing. If the goal of the research was to gather particular factual information, then confirming that the research heard from different sides and different types of organisations can assist in confirming that the research does not have unbalanced or biased information.[35] In this study, however, the goal was understand how ASX200 directors reflect on their practice of governance under the *ASXCGC Principles and Recommendations*, and in doing so would present the opportunity for others to learn from this elite group. Unlike researchers surveying the mass public, researchers using elite interviews actually know quite a bit about those who remain uninterviewed.[36]

One risk of the snowball sampling method relates to the way the sample is chosen by target people, which can make it liable to various forms of bias.[37] People tend to associate with people with the same study selection characteristic and with other characteristics, which can increase the chance of correlations being found in the study that do not generalise to a wider population.[38] To minimise this risk, particular care was taken by the researcher when asking for leads. Despite this, the researcher is not aware of how many or which ASX200 directors were 'non-respondents', being those directors who were contacted by their colleagues to be interviewed and declined; therefore, the degree of this error is unknown. However this issue is not considered critical in the context of this qualitative, grounded research.[39]

In the interview environment, the interviewer and interviewee work to construct themselves as certain types of people in relation to the topic and, reflexively, the interview itself.[40] The interactional nature of interviews means that the data is

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[34] Kenneth Goldstein, 'Getting in the Door: Sampling and Completing Elite Interviews' (2002) 35(4) *Political Science and Politics* 669, 669.
[35] Ibid.
[36] Ibid.
[37] Patton, above n 28, 298.
[38] Ibid.
[39] Leblanc and Schwartz, above n 30, 849.
[40] Timothy John Rapley, 'The Art(fulness) of Open-Ended Interviewing: Some Considerations on Analysing Interviews' (2001) 1(3) *Qualitative Research* 303, 303.

collaboratively produced.[41] Recognising this, a reflexive writing strategy was adopted where the researcher examined how their presence and stance in the interviews functioned in relationship to the subject itself.[42] Additionally, the researcher was mindful of the possible differences between men and women ASX200 directors in terms of their situation, experiences and discrimination,[43] and the need to take this into account during the analysis and writing. As a female researcher in what is typically a male dominated environment (ASX200 boards), the researcher was particularly conscious of this during the interviews and the effects it may have had on certain responses.

The sample for the study contained a significantly higher proportion of women than the total population (48.8% of the sample were female whereas only 17.7% of the ASX200 population were female, although females held 21.2% of the total ASX200 director roles). The researcher was reflexive about this significant difference, and throughout the interviews and analysis was very aware that this seemed likely to be at least partially caused by the fact that the researcher was a female. It was observed that when interviewees were asked whether they had other ASX200 contacts who they thought may be interested in participating in the study, they would sometimes ask whether the researcher would like to interview ASX200 female directors (this was the case with both female and male interviewees). The researcher remained indifferent about the gender of the leads; nevertheless, an almost equal split between males and females in the sample itself emerged. The analysis phase revealed that ASX200 directors are a fairly homogenous group, with the responses being largely consistent between male and female interviewees.

1.10 Conclusion

This chapter has outlined the research problem, question and objectives that underpin the research. As can be seen, this research is the first known study to examine the reflections of ASX200 directors on their governance under the ASXCGC principles and recommendations. The study is motivated by a desire to understand how ASX200 directors (responsible for governing some of Australia’s largest publicly

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[41] Ibid 318.
[42] Denzin and Lincoln (2011), above n 25, 662.
[43] Mats Alvesson and Kaj Skoldberg, *Reflexive Methodology: New Vistas for Qualitative Research* (SAGE, 2000), 211.

listed companies) reflect on their practice of the ASXCGC principles and recommendations.

The researcher desired to understand how the ASX200 directors were making sense of the ASXCGC principles and recommendations given their complexity and detail, and where and how they were choosing to focus their time in addressing them.

The research methodology was outlined briefly, together with the research motivation and significance of the research. A critical analysis of corporate governance literature will now be conducted, with an emphasis on foundational theories, good governance codes and the Australian context.

CHAPTER 2: Literature review

2.1 Introduction

As stated at the beginning of Chapter 1, corporate governance is the framework of rules, relationships, systems and processes within and by which authority is exercised and controlled in operations.[44] It is generally recognised that strong corporate governance structures are needed to mitigate the agency problem that arises as a result of the separation of ownership and control in corporations.[45] Since the turn of the Century, there has been a significant increase in the focus on corporate governance globally, particularly in the light of several large corporate collapses. In recent decades, a number of countries have introduced various forms of corporate governance regulation ranging from hard legislation to softer voluntary codes of best practice.

In 2003, the ASXCGC introduced the *ASX Corporate Governance Principles of Good Governance and Best Practice Recommendations*.[46] In line with many other jurisdictions, the ASXCGC's good governance code is not mandatory but contains an 'if not, why not' or 'comply or explain' mechanism. The comply or explain principle is a central feature of the code, providing companies with the flexibility of non-compliance, though requiring an explanation as to why the company has chosen not to comply. The ASXCGC released a 2nd edition in 2007 and changed the title to the *ASXCGC Corporate Governance Principles and Recommendations*.[47] The ASXCGC then made amendments to the 2nd edition in 2010,[48] then releasing a 3rd edition in 2014,[49] which is the current edition.

The literature review discussed in this chapter firstly considers the increased focus on corporate governance around the world. It then examines some of the theories underpinning corporate governance, including agency, stakeholder, contingency, resource dependency, stewardship, social contract, legitimacy, institutional, hegemony, lifecycle and signalling theories. It then looks at corporate governance in

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[44] Commonwealth of Australia, above n 1.
[45] Jensen and Meckling (1976), above n 22, 305.
[46] ASXCGC (2003), above n 4, 1
[47] ASXCGC (2007), above n 11, 1.
[48] ASXCGC (2010), above n 13, 1.
[49] ASXCGC (2014), above n 6, 1.

Australia and how the theories underpinning corporate governance have informed the ASXCGC Principles and Recommendations.

2.2 The emergence of corporate governance

In the early 20th Century, the rise of the large publicly listed company and resultant disbursement of company shareholdings led to the prominence of agency theory in the analysis of companies.[50] If shareholders became unhappy with the way in which their company was being managed, their easiest course of action was to simply sell their investment.[51] In 1932, Berle and Means drew attention to this growing separation of power between the executive management of public companies and their increasingly diverse and remote shareholders.[52] The rise of the large publicly owned company in the early 20th Century gave rise to agency theory.[53] Jensen and Meckling defined the agency relationship as one where the principal engages an agent to perform a service on their behalf, and delegates some decision making.[54] They further explained that, in situations when both parties to the relationship are utility maximisers, there is good reason to believe that the agent will not always act in the principal's best interest, thus creating the agency problem.[55]

Three significant developments occurred in corporate governance thinking in the 1970s; the US required listed companies to create audit committees, two-tiered boards were being promoted in Europe, and an increasingly litigious climate in the US led to more emphasis on checks and balances at the board level.[56] In this period, Western society began to question the role of the major corporation, and the argument emerged that companies have responsibilities to stakeholders in addition to their prime legal duty to shareholders.[57] The 1980s followed as a period when 'broad stakeholder concerns became overshadowed by the market-driven, growth-orientated

[50] Ross Grantham, 'Corporate Governance Codes in Australia and New Zealand: Propriety and Prosperity' (2004) 23(1) *University of Queensland Law Journal* 218, 220.
[51] Ibid 221.
[52] Adolf A Berle and Gardiner C Means, cited in Tricker, above n 19, 8.
[53] Grantham, above n 50, 220.
[54] Jensen and Meckling, above n 22, 308.
[55] Ibid.
[56]Tricker, above n 19, 9.
[57] Ibid 10.

attitudes of Reaganite and Thatcher economics',[58] the downside of which became evident with major corporate collapses occurring later in that decade.

In the UK in 1992, The Financial Aspects of Corporate Governance Report[59] ('the Cadbury Report') contained a number of recommendations designed to raise the standard of corporate governance in companies. Consistent with agency theory, the report called for various measures to be adopted, such as the wider use of independent non-executive directors, audit committees with independent members, delineation of chair and chief executive officer (CEO) responsibilities, remuneration committees and nomination committees. The code was not mandatory, however, it contained the comply or explain principle, requiring companies to disclose reasons for non-compliance. Many other countries, also concerned about the potential abuse of power by boards of directors, followed the UK example by releasing their own reports on corporate governance, including France, South Africa, Canada, the Netherlands and Hong Kong.[60]

In 1999, the OECD published the *OECD Principles of Corporate Governance*,[61] stating that, while a great deal of work had been undertaken in OECD countries to improve corporate governance regimes, the recent financial crises in Asia and elsewhere had made clear how important the issues of transparency and accountability in corporate governance were for investor confidence and overall national economic performance.[62] The OECD's highly influential principles of corporate governance became the basis for the development of codes of good governance by a number of developed countries, as well as the basis for the evaluation of corporate governance practices in developing countries by the World Bank.[63]

The *Sarbanes-Oxley (Sox) Act*[64] was introduced in the US in 2002 following the accounting scandals and resultant corporate collapses of organisations, including Enron and Worldcom. At around the same time, following the collapse of Australian

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[58] Ibid.
[59] Adrian Cadbury, *Report of the Committee on the Financial Aspects of Corporate Governance* (The Committee on the Financial Aspects of Corporate Governance, 1992) ('*Cadbury Report*').
[60] Tricker, above n 19, 13.
[61] OECD (1999), above n 3, 5.
[62] Ibid.
[63] Aguilera and Cuervo-Cazurra (2009), above n 16, 379.
[64] *Sarbanes-Oxley Act 2002* (US).

companies, such as Ansett, OneTel, and HIH, the ASXCGC was convened in 2002 as a collaborative, industry-based body established to develop corporate governance recommendations for listed entities which reflect international best practice.[65] The Council released the first edition of the *ASX Corporate Governance Council Principles of Good Governance and Best Practice Recommendations* in March 2003.[66]

In 2004, the *OECD Principles of Corporate Governance* were revised to respond to a number of issues that had undermined the confidence of investors in company management.[67] The revised principles advocated an increased awareness among institutional investors, strengthened transparency and disclosure to counter conflicts of interest and provided an effective role for shareholders in executive remuneration.[68]

In 2007, the GFC unfolded. In 2009 the *Report of the High Level Group on Financial Supervision in the EU* examined the contributing causes of the GFC and found that corporate governance failures were one of the most important contributors to the crisis.[69] The report noted that corporate governance had never been spoken about as much as during the preceding decade, and found that, although procedural progress (such as the establishment of board committees) had been achieved, it was clear that the financial system at large did not carry out its tasks with enough consideration for the long-term interest of its stakeholders.[70] The report also found that many boards of financial institutions did not provide the necessary oversight, had underestimated the risks associated with their businesses and remuneration practices contributed to excessive risk taking by rewarding short term expansion of risky trading rather than long term profitability of investments.[71]

In 2015, the G20 and OECD released the revised principles of corporate governance to incorporate lessons from the GFC, the increase in cross-border ownership, changes in the way that stock markets functioned and the consequences of a longer

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[65] Austin and Ramsay, above n 21, 391.
[66] ASXCGC (2003), above n 2, 390.
[67] Austin and Ramsay, above n 21, 388.
[68] Ibid.
[69] The High Level Group on Financial Supervision in the EU, above n 12, 29.
[70] Ibid.
[71] Ibid 10.

and more complex investment chain from household savings to corporate investments.[72]

The central problem identified by the ASXCGC Principles and Recommendations and other good governance codes is the agency problem, or how best to monitor senior management more effectively thereby making them more accountable where their actions are motivated by self-interest.[73] Despite this focus, accountability however is only one aspect of good governance.[74] Governance is also concerned with the quality of the decision making and in creating value and wealth.[75]

2.3 Definitions of Corporate Governance

In recent decades, many definitions have been developed to attempt to describe the essence of the increasingly commonly used term, 'corporate governance'. The OECD defined corporate governance as involving 'a set of relationships between a company's management, its board, its shareholders and other stakeholders' that 'provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance'.[76] This definition makes mention of both stakeholders and shareholders (owners) of the company, which is a wide and encompassing view recognising the importance of companies within societies. When considering the positive impact that companies can have on societies, markets and economies when they prosper and, importantly, the negative impact they have in instances of corporate collapse, this broad view of who company stakeholders are is appropriately broad when defining corporate governance.

By contrast, many other definitions recognise the obvious critical relationship between the company and its shareholders but not the full body of stakeholders. The Cadbury Report defined corporate governance as 'the system by which companies are directed and controlled'.[77] The report noted that the role of boards of directors is the governance of their companies and the role of shareholders is to appoint the directors and auditors.[78] In the US in 1997, Shleifer and Vishny described corporate

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[72] OECD, *G20/ OECD Principles of Corporate Governance* (2015) 7.
[73] Grantham, above n 49, 220.
[74] Ibid 225.
[75] Ibid.
[76] OECD (2015), above n 72, 9.
[77] *Cadbury Report*, above n 58, 15.
[78] Ibid.

governance as being ‘the mechanism by which those providing capital to corporations satisfy themselves that a return on investment will be provided’.[79] This definition expands the role of shareholders from simply appointing board members and auditors to also judging whether the company is likely to yield a satisfactory return on investment. This definition may also illustrate that the US corporate governance model is more genuinely ‘market based’ than the UK model.[80]

Overall, the emphasis on the shareholder in definitions of corporate governance is suggestive of the critical relationship of agency that exists between directors and managers (agents) and the owners (shareholders).

2.4 Theories underpinning the practice of corporate governance

The concept and practice of corporate governance has prompted diverse interpretations and theories, the most prominent being agency theory. Other important theories include stakeholder, contingency, resource dependency, stewardship, social contract, legitimacy, institutional, hegemony, lifecycle and signalling theories.

2.4.1 Agency theory

Agency theory has been the dominant theoretical perspective used in research of both corporate governance and boards of directors since its proposal more than four decades ago.[81] The theory is concerned with resolving two problems that can occur in agency relationships.[82] The first is the agency problem that arises when the desires or goals of the principal and agent conflict, and it is difficult or expensive for the principal to verify what the agent is actually doing.[83] Agency theorists increasingly have noted the costs and limits of vigilant control.[84] The second is the problem of

[79] Andrei Shleifer and Robert W Vishny, 'A Survey of Corporate Governance' (1997) 52(2) *Journal of Finance* 737.
[80] Andrew Mullineux, 'Is there an Anglo-American Corporate Governance Model?' (2010) 7(4) *International Economics and Economic Policy* 437, 440.
[81] Catherine M Daily, Dan R Dalton and Albert A Cannella Jr, 'Corporate Governance: Decades of Dialogue and Data' (2003) 28(3) *The Academy of Management Review* 371, 371; Ruth V Aguilera and Gregory Jackson, 'Comparative and International Corporate Governance' (2010) 4(1) *The Academy of Management Annals* 485, 488.
[82] Kathleen M Eisenhardt, 'Agency Theory: An Assessment and Review' (1989) 14(1) *Academy of Management Review* 57, 58.
[83] Ibid.
[84] Chamu Sundaramurthy and Marianne Lewis, 'Control and Collaboration: Paradoxes of Governance' (2003) 28(3) *Academy of Management Review* 397, 399.

risk sharing that arises when the principal and agent have different attitudes toward risk and the agent may prefer different actions because of different risk preferences.[85]

The concept of divergence of interests between principals and their agents is an essential element of the so-called contractual view of the firm.[86] The essence of the agency problem is the separation of ownership and control, and refers to the problem owners have in ensuring their funds are not expropriated or wasted.[87] In an ideal world, managers and owners would sign a contract that specifies exactly what the manager does in all states of the world and how the profits are allocated; however, the reality is that most future contingencies are hard to describe and foresee and, as a result, complete contracts are not feasible.[88] In this regard, agency theory focuses on a mechanism for aligning the conflicting interests of the owners of capital and the managers of the organisation.[89]

Agency theory addresses the inherent conflict arising from individuals with differing preferences undertaking cooperative effort.[90] Central to agency theory is the exercise of choice by the agent under conditions of uncertainty of the capital owner's preference.[91] These capital owners of companies have different motivations to those who control them.[92] Owners seek high share values while managers may have additional objectives, and agency theory maintains that management can be encouraged to act in the interests of its shareholders by being contracted, monitored, and by being offered incentives to do so.[93]

Agency theory has its roots in economics and finance and is based on the idea that the management of an organisation operates as the agent of the shareholders.[94] This

[85] Eisenhardt, above n 82, 58.
[86] Jensen and Meckling, above n 22, 309.
[87] Shleifer and Vishny, above n 79, 740.
[88] Ibid 741.
[89] Suzanne Young and Vijaya Thyil, 'A Holistic Model of Corporate Governance: A New Research Framework' (2008) 8(1) *Corporate Governance: The International Journal of Business in Society* 94, 95.
[90] Eisenhardt, above n 82, 63.
[91] Stephen A Ross, 'The Economic Theory of Agency: The Principal's Problem' (1973) 63(2) *The American Economic Review* 134.
[92] Diane K Denis, 'Twenty-Five Years of Corporate Governance Research … and Counting' (2001) 10(3) *Review of Financial Economics* 191, 195.
[93] Ibid.
[94] Catherine M Farrell, 'Governance in the UK Public Sector: The Involvement of the Governing Board' (2005) 83(1) *Public Administration* 89, 93.

theory informs a control approach aimed at curbing self-serving behaviours of managers (agents) that may negatively impact owners (principals) wealth,[95] and the purpose of the board in this regard is to control the managers.[96] Agency theory has been dominant in shaping good governance codes around the world which attempt to address how best to monitor senior management more effectively, thereby making them more accountable where their actions are motivated by self-interest.[97]

2.4.2 Stakeholder theory

Stakeholder theory requires attention to be paid to those who can affect or are impacted by an organisation's purpose on the grounds that such actors can enable or prevent the organisation from achieving its purpose.[98] Stakeholders exist both inside and outside the company, and ethical behaviour requires treating stakeholders in a manner deemed acceptable by society.[99] Attributes of legitimate stakeholders have been described as those holding power, legitimacy and urgency in relation to the organisation in question.[100]

Stakeholder theory underpins the ethical responsibilities of organisations, which requires a range of standards and expectations of behaviour that reflect a concern for what stakeholders regard as keeping with their moral rights or legitimate expectations.[101] The role of the board in stakeholder theory is to represent the interests of the client groups (stakeholders),[102] and, in doing so, it is the board's role to manage the competing interests of the stakeholder groups.[103] The board links the consideration of interests of stakeholders to the firm's performance.[104] The

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[95] Eisenhardt, above n 82, 60.
[96] Sundaramurthy and Lewis, above n 84, 398.
[97] Grantham, above n 50, 220.
[98] R Edward Freeman, *Strategic Management: A Stakeholder Approach* (Pitman, 1984) 25.
[99] Michael Hopkins, The Planetary Bargain: Corporate Social Responsibility Matters (Earthscan, 2003) 1.
[100] Ronald Mitchell, Bradley Agle and Donna Wood, 'Toward a Theory of Stakeholder Identification and Salience: Defining the Principle of Who and What Really Counts' (1997) 22(4) *Academy of Management review* 853, 853.
[101] Archie Carroll, 'Ethical Challenges for Business in the New Millennium: Corporate Social Responsibility and Models of Management Morality' (2000) 10(1) *Business Ethics Quarterly* 33, 36.
[102] Farrell, above n 94, 94.
[103] William M Evan and R Edward Freeman, 'A Stakeholder Theory of the Modern Corporation: Kantian Capitalism' in T Beauchamp and N Bowie (Eds.), *Ethical Theory and Business* (Prentice Hall, 4th ed, 1993) 83.
[104] Amy J Hillman, Gerald D Keim and Rebecca Luce, 'Board Composition and Stakeholder Performance: Do Stakeholder Directors Make a Difference?' (2001) 40(3) *Business and Society* 295, 300.

effectiveness of corporate governance is mediated by the interdependencies between organisations and their environments.[105]

As an illustration of the operation of stakeholder theory, increasingly, there have been calls for organisations to add more women and minority directors as well as directors who represent important stakeholder groups including suppliers, customers, or community representatives.[106]

2.4.3 Contingency theory

Contingency theory developed from a sense of the inadequacies of existing theories, and highlights that different situations require different governance approaches.[107] Contingency theorists emphasise that corporate governance designs and conceptualisations are embedded in a broader institutional and social environment, and that the relative power of the board depends on diverse factors, including the relative efficiency of input and output markets, the relative power and developing relationships between various coalitions of internal and external stakeholders.[108] The role of the board varies depending on the internal and external contexts, and these contexts consequently shape decisions surrounding corporate governance.[109] Contingency theory suggests that not all situations will be best served by the same model of governance, and that good governance in one situation might look quite different in another context.[110] Contingency theory underpins the flexibility provided by governance codes adopting the if not, why not (comply or explain) approach.

2.4.4 Resource dependency theory

Resource dependency theory posits that organisations require resources in order to survive; and, to acquire these resources, they must interact with others who control

[105] Ruth V Aguilera et al, 'An Organizational Approach to Comparative Corporate Governance: Costs, Contingencies, and Complementarities' (2008) 19(3) *Organization Science* 475, 476.
[106] Hillman, Keim and Luce, above n 104, 295.
[107] Lynne Bennington, 'Review of the Corporate and Healthcare Governance Literature' (2010) 16(2) *Journal of Management and Organization* 314, 325.
[108] Jonas Gabrielsson and Morten Huse, 'Context, Behaviour and Evolution: Challenges in Research on Boards and Governance' in Morten Huse (ed), *The Value Creating Board: Corporate Governance and Organizational Behaviour* (Routledge Taylor and Francis Group, 2008) 18.
[109] Ibid 18.
[110] Bennington, above n 107, 317.

the resources.[111] Given that organisations do not control the resources they need, resource acquisition can be problematic and uncertain.[112]

The key role of the board, according to resource dependency theory, is to enable the organisation to access the resources that it needs.[113] It suggests that social linkages with external organisations are important for the organisation as a means of stabilising the environment and for ensuring favourable resource exchanges.[114] The board acts as a link between the organisation and its environment,[115] and the provision of advice to management is one of the board's primary roles.[116]

Resource dependency theory suggests that boards also build legitimacy by appointing high-status individuals as directors.[117] Human and social capital are directly related to the board's ability to secure resources from outsiders,[118] and collectively make up the board capital.[119] The presence of sufficient board capital is necessary for advice provision to management to be beneficial.[120] The strength of each individual's resource provision is influenced by the director's identification with the organisation, shareholders and being a director.[121]

Organisations need to transact with others for resources they need and this can provide resource owners with power over the organisation.[122] Organisations seek to avoid being controlled and seek stability and certainty in their own resource exchanges, as it is in the interests of all participants to stabilise organisational resource exchanges and ensure the organisation's survival.[123] Organisations try to

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[111] J Pfeffer and G Salancik, *The External Control of Organizations: A Resource Dependence Perspective* (Standard Business Books, 1978) 258.
[112] Ibid 258.
[113] Amanda P Cowen and Jeremy J Marcel, 'Damaged Goods: Board Decisions to Dismiss Reputationally Compromised Directors (Report)' (2011) 54(3) *Academy of Management Journal* 509, 511.
[114] Pfeffer and Salancik, above n 111, 173.
[115] Young and Thyil, above n 89, 99.
[116] Farrell, above n 94, 94.
[117] S Trevis Certo, 'Influencing Initial Public Offering Investors with Prestige: Signaling with Board Structures' (2003) 28(3) *The Academy of Management Review* 432, 434.
[118] Cowen and Marcel, above n 113, 514.
[119] Ibid.
[120] Sundaramurthy and Lewis, above n 84, 397.
[121] Amy J Hillman, Gavin Nicholson and Christine Shropshire, 'Directors' Multiple Identities, Identification, and Board Monitoring and Resource Provision' (2008) 19(3) *Organization Science* 441, 451.
[122] Pfeffer and Salancik, above n 111, 258.
[123] Ibid 261.

avoid dependencies and external control while attempting to shape their own contexts and retain their autonomy for independent action.[124]

2.4.5 Stewardship theory

Stewardship theory states that managers are not motivated by individual goals but, rather, are stewards whose motives are aligned with the objectives of their principals.[125] Unlike agency theory, which assumes goal divergence on the part of the contracted agent, stewardship theory assumes convergence because of shared collective interests with the contracted steward.[126] The assumptions of stewardship theory are that long-term contractual relations are developed based on trust, reputation, collective goals, and involvement where alignment is an outcome of relational reciprocity.[127]

Stewardship theory is based on the idea that board members and shareholders operate collaboratively in the running of an organisation.[128] Stewardship theory places an emphasis on trust and close social ties between managers and board members.[129] It hypothesises that managers are team players, and an optimal structure is one that authorises them to act, given that they will act in the best interests of owners.[130]

Stewardship theory focuses on the board's strategic or advisory role,[131] although involvement in strategy is conditioned by the board members' interests, experience, past decisions, public pressure and corporate reputation, corporate governance policies, company history and performance, informal relationships and ties with other board members, and established board processes.[132] Stewardship theory has

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[124] Ibid.
[125] James H Davis, F David Schoorman and Lex Donaldson, 'Toward a stewardship Theory of Management' (1997) 22(1) *Academy of Management Review* 20, 21.
[126] David M Van Slyke, 'Agents or Stewards: Using Theory to Understand the Government-Nonprofit Social Service Contracting Relationship' (2007) 17(2) *Journal of Public Administration Research and Theory* 157, 159.
[127] Ibid 164.
[128] Farrell, above n 94, 94.
[129] Ibid.
[130] Lex Donaldson and Jay Barney, 'The Ethereal Hand: Organizational Economics and Management Theory' (1990) 15(3) *Academy of Management. The Academy of Management Review* 369, 377.
[131] Young and Thyil, above n 89, 98.
[132] Sharon Kemp, 'In the Driver's Seat or Rubber Stamp?' (2006) 44(1) *Management Decision* 56, 56.

been described as situational, because a stewardship role is adopted when certain organisational conditions exist, such as managerial competence.[133]

2.4.6 Social contract theory and Legitimacy theory

Social contract theory outlines that society is a series of social contracts between the members in society and society itself.[134] Similarly, legitimacy theory is based on the assertion that a social contract exists between society and an organisation.[135] Legitimacy theory has been defined as 'a generalised perception or assumption that the actions of an entity are desirable, proper, or appropriate with some socially constructed systems of norms, values, beliefs and definitions'.[136] Both social contract and legitimacy theories extend the obligations of the organisation to the whole of society rather than just the shareholders or stakeholders.

2.4.7 Institutional theory

Institutional theory states that the behaviour of companies is reflective of and influenced by the contexts in which they operate, including the legal framework, and political, cultural and social environments.[137] Institutional domains have interdependent effects on stakeholders.[138] Institutional theory regards corporate governance to be part of each country's institutional framework, which differs greatly between countries.[139] Such institutional frameworks affect corporate governance practices and hence need to be understood, which can assist in addressing the divergence and convergence debates in modern corporate governance.[140] Institutional theory proposes that companies adopt a set of practices because they either believe they will receive legitimacy through the local environment or because there is little benefit to undertake disruptive change.[141]

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[133] Davis, Schoorman and Donaldson, above n 125, 38.
[134] Rob Gray et al, *Accounting and Accountability: Changes and Challenges in Corporate Social and Environmental Reporting* (Prentice Hall, 1996) 10.
[135] Wan Fauziah Wan Yusoff and Idris Adamu Alhaji, 'Insight of Corporate Governance Theories' (2012) 1(1) *Journal of Business and Management* 52, 58.
[136] Mark C Suchman, 'Managing Legitimacy: Strategic and Institutional Approaches' (1995) 20(3) *Academy of Management Review* 571, 574.
[137] Lilian Miles and Mohammad Rizal Salim, 'Corporate Governance Reform in Malaysia: An Institutional Theoretical Approach' (2010) 5(2) *Journal of Comparative Law* 314, 316.
[138] Ruth V Aguilera and Gregory Jackson, 'The Cross-National Diversity of Corporate Governance: Dimensions and Determinants' (2003) 28(3) *Academy of Management Review* 447, 450.
[139] Miles and Salim, above n 137, 316.
[140] Ibid.
[141] Ibid.

2.4.8 Hegemony theory

Hegemony theory describes boards of directors as a legal fiction,[142] existing only for the purpose of complying with the corporate law requirements,[143] and to rubber stamp the decisions of management.[144] It assumes that CEOs are able to select directors for their boards who are similar to themselves and who are also more likely to act with a sense of loyalty to the chief executive, which overpowers their role as protectors of shareholder interests.[145] Hegemony theory suggests that management usually dominate boards of directors, and the role of independent directors is to provide a counter-balance to this dominance of management.[146]

2.4.9 Lifecycle theory

Lifecycle theory proposes that corporate governance parameters are linked to strategic thresholds in a company's lifecycle.[147] It argues that corporate governance parameters are linked to transitions from one stage to the next in the lifecycle of the organisation, and rejects a universal governance template for all organisations.[148]

2.4.10 Signalling theory

Signalling theory arises out of information asymmetry, in which one party has complete information and the other incomplete information, and requires the party with incomplete information to rely on information inferred by certain actions.[149] The theory explains how corporate decisions are made by interpretation of incomplete information in markets.[150] Signals carry information from those with more information to those with less information in equilibrium.[151]

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[142] Rita D Kosnik, 'Greenmail: A Study of Board Performance in Corporate Governance' (1987) 32(2) *Administrative Science Quarterly* 163, 166.

[143] Philip Stiles and Bernard Taylor, 'The Strategic Role of the Board' (1996) 4(1) *Corporate Governance: An International Review* 3, 3.

[144] James Wade et al, 'Golden Parachutes: CEOs and the Exercise of Social Influence' (1990) 35(4) *Administrative Science Quarterly* 587, 588.

[145] Ibid 589.

[146] Bennington, above n 107, 315.

[147] Igor Filatotchev, Steve Toms and Mike Wright, 'The Firm's Strategic Dynamics and Corporate Governance Life-Cycle' (2006) 2(4) *International Journal of Managerial Finance* 256, 256.

[148] Ibid.

[149] Phillip Nelson, 'Information and Consumer Behavior' (1970) 78(2) *Journal of Political Economy* 311, 314.

[150] Michael Spence, 'Signaling in Retrospect and the Informational Structure of Markets' (2002) 92(3) *American Economic Review* 434, 434.

[151] Ibid.

2.4.11 Summary of theories

Corporate governance theories, with their origin in agency theory and subsequent evolution into other well documented theories, have influenced governance regulations, including good governance codes, around the world. The diversity of theoretical views on governance has influenced the practice of governance and, indeed, it is the combination of various theories that best informs good governance practice rather than assessing corporate governance through the one single lens.[152]

2.5 Regulation of governance across the globe

With the increased focus on corporate governance, a number of countries have introduced various forms of corporate governance regulation, ranging from hard legislation to softer codes of best practice. At the harder end of the regulatory spectrum the US's *Sarbanes-Oxley Act*,[153] introduced in 2002, contains the infamous section 404 which threatens CEOs and chief finance officers (CFOs) with fines and even imprisonment if a corporation's 'internal controls' are found to be inadequate.[154] Most countries, however, have adopted a softer approach by introducing voluntary codes of corporate governance with the requirement to explain deviations from best practice ('comply or explain').

A primary reason for the adoption of softer forms of codes of best practice is that it allows companies to be flexible in how they comply. This approach is supported by contingency theory, which suggests that not all situations will be best served by the same model of governance, and that good governance in one situation might look quite different in another context.[155] Many of the corporate governance codes around the world are based on the *G20/ OECD Principles of Good Governance*.[156]

2.5.1 Codes of good governance and the comply or explain principle

Codes of good governance across the world vary in scope and detail, but most tackle four fundamental issues: fairness to all shareholders whose rights must be upheld; clear accountability by the board and management; transparency, or accurate and timely financial and non-financial reporting; and responsibility for the interests of

[152] Yusoff and Alhaji, above n 135, 52.
[153] *Sarbanes-Oxley Act 2002* (US).
[154] Mullineux, above n 80, 439.
[155] Bennington, above n 107, 317.
[156] OECD (2015), above n 72; Torben Beck Jørgensen and Ditte-Lene Sørensen, 'Codes of Good Governance: National or Global Public Values?' (2012) 15(1) *Public Integrity* 71, 71.

minority shareholders and other stakeholders and for abiding by the letter and spirit of the law.[157] As is clear here, codes of good governance are predominantly concerned with solving the agency problem of divergence of interests between directors and managers (agents) and the owners (principals).

Good governance codes recognise that there are multiple governance paths that lead to high firm performance.[158] There are two underlying considerations behind the adoption of good governance codes: firstly, the flexibility to adjust the governance practices to suit the individual companies; and, secondly, the assumption that the capital markets will monitor and assess value in compliance.[159] Unlike rigid legislation, codes of governance allow flexibility and recognise the idea that one size does not fit all, decreasing potential costs that may be imposed by introducing harder regulations. The onus for monitoring accountability and taking necessary action ultimately falls on the shareholders and the market.[160] In Australia, the ASXCGC principles and recommendations do not seek to prescribe the corporate governance practices that a listed entity must adopt because it recognises that different entities may legitimately adopt different governance practices based on their size, complexity, history and corporate culture.[161]

The comply or explain principle is a central feature found in many of these codes of good governance, providing flexibility in allowing non-compliance with the code, but requiring an explanation where the company has chosen not to comply. The comply or explain approach was first introduced by the *Cadbury Report* in the UK in 1992, and has been part of the Australian ASXCGC principles and recommendations since their inception in 2003. The comply or explain (if not, why not) approach is fundamental to the operation of the ASXCGC principles and recommendations and enables shareholders and stakeholders to have a meaningful dialogue with the board

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[157] Paul Coombes and Simon Chiu-Yin Wong, 'Why Codes of Governance Work' (2004)(2) *McKinsey Quarterly* 48.

[158] Roberto García-Castro, Ruth V Aguilera and Miguel A Ariño, 'Bundles of Firm Corporate Governance Practices: A Fuzzy Set Analysis' (2013) 21(4) *Corporate Governance: An International Review* 390, 390.

[159] Iain MacNeil and Xiao Li, '"Comply or Explain": Market Discipline and Non-Compliance with the Combined Code' (2006) 14(5) *Corporate Governance: An International Review* 486, 486.

[160] Ibid.

[161] ASXCGC (2014), above n 6, 3.

and management on governance matters and allows them to factor this information into their voting and investment decisions.[162]

The essential nature of the comply or explain principle is to make the board of directors accountable for what has or has not been done.[163] It is incumbent on the investors and shareholders to analyse the individual company's responses to the requirements of the code, and to take action when required. Such action may include attempting to force companies to conform, or requesting further explanation as to why the company chooses not to comply. The aim of the comply or explain principle is to empower shareholders to make an informed evaluation as to whether non-compliance is justified given the company's circumstances.[164]

One of the main criticisms of the comply or explain principle has been that its effectiveness is limited due to the 'tendency among shareholders not to utilise the rights that they have or to engage in monitoring'.[165] It has been further suggested that shareholders are not interested in monitoring companies provided they are performing well.[166] Another criticism has been that placing significant emphasis on compliance with codes can lead to box-ticking through the use of uninformative statements about compliance.[167] Despite the criticism that the codes' voluntary nature limits their ability to improve governance practices, research suggests that codes of good governance appear to have generally improved the governance of companies in countries that have adopted them.[168]

Listing rules have been adopted in most countries; such rules are mandatory disclosure requirements obliging companies to justify their reasons for non-compliance; these further encourage compliance with the codes.[169] In Australia, ASX Listing Rule 4.10.3 requires companies to disclose, in their annual reports, the extent

[162] Ibid.
[163] Andrew Keay, 'Comply or Explain in Corporate Governance Codes: In Need of Greater Regulatory Oversight?' (2014) 34(2) *Legal Studies* 279, 282.
[164] Ibid, 280
[165] Ibid.
[166] Ibid, 287.
[167] Ibid, 289.
[168] Aguilera and Cuervo-Cazurra (2009), above n 16, 1.
[169] Aguilera and Cuervo-Cazurra (2004), above n 2, 419.

to which they have followed the ASX best practice corporate governance recommendations.[170]

2.6 Boards of directors

The board of directors is a group of individuals selected for their expertise who come together to add value collectively to the organisation they lead.[171] The role of the chair is a particularly nuanced one; effective chairs are described as enabling equals rather than strong leaders.[172] Effective chairs focus on providing the structure and time for directors to monitor and provide advice, and are considerate about when and how to put forward their own views because this can reduce director engagement.[173]

Boards have four broadly defined roles: to monitor and control; to advise and counsel; to provide access to resources; and to provide strategy control.[174] Boards must balance these responsibilities because, for example, an over-emphasis on compliance will introduce the risk that directors spend more time investigating the actions of senior executives and less time debating and formulating long term strategic plans and providing stewardship.[175] Governance is not only concerned with compliance and accountability but also with the quality of the decision making and with creating value and wealth.[176] A board's purpose is, ultimately, to enable cooperation.[177] This takes place through solving conflicts among stakeholders who are exerting control, solving problems of cooperation and coordination, and engaging in processes of organised information and knowledge gathering.[178]

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170 ASX, 'ASX Listing rule 4.10.3' (2003) ch 4 Periodic Disclosure.

171 C B Ingley and N T van der Walt, 'Board Configuration: Building Better Boards' (2003) 3(4) *Corporate Governance* 5, 6.

172 Pieter-Jan Bezemer, Gavin Nicholson and Amedeo Pugliese, 'The Influence of Board Chairs on Director Engagement: A Case-Based Exploration of Boardroom Decision-Making' (2018) 26(3) *Corporate Governance* 219, 229.

173 Ibid.

174 Gavin J Nicholson and Geoffrey C Kiel, 'Breakthrough Board Performance: How to Harness Your Board's Intellectual Capital' (2004) 4(1) *Corporate Governance: The International Journal of Business in Society* 5, 16.

175 Jens Mueller, Graeme Cocks and Coral Ingley, 'The Seesaw of the Governance: Getting the Balance Right' (2009) 9(1) *Internatinal Journal of Business Strategy* 137, 137.

176 Grantham, above n 50, 225.

177 Hans van Ees, Jonas Gabrielsson and Morten Huse, 'Toward a Behavioral Theory of Boards and Corporate Governance' (2009) 17(3) *Corporate Governance: An International Review* 307, 308.

178 Ibid.

Stakeholder engagement has been attracting increasing attention in the media[179] because boards also play a key role in legitimising the corporation in relation to important stakeholders apart from shareholders.[180] Investors are also displaying an increasing interest in the strategic decisions of the companies they invest in.[181] When shareholders become active, it can be assumed as demonstrating a lack of confidence in company governance mechanisms, including in the board, that should exist to protect shareholders.[182] Non-executive directors are in a difficult position, as they are inside the organisation with access to formal control over internal information and decision-making systems, and yet are responsible for pursuing the interests of the external stakeholders.[183]

Boards have social capital, which is derived from their directors' networks and human capital, which is derived from their director's competencies.[184] These two dimensions collectively make up board capital[185] and contribute to board effectiveness, which is a function of the board's overall contribution to organisational performance.[186] Director interactions are multi-dimensional and dynamic, and can change with the nature of board meeting agendas, the board climate and the meeting arrangements.[187] Boardroom discussions are complex and nested in nature,[188] despite appearing homogenous to outsiders.[189]

The interactions between directors and management is complicated. Directors both challenge and support managers during board discussions, switching behaviours

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[179] Coral Ingley, Jens Mueller and Graeme Cocks, 'The financial crisis, investor activists and corporate strategy: will this mean shareholders in the boardroom?' (2011) 15(4) *Journal of management & governance.* 557, 557.

[180] Ibid, 582.

[181] Ibid, 557.

[182] Coral Ingley et al, 'The Social Dimension of Boards' Role in Better Corporate Governance' in Anabella Davila et al (Eds), *Understanding Organizations in Complex, Emergent and Uncertain Understanding* (Palgrave Macmillan, 2012) 45.

[183] Gavin Nicholson, Amedeo Pugliese and Pieter-Jan Bezemer, 'Habitual Accountability Routines in the Boardroom: How Boards balance control and collaboration' (2017) 30(2) *Accounting, auditing and accountability.* 222, 223.

[184] Cowen and Marcel, above n 113, 514.

[185] Ibid, 514.

[186] Ingley and van der Walt, above n 171, 7.

[187] Amedeo Pugliese, Gavin Nicholson and Pieter-Jan Bezemer, 'An Observational Analysis of the Impact of Board Dynamics and Directors' Participation on Perceived Board Effectiveness' (2015) 26(1) *British Journal of Management* 1, 1.

[188] Pieter-Jan Bezemer, Gavin Nicholson and Amadeo Pugliese, 'Inside the Boardroom: Exploring Board Member Interactions' (2014) 11(3) *Qualitative Research in Accounting and Management* 238, 238.

[189] Ibid 254.

during meetings while maintaining a consistent level of support and scepticism.[190] These interactions allow for a simultaneous level of trust and verification, both of which are necessary for accountability.[191] Interpersonal trust between the non-executive and executive board members affects the task performance of boards,[192] and may mitigate the director's perception of relational risk within the board.[193] As an example, the presence of synergy, trust and confidence between the board and executive during the strategy development process determines whether the process will be collaborative or confrontational.[194] Interpersonal relationship failure is one of the four categories of governance failure within companies (the others being strategic failure, control failure and ethical failure), and results from boardroom battles between the board and executives, further highlighting the critical nature of these relationships.[195]

2.7 Corporate governance in Australia

Throughout the 1990s, public attention in Australia increasingly focused on corporate governance, prompted by a number of factors, including major company collapses, institutional shareholder activism, excessive remuneration for executives and the roles of non-executive and executive directors.[196] The collapse of Australian companies, such as Ansett, OneTel, and HIH, led to heightened concern about the quality of corporate governance in Australia, with the *Howarth Report* noting, in 2002, that the debate about standards of corporate governance had been largely based on anecdote and opinion.[197] The report found that there was room for improvement in demonstrating openness and accountability across the top 250 listed companies, further stating that, in the 'current climate of corporate damage control, organisations need to reassure the community, investors and the government that

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[190] Nicholson, Pugliese and Bezemer, above n 183, 222.
[191] Ibid.
[192] Hans Van Ees, Gerwin Van der Laan and Theo J B M Postma, 'Trust and Board Performance' in Morten Huse (Ed), *The Value Creating Board: Corporate Governance and Organizational Behaviour* (Routledge Taylor and Francis Group, 2008) 471.
[193] Ibid 472.
[194] Denis Mowbray and Coral Ingley, 'Collaboration or Confrontation: The Characteristics of the Board and Executive that can Influence Strategy Development' (Paper presented at the International Conference on Business Strategy and Organizational Behaviour (BizStrategy), Singapore, 2013) 160.
[195] Geoffrey C Kiel and Gavin J Nicholson, 'Evaluating Boards and Directors' (2005) 13(5) *Corporate Governance* 613, 614.
[196] Austin and Ramsay, above n 21, 380
[197] *Howarth Report*, above n 9, 3.

business is conducted fairly and in the interests of all shareholders and stakeholders'.[198]

The ASXCGC was convened by the ASX in August 2002 as a collaborative, industry-based body to develop corporate governance recommendations for listed entities that reflect international best practice.[199] In 2003, the ASXCGC introduced the *ASX Corporate Governance Principles of Good Governance and Best Practice Recommendations*.[200] The ASXCGC released a 2nd edition in 2007,[201] amendments to the 2nd edition in 2010,[202] and then the 3rd (current) edition in 2014.[203]

In recent times discussions in Australia about corporate governance have ranged widely over issues including the ethical standards of directors, enlivening the role of institutional investors, ways to improve internal audit effectiveness and improving external auditor independence.[204] Additionally, discussions on governance structures have been significant, with a view to designing a system of checks and balances to protect investors from management excess while preventing conformance from becoming an obstacle to performance.[205] The nature of the current debates and influences shaping them in the Australian context is described by institutional theory, which suggests that the behaviours of companies is reflective of and influenced by, the contexts in which they operate, including the legal framework, and political, cultural and social environments.[206]

2.7.1 Directors duties in Australia

The role of the board in large public companies in Australia is not to manage the company's business, but to operate through the executives to ensure that the business of the company is properly conducted.[207] The board is the governing body of the company and, as members of the governing body, the directors are responsible for directing the company.[208] Company law stipulates that directors will act collectively

[198] Ibid 3.
[199] Austin and Ramsay, above n 21, 391.
[200] ASXCGC (2003), above n 4.
[201] ASXCGC (2007), above n 11.
[202] ASXCGC (2010), above n 13.
[203] ASXCGC (2014), above n 6.
[204] Austin and Ramsay, above n 21, 379.
[205] Ibid 380.
[206] Miles and Salim, above n 137, 316.
[207] Austin and Ramsay, above n 21, 234.
[208] Tricker, above n 19, 44.

as a board but, in carrying out functions as a member of the board, each director is individually subject to statutory and general law duties.[209]

The main purpose of directors' duties is to ensure that their loyalty is to the welfare of their company.[210] Directors' duties exist to address the agency problem, where the interests of directors may diverge from the interests of their shareholders.[211] Director's duties should achieve a balance between keeping directors accountable to the interests of the company while allowing them discretion to make decisions which inevitably involve a degree of risk.[212] Governance is not only concerned with accountability but also with the quality of decision making and the creation of value and wealth.[213] A board's purpose is, ultimately, to enable cooperation.[214] These statutory and general law duties require directors and officers of companies to act in good faith in the best interests of the company, to act for a proper purpose, and to act with reasonable care and diligence.[215]

In recent decades, much debate has occurred in Australia regarding whether directors' duties lead to directors becoming risk averse.[216] Protection does exist for directors in Australia under the 'Business Judgement Rule', which is contained in section 180(2) of the *Corporations Act 2001* (Cth). The Business Judgement Rule provides that a director of a corporation who makes a business judgement is taken to meet the requirements of the statutory duty of care and diligence in s180(1) if they make the judgement in good faith for a proper purpose, do not have a material personal interest in the subject matter of the judgement, inform themselves about the subject matter of the judgement to the extent they reasonably believe to be appropriate, and rationally believe that the judgement is in the best interests of the corporation.[217]

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[209] Austin and Ramsay, above n 21, 419.
[210] Ibid 418.
[211] Jensen and Meckling (1976), above n 22, 305.
[212] Ibid.
[213] Grantham, above n 50, 225.
[214] Van Ees, Gabrielsson and Huse, above n 177, 308.
[215] Austin and Ramsay, above n 21, 235.
[216] Neil Young QC, 'Has Directors' Liability Gone too Far or Not Far Enough? A Review of the Standard of Conduct Required for Directors Under sections 180-184 of the Corporations Act' (2008) *26 C&SLJ 216*, 216.
[217] Ibid.

Despite this protection for directors under the statute, the reality is that there has been limited cases in which the business judgement rule has been successful.[218] Further, as the requirements of the business judgement rule to apply to particular business judgements are high, there have been limited cases where a director or executive has been successful in obtaining the benefit of the rule.[219] A notable exception to this was the *ASIC v Rich*[220] case in which Justice Robert Austin declared that ASIC 'had failed in every aspect of their case' and the defendant benefited from the protection of the business judgement rule. This trial concluded in 2009 and was the first comprehensive judicial analysis of the business judgement rule in Australia.

2.7.2 The Australian Securities Exchange Corporate Governance Council (ASXCGC)

At the time of its inception, the ASXCGC was intended to be a focus for companies to enable a better understanding of stakeholder expectations and to promote and restore investor confidence.[221] The purpose of the ASXCGC was to develop governance recommendations which reflected international best practice.[222] Appendix B lists the original 21 members of the ASXCGC; the composition of the members was intended to allow for the perspectives of various groups to be represented, including directors, shareholders, large companies, large investors, company secretaries, lawyers, accountants and actuaries.

In March 2003, the ASXCGC published its *Principles of Good Corporate Governance and Best Practice Recommendations*,[223] which recommended corporate governance practices for entities listed on the ASX that are likely to achieve good governance outcomes and meet the reasonable expectations of most investors in most situations.[224] The ASXCGC principles and recommendations adopted the 'if not, why not' (comply or explain) obligation, introducing the obligation to explain deviations from the code's principles. The code noted that, because the size, complexity and operations of companies differ, a flexible approach would optimise

[218] Austin and Ramsay, above n 21, 502.
[219] Ibid 503.
[220] *ASIC v Rich* (2009) 1229 NSWSC 236.
[221] ASXCGC (2003), above n 4, 4.
[222] Ibid.
[223] Ibid.
[224] ASXCGC (2014), above n 6, 3.

performance.[225] The original code contained ten governance principles and, at the time, ASXCGC considered it ‘a major evolution in corporate governance practice in Australia, the impact of which must not be underestimated’.[226]

An amendment to the ASX Listing Rule 4.10.3 coincided with the original introduction of the ASXCGC principles and recommendations, and provided that companies must disclose in their annual reports the extent to which they have followed the ASX best practice corporate governance recommendations.[227]

In 2007, the ASXCGC released a second edition of the corporate governance principles and recommendations. At the time, the ASXCGC wrote that the second edition represented a ‘refresh’ rather than a ‘rewrite’, and said that the ‘support for the Principles based approach is reflected in the continued high level of reporting against the code by more than 2,000 listed entities’.[228] The ASXCGC also stated that the adoption of recommended practices and the ‘if not, why not’ reporting had risen in each of the three years that the principles and recommendations had been in operation.[229] As predicted by institutional theory, this suggests that many Australian companies believed they would receive legitimacy from the local environment by adopting the principles.[230]

The second edition revised the total number of principles down from ten to eight, omitting Principle 8 (Encourage enhanced performance) and Principle 10 (Recognise the legitimate interests of stakeholders). In 2010 the ASXCGC released amendments to the 2nd edition. These amendments included a recommendation on board diversity which suggested the establishment of a diversity policy with measurable objectives for achieving gender diversity so that progress could be assessed annually.[231] The Council stated that diversity includes, but is not limited to, gender, age, ethnicity and cultural background.[232] The introduction of gender diversity into the recommendations was in line with global trends and provided detailed explanation to assist in the implementation of this new addition to the code. Other inclusions in the

[225] ASXCGC (2003), above n 4, 2.
[226] Ibid.
[227] ASX, above n 170.
[228] ASXCGC (2007), above n 11, 2.
[229] Ibid.
[230] Miles and Salim, above n 137, 316.
[231] ASXCGC (2010), above n 13.
[232] Ibid.

2010 amended second edition included guidance on investor briefings, director selection processes and the structure of the remuneration committee.[233]

In March 2014, the ASXCGC released the third edition of the principles and recommendations. The eight principles remained the same, with the exception of Principle 2, which was amended from: 'Promote ethical and responsible decision-making' to 'Act ethically and responsibly'. The current third edition contains nine new substantive recommendations, making a total of 29 recommendations underpinning the eight principles. The new recommendations included checks for directors prior to appointment, written agreements between directors and the company, the company secretary's accountability to the board, director inductions and professional development, external auditor attendance at the AGM, information and communication to investors, disclosure on the internal audit function and risk exposure and management.[234] Other key changes included amendments to risk recommendations to reflect the lessons learnt from the GFC and greater flexibility in making disclosures on company websites (rather than only in annual reports).[235] Appendix C shows the composition of 22 members of the ASXCGC at the time of the third edition; the membership is largely unchanged from when the ASXCGC was formed in 2002. The current (third) edition of the *ASXCGC Principles and Recommendations* will now be examined.

2.8 *ASXCGC Principles and Recommendations* (3rd ed)

The third edition of the *ASXCGC Principles and Recommendations* was released in 2014, after 'considerable focus across the world on corporate governance practices in light of the events leading up to, and during, the Global Financial Crisis (GFC)'.[236] In response to the GFC, a number of other jurisdictions had also adopted new legislation regulating corporate behaviour and/or upgrading their corporate governance codes.[237]

[233] Ibid.
[234] ASXCGC (2014) above n 6, 3.
[235] Ibid.
[236] Ibid 2.
[237] Ibid.

After a comprehensive review during 2012-13, the then 21 members of the ASXCGC agreed that it was an appropriate time to reissue a third edition of the principles and recommendations.[238] The third edition reflected global trends in corporate governance since the second edition (in 2007) and simplified the structure of the principles and recommendations.[239]

2.8.1 Principle 1: Lay solid foundations for management and oversight

Principle 1 is: 'Lay solid foundations for management and oversight' and its purpose is: a 'listed entity should establish and disclose the respective roles and responsibilities of its board and management and how their performance is monitored and evaluated'.[240] This first principle is the broadest of the eight principles, as is evident when reviewing the recommendations that support it.

Recommendation 1.1 requires that a listed entity should disclose the respective roles and responsibilities of its board and management; and matters expressly reserved for the board and those delegated to management.[241]

Boards exist to address the agency problem, which is present when the desires or goals of the principal and agent conflict, and it is difficult or expensive for the principal to verify what the agent is actually doing.[242] The role of the board is to oversee the agent on behalf of the owners, and Recommendation 1.1 suggests that these differing roles and responsibilities of the board and management should be disclosed.

Contingency theory highlights that the role of the board varies depending on the internal and external contexts, and these contexts consequently shape decisions surrounding corporate governance.[243] Setting the roles and responsibilities of the board and management (as outlined in Recommendation 1.1) supports the idea that the internal contexts shape the delineation of roles, which supports the corporate governance of the organisation.

[238] Ibid.
[239] Ibid.
[240] Ibid, 8.
[241] Ibid.
[242] Eisenhardt, above n 82, 58.
[243] Gabrielsson and Huse, above n 108, 18.

The interactions between directors and management is complicated. Directors both challenge and support managers during board discussions, switching behaviours during meetings while maintaining a consistent level of support and scepticism.[244] The rationale for adopting this recommendation, as outlined in the commentary, is that 'articulating the division of responsibilities between the board and management will help manage expectations and avoid misunderstandings about respective roles and accountabilities'.[245] It further suggests that there are a number of tasks that the board is usually responsible for, including: providing leadership and setting the strategic objectives; appointing the chair, deputy chair and/or senior independent director; appointing and replacing the CEO; overseeing management's implementation of the strategic objectives; approving operating budgets and major capital expenditure; and overseeing the integrity of the accounting, corporate reporting systems and external audit.[246]

Recommendation 1.2 requires that a listed entity should undertake appropriate checks before appointing a person or putting forward to security holders a candidate for election to the board; and provide security holders with information relevant to a decision on whether or not to elect or re-elect a director.[247]

The commentary suggests that various checks should be undertaken as to the person's character, experience, education, criminal record and bankruptcy history. It also suggests that certain information about the candidate be provided to security holders to enable an informed decision on whether to elect or re-elect, including: biographical details; other material directorships; adverse information; interests that may affect independence; term of office (for candidates standing for re-election); whether the board considers the candidate to be independent (for candidates standing for re-election); and whether the board supports the re-election (for candidates standing for re-election).[248] Recommendation 1.2 was introduced as a new recommendation into the third edition of the *ASXCGC Principles and Recommendations* (although 1.2(b) was elevated from 'commentary' in the second edition to a 'recommendation' in the third edition). Despite this recommendation

[244] Nicholson, Pugliese and Bezemer, above n 183, 222.
[245] ASXCGC (2014), above n 6, 8.
[246] Ibid.
[247] Ibid 9.
[248] Ibid.

requiring that directors be elected to the board by shareholders, research suggests that company directors almost always run unopposed and are elected.[249]

Resource dependency theory proposes that boards should be composed of individuals who can provide access to a breadth of resources, recognising that selection and appointment should be directed towards attracting individuals with particular human capital resources to compliment the board's existing capabilities.[250] This recommendation appears to be based on the assumption that companies cannot take the risk of having directors who cannot contribute, and directors themselves must be comfortable that they have the experience and knowledge to serve, and that they know the risks and are prepared to take them.[251]

Recommendation 1.3 requires that a listed entity should have a written agreement with each director and senior executive setting out the terms of their appointment.[252] The rationale in the commentary is that the directors and senior executives of a listed entity should have a clear understanding of their roles and responsibilities and of the entity's expectations of them, and this should be reduced to a written agreement. Usually, this agreement will take the form of a letter of appointment in the case of a non-executive director and a service contract in the case of an executive director or other senior executive.[253] Recommendation 1.3 was elevated from commentary in the second edition to a recommendation in the third edition and appears to be supported by legitimacy theory.

Recommendation 1.4 states that the company secretary of a listed entity should be accountable directly to the board, through the chair, on all matters to do with the proper functioning of the board.[254] Recommendation 1.4 was elevated from commentary in the second edition to a recommendation in the third edition.

The commentary notes that the company secretary of a listed entity plays an important role in supporting the effectiveness of the board and its committees. The

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[249] Jay Cai, Tu Nguyen and Ralph Walkling, 'Director Appointments: It is Who You Know' (Paper presented at the 28th Annual Conference on Financial Economics and Accounting, March 15, 2017) 1.

[250] Val Singh, Siri Terjesen and Susan Vinnicombe, 'Newly Appointed Directors in the Boardroom: How do Women and Men differ?' (2008) 26(1) *European Management Journal* 48, 48.

[251] Ingley and van der Walt, above n 171, 6.

[252] ASXCGC (2014), above n 6, 10.

[253] Ibid.

[254] Ibid.

role should include advising on governance matters, monitoring compliance with board policies and procedures, coordinating and despatching papers, capturing the business at board meetings in the minutes, and facilitating the induction and professional development of directors.[255] It further states that all directors should be able to communicate directly with the company secretary, and the decision to appoint or remove a company secretary should be made or approved by the board;[256] this last statement appears to be related to agency theory guidelines.

Company secretaries have a significant influence on board practices and financial reporting, with the type of influence being dependent on both the expertise and busyness of the person in the role.[257] While company secretaries do not have a direct say in corporate decision making, they are promoters and facilitators of the company's governance practices.[258] They facilitate the flow of information between management and the board, schedule meetings, provide meeting support, lodge documents and provide guidance to the board of directors.[259]

Recommendation 1.5 notes that a listed entity should have a diversity policy which includes requirements to set measurable objectives for the board for achieving gender diversity, and it must disclose both the policy and the progress against those objectives.[260] It also recommends reporting on the proportions of men and women on the board and in senior executive positions within the company, and if the entity is a 'relevant employer' under the *Workplace Gender Equality Act 2012* (Cth), the entity's most recent 'Gender Equality Indicators', as defined in and published under that Act.[261]

The commentary accompanying this particular recommendation is detailed and lengthy, and even includes suggestions for the content of the diversity policy. It also points out that, while the focus of this recommendation is on gender diversity, diversity has a much broader dimension and includes matters of 'age, disability, ethnicity, marital or family status, religious or cultural background, sexual

[255] Ibid.
[256] Ibid 11.
[257] Larelle Chapple, John Nowland and Joeseph Johnston, 'Company Secretaries, Board Practices and Financial Reporting' (Unpublished, 2017), 2.
[258] Ibid 3.
[259] Ibid.
[260] ASXCGC (2014), above n 6, 11.
[261] Ibid.

orientation and gender identity'.[262] This recommendation reflects the growing influence of stakeholder theory.

In 2010, following a period of agitation by various bodies, the ASXCGC released changes to the second edition of the principles and recommendations and included the requirement that companies report on their gender diversity.[263] The three recommendations on diversity in the second edition were consolidated to form a single recommendation in the third edition, and it was relocated from principle three (ethical and responsible decision making) to principle one (lay solid foundations for management and oversight).

Following a period of high profile corporate scandals and subsequent attention to the importance of corporate governance, scrutiny began to turn towards board composition.[264] Many countries saw revisions made to their governance regulations codes, and Australia introduced the revised diversity recommendation (1.5) in 2010. In the period following its introduction, research showed that the regulative, normative and cultural cognitive elements in the Australian board context had been disrupted, and the pressure to increase women on boards that had previously been an intermittent annoyance had gained traction.[265]

The literature strongly supports the concept of board diversity in the social and moral sense.[266] Organisations are expected to reflect the society within which they exist, and are increasingly being expected to reflect that societal diversity in their governance structures (such as the board).[267] Diversity from a resource dependence view argues that a diverse board containing a broad range of backgrounds is necessary to provide the resources that the organisation requires.[268] The increase in female board members has been shown to have a flow-on effect, as female board

[262] Ibid 12.
[263] ASXCGC (2010), above n 13, 24.
[264] Siri Terjesen, Ruth Sealy and Val Singh, 'Women Directors on Corporate Boards: A Review and Research Agenda' (2009) 17(3) *Corporate Governance: An International Review* 320, 320.
[265] Alison Sheridan, Anne Ross-Smith and Linley Lord, 'Institutional Influences on Women's Representation on Corporate Boards' (2014) 33(2) *Equality, Diversity and Inclusion: An International Journal* 140, 155.
[266] Nicholas van der Walt and Coral Ingley, 'Board Dynamics and the Influence of Professional Background, Gender and Ethnic Diversity of Directors' (2003) 11(3) *Corporate governance.* 218, 230.
[267] Ibid 220.
[268] Ibid.

members inspire women employees to serve in senior management roles.[269] Women board members also often engage in mentoring women through their networks.[270]

Resource dependency theory suggests that human and social capital are directly related to the board's ability to secure resources from outsiders,[271] and collectively make up the board capital.[272] The presence of sufficient board capital is necessary to ensure that the provision of advice to management is beneficial,[273] and having a diverse board thus improves the board capital.

Despite the literature outlining various advantages of more diverse boards, including an increase in the variety of perspectives, approaches and knowledge sharing, some evidence suggests that diversity creates social divisions which, in turn, can lead to negative performance.[274]

Recommendation 1.6 requires that a listed entity should have and disclose a process for periodically evaluating: the performance of the board; its committees and individual directors; and disclose whether a performance evaluation was undertaken in the reporting period in accordance with that process.[275]

The commentary further notes that it is 'essential that the board has in place a formal and rigorous process for regularly reviewing the performance of the board, its committees and individual directors and addressing any issues that may emerge from that review' and that the board should consider periodically using external facilitators to conduct its performance reviews.[276] This is based on the propositions of agency theory.

[269] D Bilimoria and J Wheeler, 'Women Corporate Directors: Current Research and Future Directions' in M Davidson and R Burke (Eds), *Women in Management: Current Research Issues* (Athenaeum Press, vol 2, 2000) 139.
[270] Terjesen and Singh, above n 264, 55; A Kunze and A R Miller, 'Women Helping Women? Evidence from Private Sector Data on Workplace Hierarchies' (2017) 99(5) *The Review of Economics and Statistics* 769, 769.
[271] Cowen and Marcel, above n 113, 514.
[272] Ibid.
[273] Sundaramurthy and Lewis, above n 84, 397.
[274] Elizabeth Mannix and Margaret A Neale, 'What Differences Make a Difference? The Promise and Reality of Diverse Teams in Organizations' (2005) 6(2) *Psychological Science in the Public Interest* 31, 31.
[275] ASXCGC (2014), above n 6, 13.
[276] Ibid.

There are clear performance benefits to be gained by companies when their boards and directors engage in open and honest appraisal of their own performance.[277] Individual director evaluations are an effective mechanism by which director weaknesses are recognised and opportunities for development are identified.[278] Despite this, boards can be reluctant to conduct appraisals because of the importance of cohesion and trust among board members for effective functioning of the board, and the resultant concerns that such appraisals could have a negative impact on this dynamic.[279]

Recommendation 1.7 requires that a listed entity should have and disclose a process for periodically evaluating the performance of its senior executives; and disclose whether a performance evaluation was undertaken in the reporting period in accordance with that process.[280]

The performance of a listed entity's senior management team will usually drive the performance of the entity. It is essential that a listed entity has in place a formal and rigorous process for regularly reviewing the performance of its senior executives and addressing any issues that may emerge from that review.[281]

2.8.2 Principle 2: Structure the board to add value

Principle 2 states that 'a listed entity should have a board of an appropriate size, composition, skills and commitment to enable it to discharge its duties effectively'.[282] It notes that 'the board needs to have an appropriate number of independent non-executive directors who can challenge management and hold them to account, and also represent the best interests of the listed entity and its security holders as a whole rather than those of individual security holders or interest groups'.[283] The board should also 'be of sufficient size so that the requirements of the business can be met and changes to the composition of the board and its

[277] Kiel and Nicholson, above n 195, 629.
[278] Coral Ingley and Nick van der Walt, 'Board Dynamics and the Politics of Appraisal' (2002) 10(3) *Corporate governance* 163, 171.
[279] Ibid 173.
[280] ASXCGC (2014), above n 6, 14.
[281] Ibid.
[282] Ibid.
[283] Ibid.

committees can be managed without undue disruption, but should not be so large as to be unwieldy'.[284]

Recommendation 2.1 notes that the board of a listed entity should have a nomination committee with an independent chair and at least three members (a majority of whom are independent).[285] It further requires that the company disclose the committee charter, committee members, number of times the committee met and the individual attendance of committee members.[286] If it does not have a nomination committee, it should disclose the processes it employs to address board succession and how it ensures that the board has the appropriate balance of skills, knowledge, experience, independence and diversity to enable it to discharge its duties and responsibilities effectively,[287] consistent with the propositions arising from agency theory.

The commentary further outlines that having a separate nomination committee can be an efficient and effective mechanism to bring the transparency, focus and independent judgement needed on decisions regarding the composition of the board.[288]

Recommendation 2.2 requires that a listed entity should have and disclose a board skills matrix which sets out the mix of skills and diversity that the board currently has or is looking to achieve in its membership.[289] The commentary further notes that 'disclosing the mix of skills and diversity that a board currently has or is looking to achieve in its membership is useful information for investors and increases the accountability of the board on such matters'.[290] Further 'having a board skills matrix is a useful tool that can help identify any gaps in the collective skills of the board that should be addressed as part of a listed entity's professional development initiatives for directors and used in its board succession planning'.[291]

[284] Ibid.
[285] Ibid.
[286] Ibid.
[287] Ibid.
[288] Ibid.
[289] Ibid 15.
[290] Ibid.
[291] Ibid.

Resource dependency theory suggests that board skills and social capital are directly related to the board's ability to secure resources from outsiders[292] and collectively make up the board capital.[293] The presence of sufficient board capital is necessary for advice provision to management to be beneficial.[294] The use of a skills matrix which is designed to ensure that the board collectively has the skills it requires to govern the company supports resource dependency theory and the concept of board capital.

Recommendation 2.3 states that a listed entity should disclose the names of independent directors and the length of service of each board director.[295] It also notes that if a director has an interest, position, association or relationship of the type described in the recommendation but the board is of the opinion that it does not compromise the independence of the director, it should note the nature of the interest, position, association or relationship in question and an explanation of why the board is of that opinion.[296]

The commentary states that 'to describe a director as "independent" carries with it a particular connotation that the director is not allied with the interests of management, a substantial security holder or other relevant stakeholder and can and will bring an independent judgement to bear on issues before the board'.[297] It further warns that 'it is an appellation that gives great comfort to security holders and not one that should be applied lightly'.[298] The commentary describes an independent director as one who 'is free of any interest, position, association or relationship that might influence, or reasonably be perceived to influence, in a material respect his or her capacity to bring an independent judgement to bear on issues before the board and to act in the best interests of the entity and its security holders generally'.[299]

Agency theory favours the existence of independent directors on boards and suggests that it could assist in the reduction of agency costs.[300] Stewardship theory, conversely, favours the existence of non-independent directors (such as family

[292] Cowen and Marcel, above n 113, 514.
[293] Ibid.
[294] Sundaramurthy and Lewis, above n 84, 397.
[295] ASXCGC (2014), above n 6, 16.
[296] Ibid.
[297] Ibid.
[298] Ibid.
[299] Ibid.
[300] Wafa Khlif et al, 'Family Contingencies and Board Composition: Evidence from Tunisia' (2016) 17(1) *Journal of African business* 16, 19.

members in family companies), suggesting they use their influence to benefit the organisation's stakeholders, enhancing the value of the business.[301] In the case of family members (who are non-independent) in the board composition, decisions are strongly influenced by family power and family culture.[302]

Recommendation 2.4 requires that a majority of the board of a listed entity should be independent directors.[303] The commentary further explains that having a majority of independent directors makes it harder for any individual or small group of individuals to dominate the board's decision-making and maximises the likelihood that the decisions of the board will reflect the best interests of the entity and its security holders generally and not be biased towards the interests of management or any other person or group with whom a non-independent director may be associated.[304]

Recommendation 2.5 states that the chair of the board of a listed entity should be an independent director and, in particular, should not be the same person as the CEO of the entity.[305] The commentary further outlines that having an independent chair can contribute to a culture of openness and constructive challenge that allows for a diversity of views to be considered by the board, and having the role of chair and CEO exercised by the same individual is unlikely to be conducive to the board effectively performing its role of challenging management and holding them to account,[306] which relates to agency theory propositions.

Recommendation 2.6 is concerned with induction and professional development of directors and states that 'a listed entity should have a program for inducting new directors and provide appropriate professional development opportunities for directors to develop and maintain the skills and knowledge needed to perform their role as directors effectively'.[307] While this recommendation does not provide further detail on director inductions, it does state that the board or nominations committee

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[301] Davis, Schoorman and Donaldson, above n 125, 43.
[302] Khlif et al, above n 300, 27; Kristen Madison et al, 'Viewing Family Firm Behavior and Governance Through the Lens of Agency and Stewardship Theories' (2016) 29(1) *Family Business Review* 65, 66.
[303] ASXCGC (2014), above n 6, 17.
[304] Ibid.
[305] Ibid 18.
[306] Ibid.
[307] Ibid.

should 'regularly review whether the directors as a group have the skills, knowledge and familiarity with the entity and its operating environment required to fulfil their role on the board and on board committees effectively and, where any gaps are identified, consider what training or development could be undertaken to fill those gaps'.[308] The commentary also specifically mentions having an understanding of accounting matters and receiving ongoing briefings on developments in accounting standards. Recommendation 2.6 was elevated from commentary in the second edition to a recommendation in the third edition.

2.8.3 Principle 3: Act ethically and responsibly

The third principle is concerned with the need for board members to act ethically and responsibly, and outlines that 'a listed entity's reputation is one of its most valuable assets and, if damaged, can be one of the most difficult to restore'. [309] It identifies the importance that investors and stakeholders place on listed entities to act ethically and responsibly, and further highlights that the role of the board is to lead by example, and the role of management is to create an appropriate culture that promotes ethical and responsible behaviour'.[310]

Stakeholder theory underpins the ethical responsibilities of organisations, which requires a range of standards and expectations of behaviour that reflect a concern for what stakeholders regard as in keeping with stakeholders' moral rights or legitimate expectations[311] in a manner deemed acceptable by society.[312] These ethical behaviours and standards, and the obligation to behave in an ethical and responsible manner are captured within Principle 3. Further, agency theory identifies the issue of separation of ownership and control, referring to the problem company owners have in assuring their funds are not expropriated or wasted.[313] Principle 3 (act ethically and responsibly) also addresses this issue, and requires the board to set the tone for the company and also to charge management with creating an appropriate culture in the organisation that encourages the right behaviours.

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[308] Ibid.
[309] Ibid 19.
[310] Ibid.
[311] Carroll, above n 101, 36.
[312] Hopkins, above n 99, 1.
[313] Shleifer and Vishny, above n 79, 740.

Recommendation 3.1 states that a listed entity should have a code of conduct for its directors, senior executives and employees, and disclose that code or a summary of it.[314] The commentary further outlines that the code of conduct must be, and be seen to be, a meaningful statement of its core values. It needs to be promoted as such across the organisation and reinforced by proper training and proportionate disciplinary action if it is breached.[315]

2.8.4 Principle 4: Safeguard integrity in corporate reporting

Principle 4 is titled 'safeguard integrity in corporate reporting' and states that 'a listed entity should have formal and rigorous processes that independently verify and safeguard the integrity of its corporate reporting'.[316] Since the corporate collapses of Australian companies, such as HIH, Centro and ABC learning centres, the influence that director financial capability has on integrity of the financial reporting and oversight has emerged as an important area of concern for regulators, practitioners and scholars.[317]

Recommendation 4.1 notes that the board of a listed entity should have an audit committee with an independent chair (who is not the board chair) and at least three members (all of whom are non-executive directors and a majority of whom are independent).[318] It further requires that the company disclose the committee charter, the relevant qualifications and experience of the committee members, the number of times the committee met and the individual attendance of committee members.[319] If it does not have an audit committee, it should disclose the processes it employs to independently verify and safeguard the integrity of its corporate reporting, including the processes for the appointment and removal of the external auditor and the rotation of the audit engagement partner.[320]

Recommendation 4.1 also states: 'having a separate audit committee can be an efficient and effective mechanism to bring the transparency, focus and independent

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[314] ASXCGC (2014), above n 6, 19.
[315] Ibid.
[316] Ibid 21.
[317] J Bettington, P Bezemer and G Nicholson, 'Unpacking Director Financial Literacy: A Delphi Study from Australia' (Paper presented at the Australian and New Zealand Academy of Management (ANZAM), Sydney, Australia, 2.
[318] ASXCGC (2014), above n 6, 21.
[319] Ibid.
[320] Ibid.

judgement needed to oversee the corporate reporting process'.[321] The recommendation also lists certain matters that the audit committee should review and make recommendations to the board on, which include: the adequacy of the corporate reporting, the appropriateness of the accounting judgements, whether the financial statements represent a true and fair view, the appointment and removal of the external auditor, rotation of audit partner, and oversight of the internal audit function.[322]

Recommendation 4.2 requires that the board of a listed entity should, before it approves the entity's financial statements for a financial period, receive from its CEO and CFO a declaration that, in their opinion, the financial records of the entity have been properly maintained and the financial statements comply with the appropriate accounting standards and give a true and fair view of the financial position and performance of the entity, and that the opinion has been formed on the basis of a sound system of risk management and internal control, which are operating effectively.[323] As outlined in the commentary, Recommendation 4.2 largely mirrors the declaration required under section 295A[324] of the *Corporations Act 2001* (Cth) but extends it to include a declaration by the CEO and CFO that their opinion has been formed on the basis of a sound system of effective risk management and internal control. It also extends it to apply to the financial statements for any financial period, not just for the financial year.[325]

Recommendation 4.3 requires that a listed entity that has an AGM should ensure that its external auditor attends its AGM and is available to answer questions from security holders relevant to the audit.[326] This is a requirement for listed companies established in Australia under sections 250PA, 250RA and 250T of the *Corporations Act 2001* (Cth);[327] Recommendation 4.3 seeks to also encourage listed entities established outside Australia to do the same.[328] Recommendation 4.3 was elevated

[321] Ibid.
[322] Ibid.
[323] Ibid, 22.
[324] *Corporations Act 2001* (Cth) s 295A.
[325] ASXCGC (2014), above n 6, 22.
[326] Ibid 23.
[327] *Corporations Act 2001* (Cth).
[328] ASXCGC (2014), above n 6, 23.

from commentary in the second edition to a recommendation in the third edition, and reflects the propositions arising from agency theory.

2.8.5 Principle 5: Make timely and balanced disclosure

Principle 5 states that 'a listed entity should make timely and balanced disclosure of all matters concerning it that a reasonable person would expect to have a material effect on the price or value of its securities'.[329]

Recommendation 5.1 requires that a listed entity should have a written policy for complying with its continuous disclosure obligations under the Listing Rules and disclose that policy or a summary of it.[330]

The commentary explains that the listed entity should have a written policy directed to ensuring that it complies with this obligation so that all investors have equal and timely access to material information concerning the entity, including its financial position, performance, ownership and governance;[331] this recommendation appears to reflect propositions arising from agency theory.

2.8.6 Principle 6: Respect the rights of security holders

Principle 6 states that 'a listed entity should respect the rights of its security holders by providing them with appropriate information and facilities to allow them to exercise those rights effectively'.[332] The commentary explains that 'a fundamental underpinning of the corporate governance framework for listed entities is that security holders should be able to hold the board and, through the board, management to account for the entity's performance'.[333] For that to occur 'a listed entity needs to engage with its security holders and provide them with appropriate information and facilities to allow them to exercise their rights as security holders effectively'.[334] The commentary further prescribes that security holders should be given information about the company and its governance, and that the company should communicate openly and honestly with security holders and encourage their participation at meetings'.[335]

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[329] Ibid 24.
[330] Ibid.
[331] Ibid.
[332] Ibid 25.
[333] Ibid.
[334] Ibid.
[335] Ibid.

As noted above, the OECD defined corporate governance as involving 'a set of relationships between a company's management, its board, its shareholders and other stakeholders', and that corporate governance 'provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance'.[336] This definition recognises the significant role that shareholders have in monitoring the performance of the company and in corporate governance more broadly. Principle 6 recognises this role, outlining that the company must liaise with shareholders and provide them with the resources they require in order to undertake these responsibilities, and exercise their rights as security holders effectively.[337] Principle 6 recognises the role of stakeholders in corporate governance as understood by stakeholder theory, that is, that corporations should pay attention to those who can affect or are impacted by an organisation's purpose (such as the shareholders), on the grounds that these actors can enable or prevent the organisation from achieving its purpose.[338]

Recommendation 6.1 states that a listed entity should provide information about itself and its governance to investors via its website, and notes that, in the digital age, investors expect information about listed entities to be freely and readily available.[339] Recommendation 6.1 was elevated from commentary in the second edition to a recommendation in the third edition.

Recommendation 6.2 notes that a listed entity should design and implement an investor relations program to facilitate effective two-way communication with investors, and states that the investor relations program should be tailored to the individual circumstances of the entity.[340]

Recommendation 6.3 requires that a listed entity should disclose the policies and processes it has in place to facilitate and encourage participation at meetings of security holders.[341] It further states that meetings should provide an opportunity for a listed entity to: impart to security holders a greater understanding of the entity's business, governance, financial performance and prospects; discuss areas of concern

[336] OECD (2015), above n 72, 9.
[337] ASXCGC (2014), above n 6, 25.
[338] Freeman, above n 98, 25.
[339] ASXCGC (2014), above n 6, 25.
[340] Ibid 26.
[341] Ibid 27.

or interest to the board and management; and provide security holders with the opportunity to express their views to the entity's board and management about areas of concern or interest for them.[342]

Recommendation 6.4 states that a listed entity should give security holders the option to receive communications from and send communications to the entity and its security registry electronically.[343] It further outlines that most security holders appreciate the speed, convenience and environmental friendliness of electronic communications, compared with more traditional methods of communication.[344] Recommendation 6.4 was elevated from commentary in the second edition to a recommendation in the third edition.

2.8.7 Principle 7: Recognise and manage risk

Principle 7 is concerned with the recognition and management of risk and states that 'a listed entity should establish a sound risk management framework and periodically review the effectiveness of that framework'.[345]

Agency theory highlights that risk preference may differ between principal and agent.[346] A critical role of the board (as outlined in Principle 7) is to oversee risk management for the company.

After the collapse of Enron and the subsequent introduction of the *Sarbanes-Oxley Act 2002* (US) and other efforts to reform listing requirements and governance codes across other jurisdictions, risk management emerged as a major focus in a new regulatory environment.[347] Previous corporate governance structures and risk-management systems had been inadequate in addressing the challenges faced by companies and boards.[348] Additionally, companies were beginning to face more risks as a result of an increasingly sceptical and distrustful customer base, an uncertain environment, increasing competition intensity, the impact of a more aggressive mass

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342 Ibid.
343 Ibid.
344 Ibid.
345 Ibid 28.
346 Eisenhardt, above n 82, 58.
347 Ingley and van der Walt,above n 278, 43.
348 Robert E Bostrom, 'Corporate Governance: Developments and Best Practices One Year After Sarbanes-Oxley') (2003) *International Financial Law Review* 189, 189.

media and rapidly changing information technology.[349] Following the GFC, the ASXCGC third edition substantially enhanced the risk recommendations to reflect the lessons of the crisis.[350] The ASXCGC further stated it 'encouraged all listed entities to review the enhanced risk recommendations carefully and to consider whether they need to upgrade their corporate governance practices in this area'.[351]

The commentary included with principle seven highlights that 'recognising and managing risk is a crucial part of the role of the board and management', and 'failure by a listed entity to recognise or manage risk can adversely impact not only the entity and its security holders but also many other stakeholders, including employees, customers, suppliers, creditors, consumers, taxpayers and the broader community in which the entity operates'.[352] It further notes that the 'entity must have an appropriate framework to identify and manage risk', and that it is the role of the board to 'set the risk appetite for the entity, to oversee its risk management framework and to satisfy itself that the framework is sound'.[353]

Recommendation 7.1 suggests that the board of a listed entity should have a risk committee with an independent chair and at least three members (a majority of whom are independent).[354] It further requires that the company disclose the committee charter, the members of the committee, the number of times the committee met and the individual attendance of committee members.[355] If it does not have a risk committee, it should disclose the processes it employs for overseeing the entity's risk management framework.[356]

It further suggests that, while ultimate responsibility for a listed entity's risk management framework rests with the full board, having a risk committee can be an efficient and effective mechanism to bring about the transparency, focus and

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349 Roger W Raber, 'The Role of Good Corporate Governance in Overseeing Risk' (2003) 11(2) *The Corporate Governance Advisor* 11, 11.
350 ASXCGC, 'Communique: Release of Third Edition of the Corporate Governance Principles and Recommendations' 27 March 2014', 2.
351 Ibid.
352 ASXCGC (2014), 28.
353 Ibid.
354 Ibid.
355 Ibid.
356 Ibid.

independent judgement needed to oversee the entity's risk management framework.[357]

Recommendation 7.2 requires that the board or a committee of the board should review the entity's risk management framework at least annually to satisfy itself that it continues to be sound, and disclose, in relation to each reporting period, whether such a review has taken place.[358] It is important that the board of a listed entity periodically review the entity's risk management framework to satisfy itself that it continues to be sound and that the entity is operating within the risk appetite set by the board.[359]

Recommendation 7.3 states that a 'listed entity should disclose, if it has an internal audit function, how the function is structured and what role it performs; or if it does not have an internal audit function, the processes it employs for evaluating and continually improving the effectiveness of its risk management and internal control processes'.[360]

The commentary supporting this recommendation notes that 'an internal audit function can assist a listed entity to accomplish its objectives by bringing a systematic, disciplined approach to evaluating and continually improving the effectiveness of its risk management and internal control processes'.[361] It further suggests that, in terms of company structure, the head of internal audit 'should have a direct reporting line to the board or to the board audit committee to bring the requisite degree of independence and objectivity to the role',[362] which reflects agency theory. Recommendation 7.3 was elevated from commentary in the second edition to a recommendation in the third edition.

Recommendation 7.4 requires that a listed entity disclose whether it has any material exposure to economic, environmental and social sustainability risks and, if it does, how it manages or intends to manage those risks.[363] It further explains that listed entities will be aware of the increasing calls globally for the business community to

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[357] Ibid 29.
[358] Ibid.
[359] Ibid.
[360] Ibid, 30.
[361] Ibid.
[362] Ibid.
[363] Ibid.

address matters of economic, environmental and social sustainability, and the increasing demand from investors, especially institutional investors, for greater transparency on these matters so that they can properly assess investment risk.[364] Recommendation 7.4 was introduced as a new recommendation into the third edition of the ASXCGC principles and recommendations.

2.8.8 Principle 8: Remunerate fairly and responsibly

The final principle, titled ‘remunerate fairly and responsibly’, states that ‘a listed entity should pay director remuneration sufficient to attract and retain high quality directors and design its executive remuneration to attract, retain and motivate high quality senior executives and to align their interests with the creation of value for security holders’.[365] It highlights that remuneration is a ‘key focus’ for investors, and that when setting the level and composition of remuneration, an entity needs to balance four elements:

1. The desire to attract and retain high quality directors and to attract, retain and motivate senior executives;
2. The need to ensure that the incentives for executive directors and other senior executives encourage them to pursue the growth and success of the entity (both in the short term and over the longer term) without taking undue risks;
3. The need to ensure that the incentives for non-executive directors do not conflict with their obligation to bring an independent judgement to matters before the board; and
4. Its commercial interest in not paying excessive remuneration.[366]

In 2011, changes were made to *the Corporations Act 2001* (Cth) which were designed to empower shareholders to hold directors accountable for their decisions on executive remuneration, to address conflicts of interest in the remuneration setting process, and to increase transparency and accountability in executive remuneration matters.[367] These changes implemented many of the recommendations made by the Productivity Commission (PC) in its inquiry into executive remuneration in

[364] Ibid.
[365] Ibid, 31.
[366] Ibid.
[367] *Corporations Amendment Act (2011)* (Cth).

Australia in 2009.[368] This inquiry into executive remuneration was conducted after strong growth in executive remuneration between the 1990s to 2007 along with instances of large payments despite poor company performance, and the subsequent community concerns that executive remuneration was out of control.[369]

The Corporations Amendment (Improving Accountability on Director and Executive Remuneration) Act 2011 (Cth)[370] introduced a 'two-strikes and re-election' process in relation to the non-binding shareholder vote on the remuneration report. The 'first strike' occurs where a company's remuneration report receives a 'no' vote of 25 per cent or more and requires the subsequent remuneration report to include an explanation of the proposed action. The 'second strike' occurs where a company's subsequent remuneration report receives a 'no' vote of 25 per cent or more, and shareholders vote at the same AGM to determine whether directors will need to stand for re-election. If this 'spill resolution' is passed, the spill meeting will occur within 90 days.[371] This strengthening of the non-binding vote came into effect on 1 July 2011.

Stakeholder theory proposes that the role of the board is to represent the interests of the client groups (stakeholders),[372] and, in doing so, it is the board's role to manage the competing interests of the stakeholder groups.[373] Investors are a key stakeholder group who, as highlighted in this principle, are very focused on remuneration. The role of the board in meeting the requirements of this principle is to ensure that the remuneration levels for the managers are appropriate for ensuring they are incentivised to perform while also meeting the expectations of the investors. The need to manage this balance follows the key assumptions outlined in stakeholder theory.

Research on the impact of such governance structures and the impact they have on executive remuneration is supported by stakeholder theory. Firstly, in situations where governance structures are less effective, CEOs tend to earn greater

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368 Ibid.
369 Australian Government Productivity Commission, 'Executive Remuneration in Australia' (Productivity Commission Inquiry Report No. 49, 2009), XIV.
370 *Corporations Amendment Act (2011)* (Cth)
371 Ibid 6.
372 Farrell, above n 94, 94.
373 Evan and Freeman, above n 103, 83.

compensation.[374] Further, institutional investors have been found to have a significant and negative impact on CEO compensation,[375] and institutional investors significantly enhance the accountability of CEOs.[376] Other factors also influence the level of executive remuneration, which has been found to be more closely aligned to firm performance in companies where there are a majority of independent directors and where remuneration committees exist.[377]

The commentary also notes that the entity should have a formal and transparent process for developing its remuneration policy and fixing its remuneration packages, and should articulate to investors the relationship between remuneration and performance and how it is aligned to the creation of value for shareholders.[378]

Recommendation 8.1 suggests that the board of a listed entity should have a nomination committee with an independent chair, and at least three members (a majority of whom are independent).[379] It further requires that the company disclose the committee charter, committee members, number of times the committee met and the individual attendance of committee members.[380] If it does not have a nomination committee, it should disclose the processes it employs for setting the level and composition of remuneration for directors and senior executives and ensuring that such remuneration is appropriate and not excessive.[381] The recommendation further explains that having a separate nomination committee can be an efficient and effective mechanism to bring the transparency, focus and independent judgement needed on remuneration decisions.[382]

Recommendation 8.2 states that a listed entity should separately disclose its policies and practices regarding the remuneration of non-executive directors and the

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374 John Core, Robert Holthausen and David Larcker, 'Corporate Governance, Chief Executive Officer Compensation, and Firm Performance' (1999) 51(3) *Journal of Financial Economics* 371, 371.
375 Neslihan Ozkan, 'Do Corporate Governance Mechanisms Influence CEO Compensation? An Empirical Investigation of UK Companies' (2007) 17(5) *Journal of Multinational Financial Management* 349, 349.
376 Robert Mangel and Harbir Singh, 'Ownership Structure, Board Relationships and CEO Compensation in Large US Corporations' (1993) 23(91A) *Accounting and Business Research* 339, 339.
377 Martin Conyon and Simon I. Peck, 'Board Control, Remuneration Committees, and Top Management Compensation' (1998) 41(2) *Academy of Management Journal* 146, 147.
378 ASXCGC (2014), above n 6, 31.
379 Ibid.
380 Ibid.
381 Ibid.
382 Ibid, 32.

remuneration of executive directors and other senior executives.[383] The commentary explains that, because remuneration is a key focus for investors, to facilitate an open dialogue with its security holders on this topic, listed entities should clearly articulate and disclose their respective remuneration policies and practices.[384]

Recommendation 8.3 suggests that a listed entity which has an equity-based remuneration scheme should have a policy on whether participants are permitted to enter into transactions (whether through the use of derivatives or otherwise) which limit the economic risk of participating in the scheme; and disclose that policy or a summary of it.[385] Allowing participants in an equity-based remuneration scheme to hedge or otherwise limit the economic risk of participating in the scheme may act counter to the aims of the scheme and blur the relationship between remuneration and performance.[386]

2.9 Conclusion

From the review of the corporate governance literature in this chapter, it is clear that the ASXCGC principles and recommendations fundamentally exist to solve the agency problem, the essence of which is the separation of ownership and control between managers and shareholders.[387] Agency theory is the prominent theory in corporate governance literature, and has been the dominant theoretical perspective used in research on both corporate governance and boards of directors.[388] In analysing the ASXCGC principles and recommendations in this chapter, it is also clear that other corporate governance theories support some of the principles and recommendations. These theories include stakeholder, contingency, resource dependency, stewardship, social contract and legitimacy theories. For this reason these theories will be applied later in Chapter 6 to analyse the research findings.

From the literature assessed in this chapter, it is not clear how directors reflect on their governance practices under the ASXCGC principles and recommendations. In fact, there is a gap in the literature on this issue. This is likely to be influenced by the

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383 Ibid.
384 Ibid.
385 Ibid 34.
386 Ibid.
387 Shleifer and Vishny, above n 79, 740, Grantham, above n 50, 220.
388 Daily, Dalton and Cannella, above n 81, 371.

fact that boards of directors are inherently difficult to study directly;[389] as is the case in accessing elite groups in general.[390]

Both the literature and practice of corporate governance would be enhanced by understanding how the directors of Australia's largest companies reflect on their practice of the ASXCGC's principles and recommendations. Such research would inform academics, directors, governance promoters and policy makers such as the ASXCGC itself. As boards are the focus of considerable policy-making, there is scope for board literature, such as this, to have policy impact.[391]

For this reason, the research question for this study is 'How are ASX200 directors reflecting on their practising of the ASX Corporate Governance Council Principles and Recommendations?' The set of interview questions is designed to understand how they reflect on each of the principles, as well as explore the enabling and constraining factors for directors in their governing of the ASX200 companies. Such experiences are intended to enhance future iterations of the good governance principles and recommendations.

Chapter 3 will now outline the research design and methodology adopted in this study to answer the research question.

[389] Leblanc and Schwartz, above n 30, 843.
[390] Pettigrew, above n 29, 162.
[391] Adams, above n 20, 1.

CHAPTER 3: Research design and methodology

3.1 Introduction

The primary research question driving this research was 'How are ASX200 directors reflecting on their practising of the ASXCGC principles and recommendations?' Such reflections may vary markedly because the ASXCGC Principles and Recommendations are not mandatory.[392]

An interpretive approach using qualitative methods was used to reveal the variations in the ways directors meet their obligations under the ASXCGC principles and recommendations. The overall approach utilised a grounded theory approach, in which the theory was generated from the data.[393] This allowed for a refinement of the research parameters throughout the data collection period and provided the most appropriate research method for the study. Interviews were used in the study because they are an effective method of conducting qualitative research and gaining an understanding of the constructs respondents use as a basis for their opinions and beliefs about a matter.[394]

There was a risk in not obtaining a sufficient sample of ASX listed company directors for the study because, particularly ASX200 directors, are an elite group in society responsible for governing the largest companies in Australia, and are accountable to many stakeholders, including shareholders, governments, consumers, other businesses and the general public.

There are several techniques that can be used in elite group sampling and elite interviews.[395] This study used snowball sampling, enlisting the help of elites to 'get in the door' with others in the population.[396] Snowball sampling is a design strategy that can be employed in purposeful sampling that involves starting with one or a few relevant and information-rich interviewees and then asking them for additional relevant contacts.[397] The researcher builds the sample as they are interviewing by asking each interviewee for suggestions about people who have a similar or different

[392] ASXCGC (2014) , above n 6, 3.
[393] Glaser and Strauss, above n 27, 6.
[394] Easterby-Smith, Thorpe and Lowe, above n 24,74.
[395] Goldstein, above n 34, 669.
[396] Ibid 671.
[397] Patton, above n 28, 270.

perspective, and the ‘snowball effect’ occurs as referrals multiply at each step (or interview).[398] To begin ‘the snowball’, ASX200 directors known to the researcher were identified as potential interview candidates and were approached for interview. At the close of each of these initial interviews, an attempt to generate new interview leads occurred by asking the interviewees if they thought any of their ASX200 associates would be interested in participating in the study.

3.2 Approach

The first step in design alignment is to determine the inquiry purpose.[399] The purpose of the inquiry in this study was to understand how ASX200 directors reflect on their practice of governance on ASX200 boards, particularly under the ‘comply or explain’ of *ASXCGCs Principles and Recommendations* (3rd ed). In particular, the research was concerned with how the directors of ASX200 companies make sense of and implement their governance responsibilities.

3.2.1 Interpretive approach

The adoption of an interpretive approach was determined to be appropriate given the nature of this study, because this approach assumes that reality is socially constructed rather than objectively determined.[400] Interpretation means attaching significance to what was found, making sense of the findings, offering explanations, drawing conclusions, making inferences and otherwise imposing order on an unruly but surely patterned world.[401] This is in contrast to the philosophy of positivism, which uses objective accounts of the real world,[402] assuming that there is a reality out there to be studied, captured and understood.[403] The key principle of positivism is that the social world exists externally, and that its properties should be measured through objective methods rather than being inferred subjectively through sensation, reflection or intuition.[404]

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[398] Ibid 298.
[399] Ibid 265.
[400] Easterby-Smith, Thorpe and Lowe, above n 24, 24.
[401] Patton, above n 28, 570.
[402] Denzin and Lincoln (2011), above n 25, 15.
[403] Denzin and Lincoln (2000), above n 26, 9.
[404] Easterby-Smith, Thorpe and Lowe, above n 24, 22.

The ASXCGC principles and recommendations provide high level guidance on how corporate governance could be practiced.[405] The fact that they are not mandatory also suggested that there may be significant variation in how these requirements are addressed.[406] Therefore, gaining an understanding of how directors reflect on their governance practices using objective measures would have been difficult. The environment for ASX200 directors in managing companies is socially constructed and, therefore, using an interpretive approach facilitated an understanding of the meanings that directors place on their experiences as board directors governing the ASX200 companies.

3.2.2 Qualitative research

Interpretivism supports a qualitative approach which attempts to make sense of or interpret phenomena in terms of the meanings people bring to them.[407] Given that qualitative research is known to enable the researcher to get closer to an individual's perspectives (through interviewing and other methods),[408] it was determined that using qualitative research methods for this study would be the most appropriate strategy to understand how ASX200 directors reflect on their governance practices and therefore would be most suited to the purpose of the inquiry.

Qualitative research is a situated activity that locates the observer in the world.[409] It involves an interpretive, naturalistic approach of the world through a series of representations which include field notes, interviews, conversations, recordings and memos to the self.[410] Qualitative research is a commonly used tool for use in social research. Much of its popularity has come about because of the weaknesses inherent in quantitative research, including thinness of data, the control orientation often displayed and the issues surrounding the relevance of findings.[411] While both qualitative and quantitative researchers are concerned with the individual's point of view, the use of qualitative methods can, arguably, get closer to the individual's perspective through detailed interviewing and observation, whereas quantitative

[405] ASXCGC (2014), above n 6, 3.
[406] Ibid.
[407] Denzin and Lincoln (2011), above n 25, 3.
[408] Denzin and Lincoln (2000), above n 26, 10.
[409] Ibid.
[410] Denzin and Lincoln (2000), above n 26, 3.
[411] Mats Alvesson and Stanley Deetz, *Doing Critical Management Research* (Sage, 2000) 70.

researchers are seldom able to capture their subject's perspectives because they have to rely on more remote, inferential empirical methods and materials.[412]

The aspect of qualitative research that enables the researcher to get closer to an individual's perspectives,[413] determined that it was the most appropriate strategy for this research.

3.2.3 Grounded theory

Adopting a qualitative research methodology allowed for the use of grounded theory, where no up-front theory is proposed and no hypotheses are formulated for testing ahead of the research.[414] The generation of grounded theory is a way of arriving at theory suited to its supposed purposes,[415] and its proponents argue that the adequacy of theory cannot be divorced from the process by which it is generated.[416] This type of research 'starts with some research questions and an open mind, then moves into data collection, aiming to end up with a theory'.[417] This approach allows the researcher to be very open to what is uncovered when conducting the research.

In order to capture individual directors' experiences, and how they make sense of their governance responsibilities, qualitative research using a grounded theory approach was used to understand the meaning and context in which directors operate. Since the introduction of the first *ASXCGC Principles and Recommendations* in March 2003, there has been little research conducted on how listed company directors govern with them in practice, and thus there is no known theory to work from. As the explicit purpose of grounded theory is the generation of theory from data,[418] it allowed for the refinement of the research parameters during data collection and provided the most appropriate research method for this study. The use of grounded theory allowed the generation of theory around how directors meet their governance responsibilities under the ASXCGC principles and recommendations from the data gathered in the research itself.

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412 Denzin and Lincoln (2000), above n 26, 10.
413 Ibid.
414 Glaser and Strauss, above n 27, 6.
415 Ibid 3.
416 Ibid 5.
417 Keith Punch, Introduction to Social Research: Quantitative and Qualitative Approaches (Sage, 3rd ed, 2014) 135.
418 Ibid.

3.3 Interviews

In order to gain an understanding of the reflections of ASX200 directors on their practising of governance, it was determined that conducting interviews was the most effective way to gather the data required for the study. Interviews are an effective method for obtaining data when conducting qualitative research, and especially when it is necessary to gain an understanding of the constructs that the interviewee uses as a basis for their opinions and beliefs about a matter.[419] Interviews in qualitative research are relatively loosely structured and open to what the interviewee feels is important to focus on, though within the bounds of what appears to be relevant given the interest of the research project.[420] This approach is beneficial in as much as a rich account of the interviewee's experiences, knowledge, ideas and impressions may be considered and documented.[421] The researcher is able to obtain perspectives, information and ideas that they have not thought of before and, additionally, there is space for negotiation of meanings so that some level of mutual understanding may be accomplished, making data richer and more meaningful.[422]

Interviews, by their nature, are social encounters. The ability to obtain such perspectives not previously thought of and to negotiate mutual understanding lends itself to the use of grounded theory, where theory is generated from the data itself.[423] Recent proponents of grounded theory argue that language is central; it shapes meanings, fosters different types of meanings, and clarifies or conceals connections between meanings and actions.[424] The use of interviews in this study enabled the researcher to capture the language of the interviewees in order to understand the context and explore the meaning of their responses.

One on one interviews can be highly effective in situations where the step-by-step logic of a situation is not clear, where the subject matter is highly confidential and where the interviewee may be reluctant to be truthful about an issue other than confidentially in a one-to-one situation.[425]

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419 Easterby-Smith, Thorpe and Lowe, above n 24,74.
420 Alvesson and Deetz, above n 411,71.
421 Ibid.
422 Ibid.
423 Glaser and Strauss, above n 27, 6.
424 Kathy Charmaz, 'Grounded Theory in Global Perspective' (2014) 20(9) *Qualitative Inquiry* 1074, 1078.
425 Easterby-Smith, Thorpe and Lowe, above n 24, 74.

The interviews were conducted as one on one (individual) director interviews as the subject matter was confidential, and also to minimise any reluctance by directors to be open and frank.

As members of the governing body, directors on the boards of companies are responsible for directing the company.[426] Company law presumes that directors will act collectively as a board but, in carrying out functions as a member of the board, each director is individually subject to statutory and general law duties.[427] These statutory and general law director duties include acting in good faith in the best interests of the company, acting for a proper purpose, and acting with reasonable care and diligence.[428] As directors are individually responsible for meeting their directors duties, it was determined that the most appropriate way to research how they reflected on their governance practices was to conduct the research with them individually (rather than as a full board). Group interviews with the full board were not conducted in order to avoid the likely risks of social pressures conditioning the responses, and directors not being willing to air their views in front of their colleagues.[429] Further, directors on the same ASX200 board could give varying responses as to how they perceive and address their governance responsibilities.

3.3.1 Open-ended interviews

Qualitative enquiry aims to minimise the imposition of pre-determined responses.[430] Producing a topic-initiating question and following up the interviewee's answer with a question is the usual way in which open-ended interviews are conducted.[431] The topic-initiating questions introduces the issue which the interviewer would like the interviewee to focus upon; the follow-up questions provide the possibility to gain detailed and comprehensive discussion on the issue.[432] Adopting an open-ended interview increases the comparability of responses, and allows data to be collected

[426] Tricker, above n 19, 44.
[427] Austin and Ramsay, above n 21, 419.
[428] Ibid 235.
[429] Easterby-Smith, Thorpe and Lowe, above n 24, 94.
[430] Patton, above n 28, 446.
[431] Rapley, above n 40, 315.
[432] Ibid.

on all topics addressed.[433] The open-ended interview is used when it is important to minimise variation in the questions posed to interviewees.[434]

In researching how directors meet their governance responsibilities under the eight principles (and associated recommendations) outlined by the ASXCGC, it was important that all directors covered every one of the eight principles. The use of open-ended interviews covering each principle (in order) was determined to be the most effective approach to ensure this occurred. Open-ended interviews were conducted by asking a topic-initiating question and then following up the interviewee's answer with one or more other questions.[435] The use of these open-ended questions enabled directors to respond in their own words and allowed freedom in their responses, which suited the grounded theory approach.

The open-ended questions were structured as follows:

- Eight specific questions covering each of the eight individual principles from the *ASXCGC Principles and Recommendations* (in order), and
- Two general questions about governance, which were refined after pilot interviews were conducted (with non-ASX200 directors known to the researcher):
  - What keeps them awake at night (what are their key governance concerns), and
  - What makes governing ASX200 companies easier (what are the facilitating factors).

These general questions were selected given the depth in responses from the pilot interviews. Another question was screened out concerning what makes governance more difficult, as it did not elicit any new material in the responses in addition to that revealed in the eight specific questions on the principles. The list of open-ended questions are reproduced in Appendix D.

During the interviews, discussions often evolved around each principle, how the board deals with it, how they satisfy themselves as directors that they are meeting their duties and responsibilities, and problems or successes they had experienced in

[433] Patton, above n 28, 438.
[434] Ibid 440.
[435] Rapley, above n 40, 315.

relation to the principle under consideration. As discussions evolved, the responses would often drift to other principles or issues, and the researcher would write down points for further questioning as the interview progressed. This method allowed for spontaneous discussion to occur and continue.

3.4 Insider status

Trust is an important and difficult issue in interviews, especially in one-off interviews where the people involved have not met before.[436] Failure to develop trust may result in interviewees simply resorting to telling the researcher what they think the researcher wants to know.[437]

It helps if the researcher is viewed as having equal status as the interviewee, and also if the interviewee feels that they can benefit from the exchange.[438] Researchers who claim insider status indicate they share cultural membership with the group under investigation.[439] Once insider status is established, researchers may assert that their insider position allows them to have insights that outsiders could not have.[440]

In order for the interviews to be successful in providing insights into how directors reflected on their practice of governance, it was critical to earn the trust of the directors early on in the interview. 'Insider status'[441] was used as a strategy to earn trust early in the interview by the introduction of the researcher as a company director. In order to establish insider status and credibility, the researcher verbally provided a brief background of her experience as a director at the beginning of the interview. In addition, the researcher's interest in the topic of board governance and subsequent motivation for the study was outlined. In establishing this insider status, a shared cultural membership[442] with director groups was created as well as an understanding that shared common languages and experiences existed between the interviewer and interviewee.

During interviews, certain conclusions may be drawn from the dress, mannerisms, voice or language of the interviewer, and the questions asked by the interviewer and

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[436] Easterby-Smith, Thorpe and Lowe, above n 24, 77.
[437] Ibid.
[438] Ibid.
[439] Denzin and Lincoln (2011), above n 25, 662.
[440] Ibid.
[441] Ibid.
[442] Ibid.

the answers given by the interviewee will often depend on the way their situations are defined.[443] Business attire was worn to all interviews by the researcher to ensure a shared dress code, and to reinforce insider status and credibility.

3.5 Population and sample

Purposeful sampling involves selecting information-rich cases to study, cases that by their nature and substance will illuminate the inquiry question being investigated.[444] 'Information rich' cases are those from which one can learn a great deal about issues of central importance to the purpose of the inquiry; thus the term purposeful sampling.[445] Directors on the boards of Australia's largest companies, the ASX200, were considered to be 'information rich' because they generally face more intense scrutiny from analysts, investors and the general public by directing the largest Australian listed companies. Additionally, narrowing the scope of the study to the top 200 companies was designed to appeal to this 'elite' group, with participants having been made aware that the sample population was exclusively the ASX200 listed companies and not all listed companies. With this sampling strategy, however, a key risk identified early on in the study was the difficulty in getting access to this 'elite group' in society.

At the beginning of the data collection period, the 'population' consisted of 1,127 individuals who were appointed to the 200 ASX200 company boards.[446] Of these 1,127 individuals, 200 (17.7%) were female and 927 (82.3%) were male.[447]

The total number of ASX200 board roles or 'seats' at the start of the collection period was 1,381 and, therefore, the average number of board seats held was 1.23 roles per individual.[448] Of these 1,381 roles, 293 (21.2%) were held by females and 1,088 (78.8%) were held by males.[449] The average number of board seats for females (1.47) was higher than that of males (1.17).[450]

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443 Easterby-Smith, Thorpe and Lowe, above n 24, 76.
444 Patton, above n 28, 264.
445 Ibid.
446 Australian Council of Superannuation Investors, 'Board Composition and Non-executive Director Pay in ASX200 Companies' November 2016) 15.
447 Ibid.
448 Ibid.
449 Ibid.
450 Ibid.

Of the 1,381 ASX200 board roles, 1,170 were non-executive director roles.[451] Non-executive directors (NEDs) are those not involved in the full-time management of the company and are not employees of the company.[452] Table 3.1 shows the number of ASX200 board roles held by each individual ASX200 NED at the beginning of the collection period:

Table 3.1: Number of ASX200 board roles held by each individual ASX200 NED in 2015

One role	Two roles	Three roles	More than three roles
742	126	50	6

Source: Australian Council of Superannuation Investors, 'Board Composition and Non-executive Director Pay in ASX200 Companies' (November 2016)

Once the population was understood, consideration was given to the sampling strategy and options. The importance of understanding sampling options is that they constitute design options; in essence, different ways of thinking and strategising about what to study.[453] The type of sample selected follows from and supports inquiry into the questions being asked.[454] The population being sampled in the study consisted of 1,127 ASX200 directors, and the questions being asked were directly related to the *ASXCGC Corporate Governance Council Principles and Recommendations*.

3.5.1 Elite group sampling

> A well prepared personable researcher who would be able to control an open-ended and wide-ranging interview, while establishing a strong informal rapport with an elite respondent will never get to demonstrate his or her interviewing skills - or ability to decrease measurement error - if the meeting never takes place.[455]

'Getting the elite interview' is more art than science, and it is important to understand how the goals of the project interact with the process of gaining access.[456]

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[451] Ibid.
[452] Pamela F Hanrahan, Ian M Ramsay and Geof Stapledon, *Commercial Applications of Company Law 2012* (CCH Austraia, 13th ed. 2012), 190.
[453] Patton, above n 28, 264.
[454] Ibid.
[455] Goldstein, above n 34, 669.
[456] Ibid.

This helps to reveal the types of errors that are introduced to a study by what is the unavoidable inability to interview some in the elite population.[457]

It was identified early on during the study that there was a real risk of not obtaining a sufficient sample of ASX listed company directors. ASX listed company directors, particularly the ASX200, are an elite group in society who hold significant roles as they are responsible for governing the largest companies in Australia, and are accountable to many stakeholders, including shareholders, governments, consumers, other businesses and the general public. ASX200 board positions are usually held by very qualified, very experienced people, and such roles could be considered out of reach for most in society.

There are known techniques that assist in sampling and conducting interviews with elite groups.[458] One technique is to be ready and available, as elites generally have busy schedules and being able to take advantage of last minute breaks in their schedules can be advantageous.[459] In designing the sampling approach for the elite ASX200 director population, a key strategy that was adopted in this study was allowing maximum flexibility in scheduling interviews for the ASX200 directors. Directors were given the option of being interviewed in their home city as much as possible (most resided in either Sydney or Melbourne). In cases where they resided elsewhere, it was found that they often travelled to Sydney or Melbourne for board meetings, and in these cases they were given the option of being interviewed immediately before or after the board meetings. The process of taking advantage of these 'breaks in their schedules'[460] gave the interviewees maximum control over the scheduling and facilitated securing the interviews. In some cases, the ASX200 director's board meetings ran over or under time and being on the ground ready to conduct the interview at a moment's notice[461] did indeed prove to be advantageous.

Being present in the areas where the elite group is present is another technique that can assist in obtaining access, and the more time one spends in locations where the elites are, the more likely it is that one will make connections that can help one

[457] Ibid.
[458] Ibid.
[459] Ibid, 671.
[460] Ibid.
[461] Ibid.

schedule an interview.[462] A similar approach was adopted in this study with the ASX200 directors. The researcher had become a NED and commenced a board career a few years prior to commencing the study. Through various company board positions, connections had been established (with both ASX200 directors and non-ASX200 directors) that assisted in scheduling the first of the interviews.

While boards of directors are inherently difficult to study directly,[463] some researchers have been able to gain access to directors and boards through the use of snowball sampling whereby access to one director or board leads to further access.[464]

3.5.2 Snowball sampling

Good preparation not only leads to good data for a particular interview but also credibility for future interviews for the project.[465] Once rapport is established with an elite respondent, they can be enlisted to help 'get in the door' with others on the elite sample list, which is called 'snowball sampling'.[466] Snowball sampling is an effective way of gathering a sufficient sample through enlisting the help of elites to 'get in the door' with others in the population.[467]

In undertaking the snowball sampling, ASX200 directors known to the researcher were identified as potential interview candidates and were approached for an interview. At the closing of each of these initial interviews, an attempt to generate new interview leads occurred by asking the interviewees if they thought any of their ASX200 associates would be interested in participating in the study. If they confirmed this to be the case, an information pack was emailed to them for on-forwarding to these identified colleagues. It was at the interviewees' discretion whether they forwarded the material, and the researcher had no way of knowing if this exchange of email had occurred. If the prospective interviewee received the information pack and was interested in participating, they made contact with the researcher in order to participate, who then arranged for an interview to be booked. This same process of requesting new leads was adopted with each interview, and gradually more and more leads were generated using this snow-balling approach.

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462 Ibid.
463 Leblanc and Schwartz, above n 30, 843.
464 Ibid 849.
465 Goldstein, above n 34, 671.
466 Ibid.
467 Ibid.

Often the best approach for gaining entry into the population is through the use of the known sponsor approach.[468] When employing this tactic, observers use the legitimacy and credibility of another person to establish their own legitimacy and credibility.[469] In interviewing the ASX200 director population, the combination of using snowball sampling combined with the known sponsor approach was utilised to access this elite group. Utilising ASX200 directors who had been interviewees to generate further leads among their professional networks was effective in establishing both the credibility of the researcher and the generation of further interviews to constitute an effective sample size.

While it was known that snowball sampling is an effective strategy to sample elite groups, the researcher was aware of the need to ensure that there was no deviation from the target sample in the efforts to obtain a sufficient sample size.[470] Selecting these relevant cases, and thus constituting a purposeful sample, is a critical step in ensuring research design alignment (along with determining the inquiry purpose, focusing the inquiry questions and deciding what data to collect).[471]

3.5.3 Sample size

Determining an ideal sample size depends on what you want to know, the purpose of the inquiry, what's at stake, what will be useful, what will have credibility, and what can be done with the available time and resources.[472] There are no rules for what the sample size should be in qualitative inquiry. Purposeful samples should be judged on the basis of the logic, purpose and rationale of the study: that is, does the sampling strategy fit the study's purpose?[473] The purpose of this study was to understand how ASX200 directors reflected on their practice of governance as outlined by the *ASXCGC Principles and Recommendations*.

The size and composition of the sample can be adjusted based on what is learned as fieldwork is conducted and as the inquiry deepens.[474] The emergent nature of qualitative inquiry is especially powerful for determining sample size, as the sample

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[468] Patton, above n 28, 396.
[469] Ibid.
[470] Goldstein, above n 34, 671.
[471] Patton, above n 28, 265.
[472] Ibid 311.
[473] Ibid.
[474] Ibid.

can grow, or if saturation is achieved sooner than expected, the size can be reduced.[475] The challenge of determining ideal sample size becomes even more complicated when emergent strategies are used, such as snowball sampling.[476] These purposeful strategies leave the question of sample size open, which is a prime example of the emergent nature of qualitative inquiry.[477]

This study was designed using a grounded theory approach and the emergent strategy of snowball sampling and, as such, it was decided to leave the required sample size relatively open, establishing an 'approximate' or initial estimate number of interviews to be conducted based on 'expected reasonable coverage of the phenomenon'[478] given the 'purpose of the study and stakeholder interests'.[479] A useful sample size was initially estimated to be 40 ASX200 directors, calculated as two directors from 20 different ASX200 companies or 10 per cent of the total ASX200 companies (20 companies) being interviewed. The proposition of having two directors from each company represented the fact that, in utilising a snowball sampling method, directors may suggest fellow directors on the same ASX200 boards. The estimate of 40 was also expected to be achievable within the time frame allocated for conducting the interviews, being nine months.

The researcher commenced the snowball sampling by interviewing seven director colleagues and associates with ASX200 board appointments known to her, and then generated a further additional 34 interviews, equalling a total sample size of 41 ASX200 directors. It became obvious that theoretical saturation of the population was achieved after the 41 interviews had been conducted. Significantly, these 41 interviewees together had current appointments on 45 of the 200 ASX200 companies, which was significantly higher than the original estimate that predicted covering only 20 of the ASX200 companies. Put simply, the sample of 41 ASX200 directors collectively had current appointments on almost a quarter (45 companies or 22%) of the ASX200 companies in Australia, and many of the directors had prior ASX200 director experience, having previously held other ASX200 company appointments. The sample for the study contained a significantly higher proportion

[475] Ibid.
[476] Ibid.
[477] Ibid.
[478] Ibid.
[479] Ibid.

of women than the total population (48.8% of the sample were female whereas only 17.7% of the ASX200 director population were female, although females held 21.2% of the total ASX200 director roles).

The 41 interviews were conducted over a 12-month period, taking a few months longer than was originally anticipated because of the need to be flexible in fitting in with the schedules of this elite group of people. Further, it was evident that, by the time 12 months had passed since the initial interview, sufficient data had been gathered as common themes were emerging. In order not to prolong the completion of the study and publication of results (thereby impacting currency and relevance) it was deemed that 41 interviews formed a sufficient sample size from which to complete the study. To manage the complex schedule of interviews, a detailed register was kept of all interview bookings and interview leads.

3.6 Data collection

The third stage in design alignment is deciding what data to collect.[480] As explained, the purpose of this study was to understand how ASX200 directors reflect on their practice of governance as outlined by the ASXCGC's 2014 Principles and Recommendations. It was determined that the most appropriate method to gather the data required was to conduct one-on-one interviews with ASX200 directors, using open-ended questions. Like all other aspects of qualitative inquiry, questions can be emergent and are points at which discussion begins.[481] New questions can be discovered as part of the inquiry journey[482]; allowing this discovery suited the grounded theory design approach.

Designs are built around the questions we ask, and then understanding, insight, and knowledge emerge from the inquiry into the questions that we ask.[483] Given that the purpose of this study was to understand how ASX200 directors reflect on their practice of governance as articulated by *ASXCGC 2014 Principles and Recommendations*, the research was designed to study a point in time (as opposed to

[480] Ibid 265.
[481] Ibid 254.
[482] Ibid.
[483] Ibid.

longitudinally), and the questions designed to stimulate the directors thoughts on these guidelines followed the principles themselves.

To test the validity and effectiveness of the interview questions, two pilot interviews were initially conducted[484] with directors known to the researcher (non-ASX200 directors). These pilot interviews were reviewed and amendments were made to the interview questions before the ASX200 director interviews were formally commenced and the data collection began. Appendix D reproduces the interview questions.

While qualitative methods generally permit inquiry into selected issues in greater depth than quantitative methods, the breadth-versus-depth trade-off also applies within qualitative design options.[485] Human relations specialists say that we can never fully understand the experience of another person and, therefore, an issue in design is how much time and effort should be invested in trying to increase our understanding about any single person's experiences.[486]

When assessing the appropriate interview length, and taking into account the breadth-versus-depth trade off as well as the challenges in gaining access to elites, it was determined that the length of the interview should be no more than one hour. The interview duration of one hour was determined to be adequate in order to gain enough depth during the interview without being too much of an imposition on this elite group, which may have affected the likelihood of getting the interview in the first place.

When interviewing elites, 'the bottom line is that there is no silver bullet solutions, and scheduling and completing elite interviews takes a fair bit of luck.'[487] A strategy to employ when interviewing elites is to send advance letters on official stationary, outlining the research, the amount of time requested, contact details and supervisory information.[488] The purpose of the advance letter is to set out the 'ground rules', which is crucial for getting the interview, and it is also important for the research

[484] Xu Liu, 'Interviewing Elites: Methodological Issues Confronting a Novice' (2018) 17(1) *International Journal of Qualitative Methods* 1, 2.
[485] Ibid 257.
[486] Ibid.
[487] Goldstein, above n 34, 671
[488] Ibid.

discipline as a whole to be able to conduct such research in the future.[489] An "Information Sheet" on university letterhead with a covering email, including the University Ethics approval number, was provided by the researcher to prospective interviewees inviting them to participate in this study. This correspondence contained all the 'ground rules',[490] and was provided along with some background of the researcher's experience as a director, the researcher's interest in the topic of board governance and her motivation for the study. This also assisted in establishing a level of trust and understanding prior to the interview being undertaken.

3.6.1 Rapport and reciprocity

Gaining valid and reliable data from elite interviews demands that researchers be well prepared, construct sound questions and establish a rapport with respondents.[491] A critical enabler in establishing rapport with respondents was the explanation of why the inquiry was being undertaken. This explanation was provided at the opening of each interview and followed a logical sequence encompassing the researcher's career as a director (and therefore understanding of the role which also assisted in establishing insider status), the researcher's interest in board governance (particularly the ASX200), and the expected users of the study findings. Researchers are not just doing fieldwork out of personal or professional interest, they are doing the fieldwork for decision makers and information users.[492] The decision makers and information users who may benefit from the findings in this study were outlined as including the regulator (the ASXCGC) as well as other directors (both ASX200 and non-ASX200 directors) and other interested parties, such as the Australian Institute of Company Directors (AICD). Outlining these reasons for undertaking the research inquiry assisted in developing both trust and interest in the study at the commencement of the interviews.

Mutual trust, respect, and cooperation are dependent on reciprocity, where the interviewer obtains data in exchange for something that makes the interview worthwhile for the interviewee.[493] When people adjust their priorities and routines to help the researcher, they are giving of themselves and the researcher should

[489] Ibid.
[490] Ibid.
[491] Ibid 669.
[492] Patton, above n 28, 395.
[493] Ibid 396.

reciprocate.[494] Reciprocity can take various forms and could be generated through feelings of importance from being observed, gaining pleasure from the interactions and through the researcher demonstrating they are a good listener.[495] This reciprocity model was deemed critical for gaining entry into this elite group, and the researcher was very sensitive to the importance of enabling reciprocity through these means during the interviews.

3.6.2 Conducting the interviews

The interviews were conducted face to face wherever possible. Thirty nine of the 41 interviews were conducted face to face in capital cities, where the majority of the ASX200 board meetings are held, and where the majority of the interviewees reside. The remaining two were conducted over the phone because of difficulties in lining up face-to-face meetings. Whilst these two phone interviews lacked an opportunity to observe body language, they were not significantly shorter in length than the other 39 interviews and they also produced rich responses, like the face to face interviews. In line with the interview program and research methodology, the interviews were conducted over a 12-month period, allowing the research to be concluded in as close to a three-year timeframe as possible, thereby maximising the currency and value of the findings to participants, regulators and other stakeholders.

The one hour interviews were booked in appropriate locations within the capital cities at suitable times to the participants. Given that the location of the researcher was in close proximity to Sydney and Canberra, interviews were conducted in those locations when suitable to the interviewee as a first preference in order to minimise costs and time. As a second preference, the researcher travelled to Melbourne to conduct interviews when required. Travel to other capital cities was arranged in cases where Sydney, Canberra and Melbourne were not possible, as required by the interviewees. If an interviewee was willing to be interviewed but it was not possible to arrange an interview face to face, it was conducted over the phone, which occurred only in two instances.

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[494] Ibid.
[495] Ibid.

Interviews were conducted at locations where the interview was private and was able to be recorded. These locations were booked in advance and were conducted at locations including company board and meeting rooms or rented meeting rooms.

At the commencement of each interview, an introduction was provided giving details about the researcher's background and outlining the purpose of the inquiry. Participants were offered another copy of the information sheet and asked whether they had any questions before providing their written consent to participate.

The questions were used as a guide to conduct the interview, and allowed for flexibility in the discussion. When themes or ideas emerged that required further examination, probing questions were used. This method suited the grounded theory approach utilised for the study, as themes emerged early on in the research that shaped the direction of the questioning and later stages of research.

3.7 Categorising and storing

Field notes contain descriptions of what is being observed, and contain items the observer believes worthy of noting.[496] First and foremost, field notes are descriptive and should record basic information about where the observation took place, the setting, the attendees and the social interaction.[497] In order to capture the basic information about each interview, a register (spreadsheet) was created which served two main purposes. Firstly, the register recorded basic (descriptive) information regarding each participant, including their name, contact details, gender, current and past ASX200 board appointments, the referral source and a brief biography (from publicly available information such as annual reports). Secondly, the register was used to manage the actual interview bookings, so that times, locations and room bookings were recorded as well as the status of various leads for potential interviewees. This assisted in not only providing descriptive information but also managing the logistics of arranging 41 interviews in various locations, and ensured a professionally managed end-to-end experience for each interviewee. The purpose of obtaining each ASX200 director's biographical information was to further assist in establishing a rapport at the commencement of each interview.[498]

[496] Ibid 387.
[497] Ibid.
[498] Liu, above n 484, 2.

The primary method of collecting interview data used during the study was through the use of digital recordings. Digital recordings are a technological innovation that, when used judiciously, can make fieldwork more efficient and comprehensive.[499] The decision to use voice recordings as the primary method of data collection during the interviews was to ensure a complete and accurate record of each interview, and to assist the flow of the interview and engagement between the interviewer and interviewee, as the 'use of a recorder permits the interviewer to be more attentive to the interviewee'.[500] Each interview was recorded using a recording device (iPhone 5), the digital recording was numbered chronologically and immediately transferred to a hard drive following the interview. Once the transfer had occurred, the original version on the iPhone 5 was deleted.

The interview questions covered each of the eight ASXCGC Principles in chronological order, which led to the responses generally being recorded and stored in that order. However, this was not always the case because respondents had some freedom in how they shared their insights.

The use of a recording device does not eliminate the need for taking notes.[501] Field notes should contain descriptive information that assists the researcher to remember observations made during the analysis, as well as assist readers of the final research report to better understand the researchers experience in the interviews.[502] Notes taken in conjunction with voice recordings can be strategic and focused, serving multiple purposes, including assisting in the formulation of new questions, making sure the inquiry unfolds in the intended direction and assisting in later analysis.[503] In this research, notes were taken during each interview in conjunction with the primary data collection method (voice recording), which were effective in assisting with the formulation of new questions and probing as themes emerged, as well as assisting later in the analysis phase.

The period after the interview is a critical time for reflection and elaboration, and is critical to the rigour and validity of the qualitative inquiry.[504] After each interview,

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[499] Ibid 391
[500] Ibid 472
[501] Ibid 473.
[502] Ibid 387.
[503] Ibid 473.
[504] Ibid.

observations were recorded in writing, documenting the researcher's own reflections and reactions and the nature of the social interaction itself. Notes were made about various aspects of the interviews, such as the rapport, the setting, the reactions and demeanour of the interviewee, and the quality of the information. Weaknesses and problems were also recorded which aided later improvements. Such reflections and observations were made as soon as possible after the conclusion of each interview while the experience of the interview itself was still fresh in the mind of the researcher.

3.8 Coding, analysis and interpretation

Gaining valid and reliable data from elite interviews demands that researchers code responses accurately and consistently.[505] The primary method of collecting interview data used during the study was through the use of digital recordings. The use of digital recordings allowed for the use of software to assist during the analysis of the data. Qualitative software programs are designed to facilitate data storage, coding, retrieval, comparing and linking qualitative data.[506] It was noted that, while computer programs can facilitate the work of the analysis, they cannot provide the creativity and intelligence that make each qualitative analysis unique.[507] NVivo software was selected as the tool to assist in analysing the interview data collected, being particularly useful because of its functionality, which allows audio files to be imported, and coding, analysis, and the creation of memos and annotations to be conducted. NVivo has become particularly flexible in adapting to the demands of modern qualitative research projects.[508] Further, NVivo can be used to encourage good quality grounded theory research by facilitating many of the key processes and characteristics associated with the grounded theory approach.[509]

After each interview was recorded (using iPhone 5 recorder), the digital recording was numbered chronologically and immediately transferred to a hard drive and imported into NVivo. The files were then accessed in NVivo for coding, analysis and

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505 Goldstein, above n 34, 669.
506 Patton, above n 28, 529
507 Ibid.
508 Pat Bazeley, *Qualitative Data Analysis with NVivo* (London: Sage, 2nd ed, 2013) 2.
509 Andrew John Hutchison, Lynne Halley Johnston and Jeff David Breckon, 'Using QSR-NVivo to Facilitate the Development of a Grounded Theory Project: An Account of a Worked Example' (2010) 13(4) *International Journal of Social Research Methodology* 283, 283.

interpretation of the data. A photographic image was stored of each interviewee in the register of participants, which acted as a reminder, during the coding process, of the person speaking and of other aspects of the interview itself. The photographs were sourced from board websites. The written notes and reflections were also used in the coding and analysis phase of the project, and were included in the NVivo memos.

The process of analysing the data was aimed directly at generating abstract theory to explain what is central in the data,[510] supporting the grounded theory approach. Generating a theory from data means that most hypotheses and concepts not only come from the data but are also systematically worked out in relation to the data during the course of the research.[511] In order to do this, the accepted analytical approach adopted in grounded theory research, is to use open, axial and selective coding techniques. Open codes were developed as the first level of conceptual analysis by identifying conceptual categories implicit or explicit in the data, and the theoretical possibilities the data carried.[512] Axial coding was then conducted to interconnect the main themes that emerged from the open coding process. Axial codes attempted to put an 'axis' through the data, connecting the themes or categories identified by the open coding.[513] Finally, selective coding was utilised where central aspects of the data were selected as core categories to concentrate on.[514] Concurrent to this coding process, memos recorded ideas about codes and their relationships as they emerged. The Constant Comparative Method was adopted which is an iterative, integrative, analytic procedure utilised in grounded theory that involves the continuous cycling back and forth of collecting, coding and analysing the data.[515] The four stages of the constant comparative method were utilised in the analysis and included comparing the incidents applicable to each category, integrating the categories and their properties, delimiting the theory, and writing the

[510] Punch, above n 417, 179.
[511] Glaser and Strauss, above n 27, 6.
[512] Punch, above n 417, 180.
[513] Anselm Strauss and Juliet Corbin, *Basics of Qualitative Research: Grounded Theory Procedures and Techniques* (Sage, 3rd ed, 2008) 198.
[514] Punch, above n 417, 184.
[515] Glaser and Strauss, above n 27, 105.

theory.[516] In presenting the analysis, the themes that emerged were described with exemplar quotes to illustrate the typical responses of ASX200 directors.

3.9 Ethical considerations

The ethical issues checklist and related guiding principles outlined by Patton[517] were adopted in this study, including explaining the purpose, adhering to promises, confidentiality management and risk assessment.[518]

Before each interview was conducted, each director received a brief overview of the study in an email along with the 'Information Sheet for Participants' outlining the aim of the research, how the interview would be conducted and other matters, such as the use, storage and disposal of information collected. The interviews were recorded (approved by all 41 interviewees) to ensure that the information was recalled accurately, and a transcript was offered to all participants following the interview. Interviewees were asked if they agreed to being quoted under a pseudonym to ensure that they were not identifiable. Using pseudonyms is an effective way to disguise the identity of participants and provide protection[519], and was an important factor in gaining access to this elite group of interviewees. These measures were approved by the University of New England's Human Ethics Committee (under approval HE15-246).

Of the 41 interviews conducted, seven were known to the researcher as a colleague or associate. The nature of the relationship between the researcher and these seven individuals was not considered to be that of a 'friend' relationship, which represents particularly delicate ethical ground as a method of convenience sampling;[520] rather, these seven individuals were known to the researcher as a result of professional board appointments, and there was no other contact with the researcher outside of these work associations.

[516] Ibid 105.
[517] Patton, above n 28, 496.
[518] Ibid.
[519] Ibid 499.
[520] Joanna Brewis, 'The Ethics of Researching Friends: On Convenience Sampling in Qualitative Management and Organization Studies' (2014) 25(4) *British Journal of Management* 849, 860.

3.10 Challenges and limitations

Systematic error from non-response is a function of both the number of non-respondents and the degree to which those who cannot be contacted or refuse to be interviewed differ in traits or attitudes from those who are successfully contacted or interviewed.[521] The consequences of non-response in elite interviewing depends on the goals of the research. If the goal of the research was to gather particular factual information, then confirming that the researcher heard from different sides and different types of organisations can assist in confirming that the research does not have unbalanced or biased information.[522] In this study, however, the goal was to gather a more broad generalisation, and this is actually an area where small N elite interviews have an advantage over mass surveys.[523] Unlike researchers surveying the mass public, researchers using elite interviews actually know quite a bit about those who remain uninterviewed.[524]

As stated, access to participants was a consideration that was front of mind throughout the selection of the methods and procedures for the study. A key risk to successful completion of the study was identified as being failure to find sufficient numbers of ASX200 directors to meet the required sample size. The identification of this risk led to the decision to use snowball sampling as a design strategy which involved starting with one or a few relevant and information-rich interviewees and then asking them for additional relevant contacts.[525] The researcher used seven known director colleagues and associates with ASX200 board appointments from which to commence the snowball sampling process and, as a professional director, was also able to establish credibility as a researcher in the field. Snowball sampling is known as an effective way of gathering a sufficient sample through enlisting the help of elites to 'get in the door' with others in the population.[526]

As explained, in addition to the adoption of the snowball sampling technique and in order to minimise the risk of failing to obtain a sufficient sample size from this elite group, the researcher provided maximum flexibility in the scheduling of interviews.

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521 Goldstein, above n 34, 669.
522 Ibid 672.
523 Ibid.
524 Ibid.
525 Patton, above n 28, 270.
526 Goldstein, above n 34, 671.

Directors on ASX200 companies have significant responsibilities by nature of their roles, often having full schedules and significant travel commitments. The researcher was very accommodating of their schedules and requirements, and travelled regularly to conduct the interviews at convenient times and locations as required. The strategy of using snowball sampling to gain access to this elite group generated a sample size of 41 out of the total population of 1,127 ASX200 directors. These 41 information rich interviewees collectively held board appointments on 45 of the 200 ASX200 companies, representing a sufficient sample size and eliminating the need for an alternative sampling strategy.

One risk of the snowball sampling method is that the way the sample is chosen by target people makes it liable to various forms of bias.[527] Because people tend to associate not only with people with the same study selection characteristic but also with other characteristics, which could increase the chance of correlations being found in the study that do not apply to the generalised wider population.[528] Despite this, snowball sampling can be a very useful sampling method, particularly if there is no other way of reaching the target population,[529] as was the case with this elite group. To minimise this risk, particular care was taken by the researcher when asking for leads. Despite this, the researcher was not aware of how many or which ASX200 directors were 'non-respondents', being directors who were contacted by their colleagues to be interviewed but declined and, therefore, the degree of this error is unknown. However, such concerns are not critical when the research being undertaken is qualitative, grounded research,[530] and this risk was therefore not deemed to be significant.

As has been established, researchers who claim insider status indicate they share cultural membership with the group under investigation.[531] Despite the fact that researchers may assert that their insider position allows them to have insights that outsiders could not have,[532] in this study, the researcher was acutely aware that her knowledge and relationship as a director could not be separated from the research

[527] Patton, above n 28, 298.
[528] Ibid.
[529] Goldstein, above n 34, 671.
[530] Leblanc and Schwartz, above n 30, 849.
[531] Denzin and Lincoln (2011), above n 25, 662.
[532] Ibid.

itself.[533] To overcome this, a reflective approach during writing was taken to ensure an honest and trustworthy account[534] of the findings from the study.

In the interview environment, the interviewer and interviewee work to construct themselves as certain types of people in relation to the topic, and reflexively, the interview itself.[535] The awareness of this local context of data production is central in the analysis of the interview data and, to overcome this, the interviewer should focus on the actual lived practice of the interview.[536] Seeing an interview as a specific type of interaction highlights the interactional, or social, nature of the interview, and the interviewer should see themselves as a central and active participant in the interaction.[537] Interview-talk is produced in a specific context and an awareness of that context is vital for understanding the talk and, therefore, the 'data', itself.[538] The interactional nature of interviews means that the data is collaboratively produced.[539] Recognising this, a reflexive writing strategy was adopted where the researcher examined how their presence and stance in the interviews functioned in relation to the subject itself.[540] Additionally, the researcher was mindful of the possible differences between men and women ASX200 directors in terms of their situation, experiences and discrimination[541] and the need to take this into account during the analysis and writing. As a female researcher in what is typically a male dominated environment (ASX200 boards), the researcher was particularly conscious of this during the interviews and the effects it may have had on certain responses.

The sample for the study contained a significantly higher proportion of women than the total population (48.8% of the sample were female whereas only 17.7% of the population were female, although females held 21.2% of the total ASX200 director roles). The researcher was reflexive about this significant difference and, throughout the interviews and analysis, was very aware that this seemed likely to be at least partially caused by the fact that the researcher was a female. It was observed that when interviewees were asked whether they had other ASX200 contacts who they

[533] Ibid 663.
[534] Ibid.
[535] Rapley, above n 40, 303.
[536] Ibid 317.
[537] Ibid.
[538] Ibid.
[539] Ibid 318.
[540] Denzin and Lincoln (2011), above n 25, 662.
[541] Alvesson and Skoldberg, above n 43, 211.

thought may be interested in participating in the study, they would sometimes ask whether the researcher would like to interview ASX200 female directors (this was the case with both female and male interviewees). The researcher remained indifferent about the gender of the leads, however an almost equal split between males and females in the sample itself emerged.

Given that interviews are not a neutral environment and can be controlled by the interviewees,[542] control was facilitated by the researcher as required to minimise long-winded responses and digressions. Control was maintained by asking focused questions, listening attentively and giving appropriate verbal and non-verbal feedback during the interviews.[543]

3.11 Conclusion

The methods and procedures used for this study were determined by the need to understand how ASX200 board directors reflect on their practice of governance. As the *ASXCGC Principles and Recommendations* are not mandatory, how they are addressed by ASX200 directors may vary.[544]

Employing an interpretivist paradigm, qualitative methods were used to study the variations in ways directors meet their obligations under the *ASXCGC Principles and Recommendations*. A grounded theory approach, where the theory was generated from the data,[545] was utilised, allowing for the refinement of the research parameters during the data collection process.

There was a real risk of not being successful in obtaining a sufficient sample of ASX listed company directors for the study. The population of ASX200 directors hold significant roles because they are responsible for governing the largest companies in Australia, and are an 'elite group' in society. Snowball sampling was used in the study as it is a very effective way of gathering a sufficient sample through enlisting the help of elites to 'get in the door' with others in the population[546]. This sampling strategy involved beginning by interviewing seven director colleagues and associates with ASX200 board appointments known to the researcher, from which another 34

[542] Patton, above n 28, 396.
[543] Ibid.
[544] ASXCGC (2014), above n 6, 3.
[545] Punch, above n 417, 135.
[546] Goldstein, above n 34, 671.

interviews where generated, resulting in a total sample size of 41 ASX200 directors in the study. As a professional director with board experience the researcher was also able to establish credibility as a researcher in the field of study.

In analysing the data, the accepted analytical approach adopted in grounded theory research using open, axial and selective coding techniques was utilised. Concurrent to this coding process, memos were utilised to write up ideas about codes and their relationships as they emerged, further supporting the grounded theory approach.

In the following chapters (4 and 5), the analyses of the ASX200 directors interviews is presented.

CHAPTER 4: The process and laying the foundations (Principle 1)

4.1 Introduction

The primary research question for the study was ‘How are ASX200 directors reflecting on their practising of the ASXCGC principles and recommendations?’ A snowball sampling strategy was used to gain access to the ASX200 directors, which is an effective method for obtaining access to elite groups.[547] This produced a sufficient sample size of ASX200 directors, who were interviewed over a twelve month period.

After analysing data from the first few interviews, it emerged that certain principles and recommendations attracted more reflection and attention than others. Accordingly, the researcher adjusted the interview questions, as appropriate when using the grounded theory approach. The first principle in the ASXCGC principles and recommendations is ‘Laying solid foundations for management and oversight’. The recommendations supporting this principle form the foundational matters for the board from which to govern.

This chapter first discusses the sample characteristics and the varying levels of reflections by interviewees on particular principles and recommendations. The chapter then conducts a detailed exploration of the reflections on Principle 1: Laying solid foundations for management and oversight. Analyses of the remaining Principles is presented in Chapter 5.

4.2 Sample characteristics

Figure 4.1 illustrates the snowballing approach for recruiting interviewees. As explained in Chapter 3, interviews occurred over a 12-month period and each interview was given a chronological number. Seventeen of the 41 interviews were ‘first generation’ leads, seven of whom were known to the researcher as colleagues or associates. A further 10 ‘first generation leads’ were referred from other colleagues or associates of the researcher who were aware of the research project.

[547] Ibid.

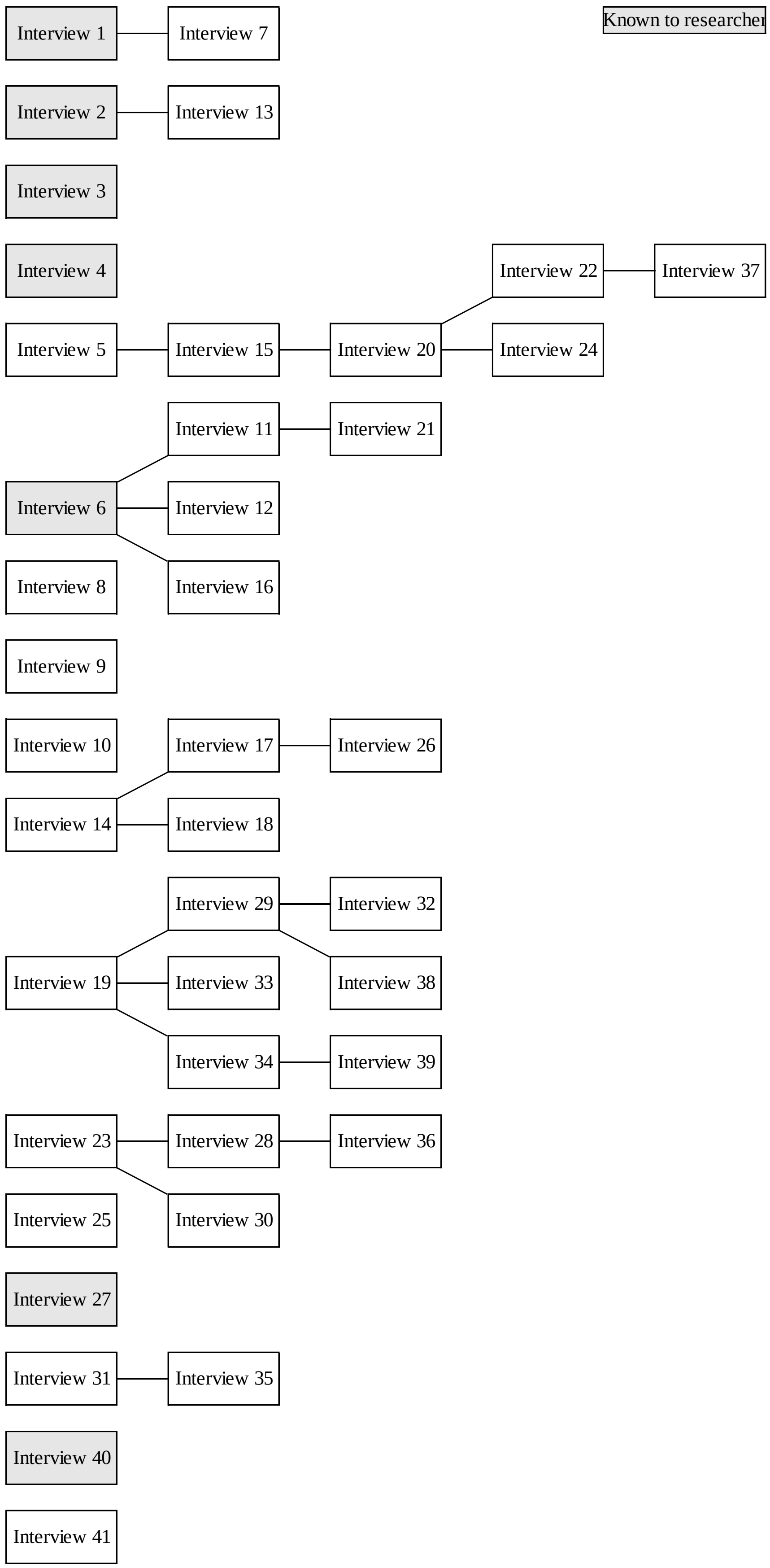

Figure 4.1: Snowball approach of interviews

At the end of each interview, the participant was asked whether they knew of one or more ASX200 contacts who might be interested in participating in the study. If the interviewee answered 'yes', they were emailed an information pack to be on-forwarded to the prospective interviewee(s). The prospective interviewee then chose whether or not to make contact with the researcher in order to participate. If contact was made, discussions around appropriate meeting times and places would occur. Every lead that made contact with the researcher was interviewed, and towards the end, when it became obvious that theoretical saturation had been achieved the researcher stopped seeking further leads from the final few participants.

The 17 first generation leads generated 14 second generation leads, who then generated seven third generation leads, who generated two fourth generation leads, who generated one fifth generation lead.

Table 4.1 shows that, of the 41 study participants, 21 (51.2%) were male and 20 (48.8%) were female. Of the total population of 1,127 individuals who were appointed to the 200 ASX200 company boards at the beginning of the data collection period, 927 (82.3%) were male and 200 (17.7%) were female.[548] The sample for the study contained a significantly higher proportion of women than the total population (48.8% of the sample were female whereas only 17.7% of the population were female, although females held 21.2% of the total ASX200 director roles). The researcher was reflexive about this significant difference, and throughout the interviews and analysis was very aware that this seemed likely to be at least partially caused by the fact that the researcher was a female. It was observed that when interviewees were asked whether they had other ASX200 contacts who they thought may be interested in participating in the study, they would sometimes ask whether the researcher would like to interview ASX200 female directors (this was the case with both female and male interviewees). The researcher remained indifferent about the gender of the leads, however an almost equal split between males and females in the sample itself emerged.

Table 4.1: Director gender and the city of residence

	Number	Percent of the sample
Gender		
Male	21	51.2

[548] Australian Council of Superannuation Investors, above n 446, 15.

Female	20	48.8
TOTAL	**41**	**100.0**
City of residence		
Sydney	17	41.5
Melbourne	13	31.7
Perth	5	12.2
Brisbane	1	2.4
Canberra	1	2.4
Adelaide	1	2.4
Regional	1	2.4
International	2	4.9
TOTAL	**41**	**100**

Table 4.1 shows the directors' cities of residence. As can be seen, they predominantly resided in Australian capital cities. Seventeen (41.5%) lived in Sydney and 13 (31.7%) lived in Melbourne. Five directors (12.2%) lived in Perth, and one director (2.4%) lived in each of Brisbane, Canberra and Adelaide. Of the three directors not based in an Australian capital city, 1 director (2.4%) lived in regional Australia, and two (4.9%) lived overseas.

Directors in this elite group were given the option of being interviewed in their home city as much as possible. In cases where they resided in areas outside of Sydney and Melbourne, it was found that they often travelled to Sydney or Melbourne for board meetings, and they were given the option of being interviewed immediately before or after these board meetings. The process of taking advantage of these 'breaks in their schedules'[549] gave the interviewees maximum control over the scheduling and facilitated securing the interviews. In some cases, the ASX200 director's board meetings ran over or under time and being on the ground ready to conduct the interview at a moment's notice[550] did prove to be advantageous. Of the 41 interviews conducted, 38 were conducted face to face in Sydney or Melbourne, one was conducted face to face in Canberra and two were conducted over the phone (due to difficulties in arranging a face-to-face meeting).

[549] Goldstein, above n 34, 671
[550] Ibid.

Table 4.2 outlines the ASX200 current appointments and roles of the directors interviewed.

Table 4.2: ASX200 director current appointments and roles

	Number	**Percent of sample**
Number of current ASX200 Listed appointments held by each director		
1 role	22	53.7
2 roles	13	31.7
3 roles	3	7.3
More than 3 roles	3	7.3
TOTAL	**41**	**100**
ASX200 director appointments by ASX200 company rank		
ASX1 - ASX50	30	42.9
ASX51 - ASX100	12	17.1
ASX101 - ASX150	12	17.1
ASX151 - ASX200	16	22.9
TOTAL	**70**	**100.0**
Current ASX200 listed roles held by the directors		
Non-Executive Director	57	81.4
Non-Executive Chair	10	14.3
Non-Executive Deputy Chair	2	2.9
Executive Director	1	1.4
TOTAL	**70**	**100.0**

As can be seen in Table 4.2, of the 41 directors interviewed, 22 directors (53.7%) held one ASX200 role, 13 (31.7%) held two ASX200 roles, three directors (7.3%) held three ASX200 roles, and three directors (7.3%) held more than three ASX200 roles. It is important to note that in cases where directors held more than one board role, during the interviews they were still only asked each question once. It was at their discretion as to how they answered each question, and which board examples or situations they chose to highlight in their responses.

The sample contained a lower proportion (53.7%) of directors with one role than the total NED population (80.3%), and a higher proportion (31.7%) of directors with two roles than the total NED population (13.6%). The sample contained a higher proportion (7.3%) of directors with three roles than the total NED population (5.4%), and a higher proportion (7.3%) of directors with more than three roles than the total NED population (0.6%).[551]

As can be seen in Table 4.2, the 41 directors interviewed held a combined total of 70 ASX200 appointments at the time of their interviews. These 70 current ASX200 appointments were held across 45 (22.5%) of the 200 ASX200 companies. Of these current roles, the majority (57 or 81.4%) were non-executive director roles, ten (14.3%) were non-executive chair roles, two were non-executive deputy chair roles and only one was an executive director role. Non-executive roles are those that are not involved in the full-time management of the company and are not employees of the company.[552]

In the sample of 41, there was a disproportionately higher number of director appointments from the ASX1-ASX50. The sample consisted of 30 director appointments (42.9%) from the top quartile (ASX1-ASX50). The second and third quartiles (ASX51-ASX100 and ASX101-ASX150) had 12 director appointments (17.1%) each, and the fourth quartile (ASX151-ASX200) had 16 director appointments (22.9%). This was not deemed to be of concern as the responses did not vary materially across the quartiles. Further, unlike researchers surveying the mass public, researchers using elite interviews actually know quite a bit about those who remain uninterviewed,[553] and the nature of the methodology adopted for this study meant that having an even distribution across the quartiles was not seen as important for this sample.

Table 4.3 reproduces the Global Industry Classification Standard (GICS) sectors and GICS Industry Groups of the 70 ASX200 appointments. As shown, 70 ASX200 appointments were held by the directors interviewed, 20 (28.6%) were from the financials sector, 13 (18.6%) were from the consumer discretionary sector, 10 (14.3%) were from the consumer staples sector, 8 (11.4%) were from the industrials sector, 7 (10%) were from the health care sector, and the remainder (12 or 17.1%) were from other sectors. There was, therefore, a reasonably broad coverage over a variety of GICS sectors in the current ASX200 appointments.

Table 4.3: ASX200 company GICS sectors and GICS industry groups

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[551] Australian Council of Superannuation Investors, above n 446, 19.
[552] Hanrahan, Ramsay and Stapledon, above n 452, 190.
[553] Goldstein, above n 34, 672.

	Number	Percentage of sample
Financials	**20**	**28.6**
Banks	9	12.9
Diversified financials	5	7.1
Insurance	2	2.9
Real estate	4	5.7
Consumer discretionary	**13**	**18.6**
Consumer durables and apparel	1	1.4
Consumer services	6	8.6
Media	2	2.9
Retailing	4	5.7
Consumer staples	**10**	**14.3**
Food & staples retailing	4	5.7
Food, beverage & tobacco	3	4.3
Household and personal products	2	2.9
Products	1	1.4
Healthcare	**7**	**10.0**
Health care equipment and services	2	2.9
Pharmaceuticals, biotechnology and life sciences	5	7.1
Industrials	**8**	**11.4**
Capital goods	2	2.9
Commercial and professional services	2	2.9
Transportation	4	5.7
Energy	**5**	**7.1**
Materials	**3**	**4.3**
Real estate	**2**	**2.9**
Utilities	**2**	**2.9**
TOTAL	**70**	**100.0**

As might be expected, a number of the ASX200 directors interviewed also had other ASX listed experience (on ASX201+ companies). Table 4.4 shows the total ASX listed company appointments held by the directors at the time of their interviews, and also shows their years of experience on listed company boards.

Table 4.4: ASX listed company experience and appointments

Years of ASX listed experience	No of directors	Percentage of sample
Less than 1 year	1	2.4

1 – 5 years	14	34.1
6 – 10 years	8	19.5
10 – 15 years	8	19.5
16 – 20 years	3	7.3
Over 20 years	7	17.1
TOTAL	**41**	**100**
Current ASX listed roles held by the directors		
Non-Executive Director	66	77.6
Non-Executive Chair	15	17.6
Non-Executive Deputy Chair	2	2.4
Executive Director	2	2.4
TOTAL	**85**	**100.0**

As shown in Table 4.4, the directors interviewed held a total of 85 current appointments on ASX listed boards (including the 70 appointments on ASX200 company boards) and the majority (66 or 77.6%) were non-executive director roles. The years of experience is also shown in Table 4.4, with 14 (34.1%) directors having 1–5 years of experience on listed boards, eight directors (19.5%) each having 6–10 years and 10–15 years of experience on listed boards. Three directors (7.3%) had 16–20 years of experience on listed boards, and seven directors (17.1%) had over 20 years of experience on listed boards. Only one director interviewed had less than one year of experience on an ASX listed company board.

Upon analysing the characteristics of the sample with respect to the various categories, such as gender, years of experience, number of roles, company rank and industry groups, the researcher looked for patterns. No clear pattern occurred across industries, with greater similarities than differences between directors' comments when analysed by industry. The only exception to this was when directors focused on industry specific risks, such as safety in the resources sector or regulatory risk in the banking sector. In these instances, they simply focused on them by way of providing governance examples specific to their experience.

4.3 The elite group effect

As already discussed, narrowing the scope of this research to the ASX200 group of companies was designed to gain an insight into how directors of Australia's largest companies reflect on their governance responsibilities. In addition, this narrowing of the scope of the study to the ASX200 was designed to appeal to the 'elite' group of directors and assist in gaining access to them.

A consequence of this approach was the outcome that two female ASX200 directors in the sample asked whether the list of participants would be published together with the thesis. Both participants had been on ASX200 boards for less than five years and, when compared to others in the participating group, were at the beginning of their ASX200 board careers. As resource dependence theory suggests, boards build legitimacy through the appointment of high-status individuals as their directors.[554] The human capital (among other factors) of a board endorses the organisation and persuades external audiences of its credibility.[555] Having their names listed among other higher profile ASX200 directors seems to have been desired by these women who were starting out in their ASX200 careers, because they believed it would enhance their own status and human capital. The researcher observed this 'elite group effect' that appeared to be important in these two cases, where the interviewees were interested in not only having their own names published with the elite group but also in knowing the identity of the other participants in the group.

It was explained to these participants that the identity of all participants was confidential and, therefore, it was not possible to publicly list the participants of the study.

4.4 The hot spots and the not spots

As the interview program progressed over the 12-month period, it quickly became evident that patterns were emerging in the duration and nature of the responses to the different questions on the ASXCGC principles and recommendations. Some of the principles and recommendations were frequently being dismissed, or were not attracting much attention and focus; other principles and recommendations were gaining a lot of attention, focus and detail. The researcher termed the principles and recommendations that attracted much focus and attention – and most discussion during the interviews – 'hot spots'.

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554 Terjesen, Sealy and Singh, above n 264, 323.

555 Alison Sheridan, Anne Ross-Smith and Linley Lord, 'Changing Boundaries: Women, Boards and Genger Capital in Australia' (Paper presented at the Academy of Management Conference, Atlanta, August 2017) 3.

These hot spots contrasted significantly with other principles and recommendations that interviewees chose not to focus on, which the researcher termed ‘not spots’. With these ‘not spots’, directors were almost dismissive and, at times, their tone and body language would change when they responded.[556] The interviewee’s dismissive tone was indicative that the compliance was obvious, and they often did not feel it necessary to elaborate on their answer. These not spot areas were the most directive recommendations in the *ASXCGC Principles and Recommendations*. It was very clear that these not spots were embedded and normalised in the behaviours of the directors being interviewed and their ASX200 boards.

Grounded theory requires the researcher to have an in-depth interaction with the data and to undertake a process of ‘creative crafting’[557]. Through detailed in-depth analysis and reflection the researcher was able to identify the hot spots and not spots, being two distinct groupings within the ASXCGC Principles and Recommendations as reflected by the ASX200 directors. As the emergence of the hot spots and not spots became evident, adjustments were made to the interview questions. Questions relating to the not spot areas were screened out as they were not getting responses beyond a simple and dismissive ‘yes’ (indicating compliance). This enabled more time in the interviews to focus on the hot spot areas, where directors were placing their focus. Making these adjustments to the interview questions as the interviews were being conducted supported the grounded theory approach, where the research parameters were refined during the data collection and the theory was generated from the data itself.[558]

Table 4.5 summarises where the hot spots (boxes ticked) and not spots occurred in the discussion of the *ASXCGC Principles and Recommendations*. As shown, Principle 1, the broadly termed ‘Lay solid foundations for management and oversight’ had five of its seven recommendations as hot spots. The recommendations within Principle 1 are fairly diverse and cover a number of foundational matters, as the title of the principle suggests. The five hot spots in the recommendations

[556] J M Wilce, *Language and Emotion* (Cambridge University Press, 2009) 42; Diane Elizabeth Luhrs, 'Consider the Daughters, They are Important to Family Farms and Rural Communities Too: Family-Farm Succession' (2015) 23(8) *Gender, Place & Culture* 1078, 1083.
[557] Carmel Maher et al, ‘Ensuring Rigor in Qualitative Data Analysis: A Design Research Approach to Coding Combining NVivo With Traditional Material Methods’ (2018) 17(1) *International Journal of Qualitative Methods* 1, 2.
[558] Glaser and Strauss, above n 27, 6.

included the roles and responsibilities of board and management, appointment and re-appointment of directors, company secretary reporting arrangements, diversity and the performance evaluation for the board.

Table 4.5: The 'hot spots' (ticks in column 2) **and the 'not spots' in discussions of the *ASXCGC Principles and Recommendations* (3rd ed)**

Principle 1: Lay solid foundations for management and oversight	
Recommendation 1.1: Roles and responsibilities of board and management	√
Recommendation 1.2: Appointment and re-appointment of directors	√
Recommendation 1.3: Written agreements with directors and senior executives	
Recommendation 1.4: Company Secretary reporting arrangements	√
Recommendation 1.5: Diversity	√
Recommendation 1.6: Performance evaluation for the board	√
Recommendation 1.7: Performance evaluation for senior executives	
Principle 2: Structure the board to add value	
Recommendation 2.1: Nominations committee	
Recommendation 2.2: Skills matrix	√
Recommendation 2.3: Independence of directors	√
Recommendation 2.4: Majority independent board	
Recommendation 2.5: Chair should be independent and not CEO	
Recommendation 2.6: Induction and professional development	√
Principle 3: Act ethically and responsibly	√
Recommendation 3.1: Code of conduct	
Principle 4: Safeguard integrity in corporate reporting	√
Recommendation 4.1: Audit committee	√
Recommendation 4.2: CEO and CFO declaration	
Recommendation 4.3: External auditor attends AGM	
Principle 5: Make timely and balanced disclosure	√
Recommendation 5.1: Continuous disclosure policy	
Principle 6: Respect the rights of security holders	√
Recommendation 6.1: Information for investors on website	
Recommendation 6.2: Investors relations program	
Recommendation 6.3: Policies and processes to encourage meeting participation	
Recommendation 6.4: Option for electronic communications	
Principle 7: Recognise and manage risk	√
Recommendation 7.1: Risk committee	
Recommendation 7.2: Risk management framework review	
Recommendation 7.3: Internal audit	√
Recommendation 7.4: Exposure to economic, environmental and social sustainability risks	

Principle 8: Remunerate fairly and responsibly	√
Recommendation 8.1: Remuneration committee	
Recommendation 8.2: Disclose remuneration policies and practices	
Recommendation 8.3: Equity-based remuneration scheme policies	

Principle 2, ‘Structure the board to add value’, had three hot spots within the six recommendations: the skills matrix, independence of directors, and induction and professional development. The principles thereafter appeared to follow a pattern where the hot spots mostly appeared at the principle (highest) level, rather that the individual recommendations supporting them. This was observed to be related to the nature of principles, because principles three to eight were narrower in their focus, and the recommendations supporting them tended to prescribe the use of particular policies, programs or committees and, were therefore more directive than most of the recommendations in principles one and two.

Principle 3 (act ethically and responsibly) was itself a hot spot, with its one recommendation (having a code of conduct) being a not spot, and Principle 4 (safeguard the integrity in corporate reporting) was a hot spot, with only one of its three recommendations being a further hot spot (role of the audit committee). It was also noted that although four types of board committees were identified across the recommendations (nominations, audit, risk and remuneration), the audit committee recommendation was the only one that emerged as a hot spot. This seemed to be because of the nature of the work that the committee performs and its responsibilities as delegated by the board.

Principle 5 (make timely and balanced disclosure) was a hot spot but the one recommendation supporting it, which prescribed having a policy on continuous disclosure was not. Principle 6 (respect the rights of security holders) was a hot spot but none of the four recommendations supporting it were; the four recommendations are prescriptive: information for investors on the website, an investor relations program, policies encouraging participation at meetings and options for electronic communications. Principle 7 (Recognise and manage risk) was a hot spot, and one of its four recommendations (internal audit) was also a hot spot. However, the other three recommendations on how to manage risk, which were, again, prescriptive, were not spots. Principle 8 (Remunerate fairly and responsibly) was itself a hot spot, but none of the three prescriptive recommendations that supported it were (dealing with remuneration policies and the remuneration committee).

The not spots will now be further discussed, with hot spots in Principle 1 discussed in this chapter and the balance of the hot spots discussed in Chapter 5.

4.5 Not spots in the ASXCGC recommendations

To restate, not spots were the issues raised in the ASXCGC principles and recommendations interviewees chose not to focus on. Their responses, when reflecting on the not spot recommendations, were dismissive and their tone would often change. The ASX200 directors understood the not spots as ‘normalised practice’; that is, the directors did not challenge the value or importance of the not spots, but rather dismissed them as a given, obvious or common (normalised) practice. The interviewees indicated that there was no value in discussing why or how they meet these requirements, as these not spots were commonly accepted in their practice of governance.

Within principle one, there were only two not spots (out of the seven recommendations). Recommendation 1.3 requires that ‘a listed entity should have a written agreement with each director and senior executive setting out the terms of their appointment’.[559] Responses to this not spot recommendation were brief and generally indicating compliance ‘yes without a doubt’ (Interview 6). Some of the responses revealed that such documents were more letters of offer rather than written agreements, though two interviewees responded that they did not have either but neither interviewee was concerned, stating there was a ‘very clear understanding of what is required’ (Interview 27).

Performance evaluations for executives (Recommendation 1.7) were clearly normalised practice, with no interviewee nothing that they were not conducted. Responses were often limited to short ‘yes’ answers, indicating compliance, hence this recommendation emerged as a definitive not spot. Despite this, Principle 8 (Remunerate fairly and responsibly) generated significant discussion and these

[559] ASXCGC (2014), above n 6, 10.

responses often included mention of the executive performance review forming part of this process without being elaborated on further.

Recommendation 2.1 states that the board should have a nominations committee, with at least three members, a majority of whom are independent directors, it should be chaired by an independent director and should disclose the charter of the committee.[560] It further states that if it does not have a nominations committee it should disclose that fact and outline the processes it employs to address board succession and ensure it has the appropriate skills, knowledge, experience, independence and diversity to enable it to discharge its duties.[561] Responses to the question on this recommendation indicated that not only was this requirement met but also the nominations committee is regularly comprised of the full board. In these instances, respondents gave the rationale that board recruitment is so critical that all directors should be part of the committee responsible for leading the process.

Three of the recommendations under Principle 2 covered matters relating to the independence of directors. The disclosure of the independence of directors and their tenure in Recommendation 2.3 was a hot spot, however Recommendation 2.4 (majority independent board) and Recommendation 2.5 (chair should be independent, and should not be the CEO) both emerged as not spots. These recommendations were typically dismissed in a manner that indicated compliance, although discussion around the definition of independence was discussed in relation to the hot spot Recommendation 2.3.

Principle 3 deals with acting ethically and responsibly, and directors spent considerable time discussing how they reflect on this principle (hence it emerged as a hot spot). The sole recommendation under this principle is 3.1, which states that the company should have a code of conduct and should disclose a copy of it,[562] was clearly indicated as normalised practice; directors tended not to focus on the document itself but rather the ethical and responsible behaviours and how to manage and encourage them. ‘You’ve got to walk the talk, and it’s not just a matter of codes’ (Interview 5), and ‘Yes we have a written code of conduct, but it’s more than that’ (Interview 7). Some even questioned the effectiveness of such documented codes:

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[560] Ibid 14.
[561] Ibid.
[562] Ibid 19.

‘So the person who acts dishonestly is going to read the code of conduct and change their ways?’ (Interview 36), and ‘We certainly have codes, but let me tell you: If somebody is going to act unethically, a code is not going to stop them’ (Interview 5).

Under Principle 4 (Safeguard the integrity in corporate reporting), two of the three recommendations were quite prescriptive in detailing aspects of corporate reporting processes. Recommendation 4.2 notes that before the board approves the financial statements it should receive a declaration from the CEO and CFO that confirms that the records have been maintained, the financial statements comply with the appropriate accounting standards, give a true and fair view of the financial position and that the opinion is formed on the basis of a sound system of risk management and internal control.[563] The recommendation also refers to section 295A of the *Corporations Act 2001* (Cth), and states that Recommendation 4.2 ‘largely mirrors’ section 295A.[564] Recommendation 4.3 suggests that the external auditor should attend the AGM and be available to answer questions.[565] Both of these recommendations attracted a dismissive response from directors, indicating that they were embedded as normalised practice and were not to be challenged.

Principle 5 (Make timely and balanced disclosure) was a hot spot for responses, but its only supporting Recommendation 5.1, which suggests the company should have a written policy for complying with its continuous disclosure obligations and disclose that policy, emerged as a not spot. Again, directors spent time reflecting on the principle but not the existence of the policy outlining the principle. As one director noted: ‘The most important thing about the disclosure policy is the debate that goes into preparing the disclosure policy’ (Interview 5).

Principle 6 ‘Respect the rights of security holders’, was itself a hot spot, however while interviewees spoke about this principle as a whole, they usually did not discuss it in detail with references to the four attendant prescriptive recommendations, which were, therefore, categorised as not spots. The Principle 6 recommendations covered the provision of information on the company website, the presence of an investor relations program, policies and practices to encourage participation and the option

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563 Ibid 22.
564 *Corporations Act 2001* (Cth), s 295A
565 ASXCGC (2014), above n 6, 23.

for electronic communications.[566] Directors generally responded briefly, indicating that these recommendations were embedded as normalised practice. One director suggested that the four recommendations were not the most critical elements of respecting the rights of security holders, suggesting that ‘dividend reinvestment programs’, ‘providing for minorities versus people who have more heft in the game’, and ‘retail versus institutional shareholders’ were of greater importance in meeting the requirements of Principle 6 (Interview 34).

Principle 7 deals with the recognition and management of risk and was categorised as a hot spot, as was one of the four recommendations, Recommendation 7.3 relating to internal audit. The other three recommendations, which included the risk committee, the risk framework review and exposure to economic, environmental and social sustainability risks were not spots. Recommendation 7.1 deals with the risk committee, its composition, charter and meeting attendance.[567] Generally such structural aspects were not discussed by interviewees, although a small number of directors indicate that the risk committee was combined with the audit committee. The researcher adjusted the questioning throughout the interviews to better uncover the instances and reflections regarding this issue. Some directors described the separation of the two committees as a regulatory requirement for their industry, others outlined the benefits as avoiding ‘seeing risk through a financial prism’ (Interview 2).

Recommendation 7.2 covers the requirement that a review of the risk framework is conducted at least annually.[568] While directors reflected on the use of risk frameworks in addressing the requirements of the principle, they did not focus on the regularity of the review of the framework because it appeared to be a given that the frameworks are reviewed regularly and, hence, it emerged as a not spot. Recommendation 7.4 states that listed entities should disclose whether they have any material exposure to economic, environmental and social sustainability risks, and if so how they manage them.[569] Only a small number of interviewees chose to directly address these particular types of risk and, those that did, emphasised it in relation to the nature of their industry. ‘We have these in a separate committee … they have

[566] Ibid 27.
[567] Ibid 29.
[568] Ibid.
[569] Ibid 30.

major complications if they are not managed' (Interview 17). 'Economic is so big it is really the whole board, China is our biggest trading partner, so when they hiccup we feel it' (Interview 26). Some interviewees outlined the lack of focus on this recommendation 'in our case, it's just not on the radar' (Interview 24).

Principle 8, 'Remunerate fairly and responsibly', attracted substantial focus and attention. Despite this, the prescriptive recommendations supporting Principle 8 did not, and thus they emerged as not spots in the data collection. These include the remuneration committee and charter, policies and practices relating to remuneration and policies on equity-based remuneration schemes.[570]

As has been described, these not spot areas were often found where the recommendations were more directive, such as those prescribing the use of certain policies, practices, programs and committees. The dismissive tone was indicative that the compliance was obvious, and the interviewees usually did not feel it was necessary to elaborate on their answer. Following the grounded theory approach, as the not spots began to emerge, adjustments were made to the interview questions, and the not spot areas were screened out. This enabled more time in the interviews to focus on the hot spot areas. These hot spot issues will now be considered individually. The themes to emerge are detailed, with example quotes to illustrate typical responses of the theme.

4.6 Principle 1: Lay solid foundations for management and oversight

Principle 1 is broadly termed 'Lay solid foundations for management and oversight', with its purpose stated as: 'a listed entity should establish and disclose the respective roles and responsibilities of its board and management and how their performance is monitored and evaluated'.[571] As already explained above, Recommendation 1.3 (written agreements with directors and senior executives) and Recommendation 1.7 (performance evaluation for senior executives) were found to be not spots (normalised practice). The remaining hot spots under Principle 1 will now be discussed.

[570] Ibid, 34.
[571] Ibid, 8.

This first principle of the ASXCGC principles and recommendations, is the broadest of the eight principles, as is evident when reviewing the recommendations that support it. The supporting recommendations cover the delineation of board and management roles, appointment and re-appointment of directors, the company secretary reporting arrangements, diversity and performance evaluation. It was evident during the interviews that directors spent a significant portion of time on principle one, and the interviewer allowed for this to occur. Directors were often enthusiastic in elaborating on their responses to the recommendations under this principle, and had clear views on how they address these recommendations in practice.

4.6.1 Recommendation 1.1: Roles and responsibilities of board and management

Recommendation 1.1 requires that a listed entity should disclose the respective roles and responsibilities of its board and management, and matters expressly reserved to the board and those delegated to management.[572]

The delineation of roles between the board and management was not a clear or easily defined separation, and this complexity was consistently illustrated by all interviewees. The 'blurred line' (Interview 31) separating board and management responsibilities was frequently described as a 'grey area' (Interview 7). As one director noted: 'Despite it being clear in writing with delegations and things … the world is not clear and things pop up' (Interview 39). Boards engage in regular reflection on where the line of responsibility actually lies, and whether adjustments are required to switch their behaviour more to oversight mode or, alternatively, to get more involved 'it is a constant discussion' (Interview 8).

The board largely self-manages this interplay between oversight (governance) and delving into more detail. The variable nature of the role delineation between the board and management and the many factors that can influence it was described by some directors as being a 'horses for courses' environment (Interview 3). The complexities around this uncertain grey area are due to the situational factors, including the matters being considered. As noted by one director, 'there are some instances where it feels appropriate to delve in to operations, and a good example of

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572 Ibid.

that is safety'. (Interview 31). This highlights that decisions by the board to involve themselves more in the detail of certain matters was linked to the perceived risk of the matter being deliberated.

The capability and performance of the executive team is another significant determinant of the role separation between the board and management. Directors make assessments on the experience, capabilities and performance of their executives, which influences the degree of trust and reliance they place on those executives. The 'board plays a very different role depending on this … they will step in if they don't think things are working' (Interview 6).

Other factors that determine the role delineation between the board and management include the congruence of views in relation to the strategic direction of the company, and other economic or external factors. As one director stated, the impacts of the GFC on the organisation 'caused board members to feel like they had to get more closely involved' (Interview 23).

Additional Australian Prudential Regulation Authority (APRA) regulations imposed across the banking industry required the directors be 'more involved in the detail … so in banking the blending between the board and management will be more confused than average' (Interview 9). This highlighted the impact that regulations have on the interplay of responsibilities between the board and management within the financial sector.

The complexities of defining the board's role and the moveable nature of the line of separation between the board and management, not surprisingly, causes a natural and healthy tension. 'There is always a tension between management and conscientious directors' (Interview 7). The chair plays a significant role in managing this tension, particularly in times when the tension between a director and executive have stifled the progression of a decision or deliberation, or resulted in an impasse 'As chair there have been times where I have had to pull a director aside' (Interview 14). The performance evaluation process can be used as another check to monitor 'if the understanding between the board and management is working well' (Interview 2).

Despite this complex nature of role delineation between the board and management, directors are fundamentally aware that their role is to govern and not manage the company: 'What is sure is that you can't have the board managing the business'

(Interview 3), ‘the board doesn’t try to interfere with the day-to-day management’ (Interview 37). However, directors were unanimous in highlighting that effective board governance requires the board and executive to have effective working relationships and a sense of trust ‘you need a very open and transparent environment … it comes back to the individuals who are in those roles’ (Interview 16), ‘we are all in this together’ (Interview 1). The relationships between the board and executive were seen as critical, and ‘the most important relationship is the chair and CEO’ (Interview 28).

As can be seen, the reflections of ASX200 directors on Recommendation 1.1 were consistent in describing the role delineation between the board and management as being complex, variable and largely self-managed by the directors. The role delineation is agile and moves depending on many factors, including the skills and performance of the executives, the matters at hand and other external factors. In order to enable this flexibility in the separation of the roles and responsibilities, there needs to be strong working relationships within the board and between the board and management. The chair plays an important leadership role in resolving impasses to ensure the continuity and effectiveness of the relationships between the board and management.

4.6.2 Recommendation 1.2: Appointment and re-appointment of directors

The *Cadbury Report* highlighted that boards of directors are responsible for the governance of their companies, while the shareholders’ role in governance is to appoint the directors and auditors.[573] The ASXCGC Recommendation 1.2 states that the board should undertake appropriate checks before appointing a person or putting forward to security holders a candidate for election to the board.[574]

In practice, ASX200 directors see the appointment process largely as the responsibility of the board, with elections by the shareholders mostly being mere endorsement of the board’s preferred candidate. This supported the findings of previous research that found that company directors almost always run unopposed and are elected.[575] Directors outlined wide variations in processes for the

[573] *Cadbury Report*, above n 59, 15.
[574] ASXCGC (2014), above n 6, 9.
[575] Cai, Nguyen and Walkling, above n 249, 1.

appointment of new directors to ASX200 boards. It emerged that there are two schools of thought around the use of existing director networks in candidate identification.

A majority of interviewees indicated there still remains a strong bias towards using the networks of existing directors for candidate identification; 'There is always a bit of a bias there for people you know' (Interview 19). The predominant justification for using existing contacts was to minimise the risk of appointing a director who was unable to work with the existing board, 'we have to work with this person' (Interview 5). This risk was frequently mentioned as being of real concern to directors, who emphasised the need for cohesion, good working relationships and the ability to work as a team: 'It's all about does this person fit culturally … and contribute in a way that our ecosystem works' (Interview 28). This finding supported the finding of previous studies that suggested diversity creates social divisions, which, in turn, can lead to negative performance outcomes for the group.[576]

This risk is amplified by the perceived difficulty of removing directors before their maximum term is reached, hence significant importance was placed on getting the right person who could work with the rest of the board upfront at the recruitment stage. As one director stated: 'What if they get on the board and you find out you can't get on with them?' (Interview 11). Here the director was highlighting the detrimental effect this would have on the team, and the practical limitations on removing a director once appointed if they were deemed to be unsuitable.

The opposing school of thought regarding the use of director networks for candidate identification was critical of this approach, citing lack of diversity as being a key outcome in the selection method. As noted by one male interviewee: 'It's an old boys' network to some degree' (Interview 4). Another director was much more cynical, indicating that being known to the existing directors was a pre-requisite for appointment 'the nominations committee plays a game of who do we know, all the fresh faces get turfed out because no-one knows them' (Interview 12).

Despite this, there was clear evidence that the historical practice of using contacts alone to find new candidates is changing, 'I was the last director to be appointed by a

[576] Mannix and Neale, above n 274, 31.

tap on the shoulder' (Interview 18). This was driven by the greater awareness of the board for the need for improved diversity and the need to consider the collective skills base of the board.

There were mixed views on the value that recruitment companies (head hunters) added to the director recruitment process. For many interviewees, the primary benefit of using head hunters was through the increased transparency of the process and the external due diligence. Head hunters were viewed as providing external validation to the recruitment process: 'It's the IBM syndrome … you never get sacked for hiring IBM, it's very safe' (Interview 34). Here, the interviewee was describing using a known recruiter to provide verification and validation to the process. This external validation was sought to stop external stakeholder influences, as explained by one director: 'I needed a wedge to stop the investment banks telling me who they were going to put in, it just gave me that independence' (Interview 24).

While head hunters bought external validation to the recruitment process, there were opposing views on the quality of the lists of potential candidates they provided at the identification stage of the process. As one director noted, they did not provide a diverse list of suitable candidates; 'they tend to give you the same people' (Interview 10). By contrast, some viewed head hunters as being of significant value when identifying candidates in order to attract a more diverse board, believing that only considering potential candidates from existing director networks was limiting and would not achieve the desired diversity levels for the company, or the country; 'the result is also an increased diversity for the Australian director pool which must be good for the nation' (Interview 17).

Just as the reality of the director appointment process generally sees shareholders endorsing the board's preferred candidate, the same is usually the case with reappointment. Directors see the reappointment process as being very limited in its use to remove a non-performing director. Boards are not prepared to use the voting mechanism to announce their lack of support for a director in order to avoid re-election. As one director stated: 'That is so nuclear it never happens' (Interview 12). Their responses suggested they strongly believed ASX200 directors and boards need to have a united face in front of shareholders, and they will avoid announcing any lack of support for each other in front of shareholders.

Altogether, therefore, the reflections of ASX200 directors on Recommendation 1.2, were varied in terms of how they conduct the recruitment process, particularly in how they identify possible candidates for recruitment to the board. There appears to be a change in the historical practices away from the practice of inviting close colleagues to join the board to seeking a wider pool from which to select in order to attract a more diverse board. Diversity in this context is seen as diversity of skills and experience, gender and other factors. The value that Directors thought head hunters brought to the process varied; while headhunters provide external validation to the process, they varied in their ability to identify suitable candidates. Also notable is that although the actual appointment is performed by an election by shareholders, directors reflected the recruitment of a director was, in practice, their decision, and they emphasised the importance of the fit of the candidate with other members of the board. Directors believed that it is essential that the board can work with the candidate and that strong and trusting relationships are shared between directors to ensure that they perform as an effective team in governing the company.

4.6.3 Recommendation 1.4: Company secretary reporting arrangements

Recommendation 1.4 states that the company secretary of a listed entity should be accountable directly to the board, through the chair, on all matters to do with the proper functioning of the board.[577] Company secretaries have a significant influence on board practices and financial reporting, with the type of influence being dependent on the expertise and busyness of the person in the role;[578] company secretaries do not have a direct say in corporate decision making but they are promoters and facilitators of the company's governance practices.[579]

Company secretaries facilitate the flow of information between management and the board, schedule meetings, provide meeting support, lodge documents and provide guidance to the board of directors.[580] This was confirmed by the interviewed ASX200 directors, who noted they are reliant on the company secretariat in the provision of service and information as a key enabler for the board's effectiveness.

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[577] ASXCGC (2014), above n 6, 10.
[578] Chapple, Nowland and Johnston, above n 257, 2.
[579] Ibid 3.
[580] Ibid.

In practice, the company secretary role has a dual reporting relationship: Their primary responsibilities are in serving the board ‘the first duties lie to the board’ (Interview 14) but operationally, they have a line of reporting through to the CEO and are part of the executive team, often with other responsibilities such as general counsel.

Responses from many interviewees pointed to the complexities of the nature of the company secretary role, requiring an extremely nuanced person to carry out their responsibilities effectively. The company secretary needs to adapt their actions in line with their various responsibilities. As one director noted: ‘A company secretary is completely impartial and, yet, in a management role they can be putting forward a position in a paper’ (Interview 13). Here, the director is highlighting this need for the company secretary to understand their position in relation to the individual tasks they are performing.

The company secretary was perceived by the participants as a key enabler to the effective operation of the board. The relationship between the company secretary and chair is particularly important, as described by one director: ‘If that doesn’t work everything falls apart’ (Interview 28). This director was referring to the significant negative impact on the full board the break down in relationship between the chair and company secretary is likely to cause. Another director noted that the absence of an effective relationship between the company secretary and the chair and board is cause for termination ‘the secretary only really survives if they have a good relationship (with the board and the chairman)’ (Interview 15).

The necessary qualities of a good company secretary include being a nuanced, mature person with high levels of emotional intelligence. Absence of such qualities can result in inappropriate actions on the part of the company secretary, as one director provided: ‘They can use reporting to the board incorrectly’ or ‘take some things directly to the board when they shouldn’t’ (Interview 17). As one director articulated: ‘The model depends on the personalities’ (Interview 28), indicating that people and their behaviours will determine the presence of effective relationships between the board, company secretary and CEO.

The company secretary needs complex judgement skills in order to determine how and when to alert the board to certain issues. Balancing the need to disclose serious matters to the board against 'matters that might impinge on the effectiveness of the board or relationship between the chair and CEO' (Interview 34) requires extreme skill and judgement, together with emotional intelligence.

As can be seen, the company secretary role is extremely important in providing the board with the resources and information that it requires to perform its duties effectively. The company secretary needs to be a nuanced, emotionally intelligent and savvy person in order to be effective in managing the delicate nature of their complex and dual natured role. The relationship between the company secretary and board members (particularly the chair) is seen by ASX200 directors as a critical enabler of the board's effectiveness in governing the company.

4.6.4 Recommendation 1.5: Diversity

Recommendation 1.5 states that a listed entity should have a diversity policy which includes requirements to set measurable objectives for the board for achieving gender diversity.[581] It also recommends reporting on the proportions of men and women on the board and in senior executive positions within the company.[582]

It is clear that the introduction of the diversity recommendation to the ASXCGC principles and recommendations in 2010 has increased the focus on diversity across the ASX200 boards. The increased external scrutiny of listed companies (particularly the ASX200) has caused directors to develop 'conscious bias' (Interview 35) towards female candidates throughout the appointment process. This bias is not necessarily suggestive that female directors are being appointed lacking the necessary skills and experience but, rather, boards are searching harder to find suitable female candidates for consideration in the recruitment process. One director described their message to a head hunter who failed to find appropriate female candidates for inclusion in the recruitment process 'go away and if you can't do it then another head hunter can' (Interview 26). The director was explaining the importance of having suitable females in the mix of candidates as a pre-requisite for having a more diverse board.

The majority of directors fundamentally agreed that having a diverse board was better for business 'a better gender balance around the table drives better results'

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[581] ASXCGC (2014), above n 6, 11.
[582] Ibid 12.

(Interview 6). Directors reflected on the need to extend diversity on the board to be more representative of the company's stakeholders. As one director noted: 'It's about the company and its profits … we have sixty to seventy percent female employees, and our consumers are eighty percent female' (Interview 11). Here he was explaining how having a board that is more representative of the stakeholder base has a positive impact on the financial position of the company.

Despite the general focus across the ASX200 on achieving better diversity on their company boards, there was evidence of some resistance. Some head hunters were found to be resisting the conscious bias towards female candidates; 'we had an experience with a recruiter who did not want to talk about gender' (Interview 11). There was also some evidence of gender stereotypes, with one board member describing how a preferred female candidate pulled out of the recruitment process due to her 'grandmother duties' (Interview 7). Only one male candidate interviewed was candidly critical on the focus on board gender diversity 'the pendulum has swung too far one way … sometimes it feels like we are treading on egg shells … we shouldn't feel guilty about appointing a male' (Interview 16).

The researcher, as a female board director, was reflexive about the possible impacts this may have had on the responses of the interviewees in relation to the diversity recommendation. While a strong majority of interviewees showed support for gender diversity during their interviews, the researcher was aware of the possibility that there may have been other interviewees who felt uncomfortable about being critical about the gender diversity focus across the ASX200 boards.

While boards have been becoming more gender diverse, a key enabler is the pipeline of female executives, an area where there is much room for improvement. The small number of female CEOs across the ASX200, combined with the fact that female executives are more often found in certain disciplines, such as HR and marketing (rather than operational business units with profit and loss responsibility), is evidence that the executive pipeline requires change. As one director noted: 'If you take out marketing and HR, there are not many female executives in roles that generally lead to board roles' (Interview 23).

Many of the female interviewees reflected on their experiences of being female directors during this time of increased focus on gender diversity. One female director reflected on her status and the mentoring role she performed as the first female on the board: ‘I was warmly looked upon … the women in the organisation clustered around me’ (Interview 1). Another female was reluctant to be a female role model for female executives, preferring that it be ‘a leadership conversation’, believing the ‘males in the organisation’ should also be involved (Interview 28). Female directors reported experiencing the existence of a gender tipping point on boards, where reaching a certain number of females caused them to no longer feel like an outsider to the rest of the group – ‘now there is three of us … it’s no longer that different … it does change the dynamics’ (Interview 38).

Most of the focus on board diversity in recent years has focused on gender diversity, not only from the introduction of the diversity recommendation in 2010, which suggests measuring gender as one measure of diversity, but also from other external pressures, such as the thirty percent club. This was launched in May 2015 with the objective of achieving thirty percent of ASX200 director roles held by women by the end of 2018.[583]

Non-gender diversity is outlined in the commentary accompanying Recommendation 1.5, which notes that while the focus of the recommendation is on gender diversity, diversity has a much broader dimension and includes matters of ‘age, disability, ethnicity, marital or family status, religious or cultural background, sexual orientation and gender identity’.[584] Directors were very aware of the value of treating diversity more broadly, citing reasons, such as having the board more reflective of the stakeholder base of the company. Many view non-gender diversity as the next frontier in the diversity discussion: ‘Gender to some extent is the easier part of diversity (Interview 9). ‘It needs to be geographical diversity, ethnic diversity, gender diversity, age diversity, technical mastery diversity … it’s a much broader debate’ (Interview 6). As one director described: ‘You want diversity of thought, diversity of network, diversity of experience … because that’s what builds a strong team’ (Interview 17).

[583] 30 percent club Australia, '30% Club Growth through diversity: Business Leadership: The catalyst for accerlerating change' (2016), 2.
[584] ASXCGC (2014), 12.

As can be seen, the introduction of the diversity recommendation in 2010 in the ASXCGC principles and recommendations together with other external pressures[585] has caused directors on the ASX200 to turn their focus to improving the diversity of their boards. In order to achieve this, they have been actively seeking suitable female candidates who can be considered in the recruitment process. In general, directors are of the view that having a diverse board is better for business; however, they are cautious in their selection process to ensure that they find candidates that they can work with, place trust in and have good relationships with, all of which are crucial to the board's effectiveness in governing the company.

While most directors support the benefits of increased diversity on the board, there is still some resistance, which could be even more prevalent given the possibility that some directors may have been reluctant to share their views given the researcher was herself a female board director. Despite the increasing diversity on Australian listed boards, there still remains an issue, in part due to a lack of females in executive positions, the usual route that typically leads to board positions (women make up 16.5% of CEO positions and 29.7% of key management personnel in 2018 in Australia).[586] While gender is one of the easier forms of diversity to measure, directors are turning their thoughts and conversations to other forms of diversity.

4.6.5 Recommendation 1.6: Performance evaluation for the board

Recommendation 1.6 requires that a listed entity should have and disclose a process for periodically evaluating the performance of the board, its committees and individual directors; and disclose whether a performance evaluation was undertaken in the reporting period.[587]

ASX200 boards conduct performance reviews on a regular basis, although views of directors on their effectiveness varies. The use of skilled external facilitators was seen to be of benefit in drawing out issues through interview that may not otherwise come out in an internally conducted survey. Directors were more likely to be honest when external facilitation was used as it is perceived to offer confidentiality allowing directors to be more confident in being open and honest, 'in a non-threatening way it brings up issues' (Interview 35). Engaging an experienced external facilitator can

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[585] Sheridan, Ross-Smith and Lord (2014), above n 265, 141.
[586] Workplace Gender Equality Agency, 'Gender workplace statistics at a glance' (February 2018) 1.
[587] ASXCGC (2014), above n 6, 13.

also provide the opportunity to benchmark boards against boards of other similar companies. While externally facilitated performance reviews are considered very helpful in assessing performance, they are used only every two or three years with boards tending to conduct their performance review internally every other year because of cost considerations and the view that every year is too regular to detect meaningful change: ‘External facilitators every year are a waste of time and money, once every three years is enough for that’ (Interview 12).

Companies engage in regular performance evaluation of the board itself but directors are more sensitive about individual director evaluations. Directors are generally concerned about the detrimental effect of negative feedback that individual evaluations can have on board relationships. The criticality of effective board relationships between board directors is essential to the effective operation of the board. As there is significant variation in how directors accept feedback ‘some people are better at taking feedback than others’ (Interview 13), it is risky to undertake individual performance evaluations which may cause disharmony and impact the effective functioning of the board. Another risk with providing individual feedback to directors is the possibility that directors will centre to a norm, which can ‘lose the benefit of the diversity of thought or perspective’ (Interview 9).

When boards did evaluate individual director contributions, caution was exercised and directors avoided being too critical of each other. As one director noted: ‘You are worried about putting your head above the parapet’ (Interview 20). One chair described their preference for having ‘a thoroughbred team … that works magnificently’ and how that was ‘more important than having everybody fighting each other’ (Interview 5). Here they were explaining how individual performance reviews could cause tension between directors and impact on their effectiveness as a team. Conversely, some directors felt that this reluctance to individually assess each other reflected that ‘group think, self-preservation’ (Interview 20) and ‘collegial feeling’ (Interview 32) were evident on their ASX200 boards.

Despite reservations around conducting individual director evaluations, directors do expect that ‘every director is making the contribution that is expected of them’ (Interview 2). Boards have difficulty in managing poor performance of individual directors and, as noted previously, find it inherently difficult to remove a non-performing director. One director described the presence of an ‘entitlement issue ... (they think) I’ll come and tell you when I’m ready to go’ (Interview 24). Despite the difficulties in managing non-performance, a small number of directors did discuss the use of external facilitators when attempting to manage a non-performing director. Here they described using an external independent person to support the collation and delivery of the performance review results to the underperformer. This was deemed to be helpful where ‘that individual has already been given feedback from the team (through the chair) and hasn’t responded to it’ (Interview 6).

In summary, board performance reviews are conducted on a regular basis, with externally facilitated reviews being favoured as the more useful mechanism to obtain the honest and frank views of directors. Boards are, however, generally reluctant to conduct individual director performance reviews because of the possible impact on good working relations among directors that enable the efficient functioning of the board. Non-performing directors are difficult to manage and even more difficult to remove from the board and, in many cases, this issue remains unresolved, with directors remaining in place until the expiry of their final term (especially when it is near). In cases where non-performance is addressed, the use of an external facilitator was seen to be useful in assisting with the delivery of results of the performance review to the underperforming director.

4.7 The founder factor

As discussed, principle one (lay solid foundations for management and oversight) covers a broad range of recommendations designed to set the foundations for how the board will govern the company. The analysis of the responses to the recommendations within principle one uncovered the emergence of the ‘founder factor’, which is the case when company founders are present on the board, requiring ‘different approaches’ (Interview 22); ‘there are a lot of things we do differently because of the founder’ (Interview 6). Founders generally have significant ownership in the company and are considered non-independent.

Directors on boards with founders present noted a ‘tipping point’ (Interview 24) at which companies controlled by the founders reach a stage in their growth where they need to introduce good governance practices, which can include appointing a CEO, CFO, company secretary, independent directors and an independent chair. The presence of independent directors on a board is as recommended by agency theory, and is based on the need to align the conflicting interests of the owners of capital and the managers of the organisation.[588]

Appointing an independent chair was found to be effective in bringing best practice governance leadership experience to the board. Directors described how an independent chair can argue the merits of introducing the ASXCGC principles and recommendations, based on their experience in directing other ASX listed companies. One independent chair described how they argue that 'these principles are like my bible … (I tell the board) everyone else in Australia is doing it!' (Interview 24). The chair was using an external argument to reinforce their argument on the board where the founder was present.

Some directors also reflected on the challenges and frustrations when implementing good models of governance, such as the slow pace of change, and that to manage this required relationship skills to build momentum and ensure that the frustrations did not result in director resignations. This was illustrated by 'after all those hard yards it would seem silly to have a hissy fit and leave' (Interview 24).

To overcome these challenges, it was imperative to be pragmatic, to find the right 'approach and style' (Interview 22), and to 'pick your battles' (Interview 6). The need to understand the politics and relationships between board members and executives when founders were present was seen as critical. For example, on one board 'the CEO must be on board … and if he is on board you have a fair chance' (Interview 4). Another tactic for responding to this challenge was for directors to engage external consultants in times 'when there was still push back' (Interview 4). Here they were describing using external independent advice to strengthen their argument when attempting to introduce good governance practices.

Resistance by founders to changing board practices to meet best practice governance guidelines was reported as being due to the fears of losing control over the company that they had established or founded. Founders display 'paranoia about letting go' (Interview 22), and 'wonder why people would be questioning their role or power' (Interview 22). This fear of losing control impacted their willingness to introduce

[588] Young and Thyil, above n 89, 95.

some of the recommendations in principle one, which sets the foundation for the good governance of the company. Resistance to particular recommendations such as improving board diversity, appointing independent directors and conducting board and director performance evaluations were mentioned by directors with founders on their board.

Despite the frustrations that directors experience in establishing good governance practices when founders were present on the board, the value the founder brought to the company was ascertained from their passion for the organisation and their extensive knowledge. As one director described, the founding director's 'pluses outweigh his minuses one hundred to one' (Interview 6). This is recognised in the ideology of stewardship theory, which, unlike agency theory which assumes goal divergence on the part of the contracted agent, assumes convergence because of shared collective interests with the contracted steward.[589]

As discussed in this section, a key finding that emerged in the analysis of principle one, which serves as the foundational principle in the establishment of good governance practices, was that boards with founders present experience distinct challenges. These challenges and frustrations are experienced when introducing an appropriate good governance framework because of resistance on the part of the founder. These boards tread carefully and need a good understanding of the politics and board and executive relationships before strategically 'picking their battles' (Interview 6) because the founders often fear losing control of what they can perceive to be their company. There are, however, distinct advantages to having founders as board members because of their passion for and historical knowledge of the organisation. These advantages make it very important for boards to be cautious about introducing change and better governance in case they disturb the critical relationship between the founder and the rest of the board.

4.8 Conclusion

As stated, the majority of the recommendations under principle one emerged as hot spots, and directors spent considerable time in the interview reflecting on their governance practices in line with them. These hot spot recommendations within

[589] Van Slyke, above n 126, 159.

principle one were reflected as fundamental to the foundations of governance within ASX200 companies, and provided the basic elements of good governance practice from which to build the remaining principles and recommendations. As was evident, there were variations in the consistency of governance practices across each recommendation, some recommendations were found to have commonly accepted practices across the ASX200 while others demonstrated a range of differing practices.

A key theme that emerged from the analyses of Principle 1 was that the relationships that directors have with each other, the chair, CEO and company secretary are critical for enabling effective governance of ASX200 organisations. These relationships must be transparent, open and trusting to enable the board to work as an effective team. This fact drives many foundational governance matters, such as the appointment process, performance evaluation process and delineation of roles between the board and executive.

It emerged that directors who had founders present on their boards presented additional reflections. They noted that, in order to successfully begin to implement some of the best practice recommendations within Principle 1, they need to adopt different approaches to take the founders on the journey towards best practice governance required once companies reach a certain tipping point in their growth; that is, directors with founders on their board are particularly cautious in their efforts to introduce change and better governance in order to preserve the critical relationship between the founder and the rest of the board.

CHAPTER 5: Principles 2 to 8 and other governance questions

5.1 Introduction

The same process of using the grounded theory approach for analysing the interview responses to Principle 1 of the *ASXCGC Principles and Recommendations* was used for analysing responses to questions concerning Principles 2 to 8.

The not spots (normalised practice) for principles 2 to 8 were already examined in Chapter 4, and the hot spots will now be analysed in this chapter. Three of the six recommendations for Principle 2 (structure the board to add value) were hot spots. Other principles (Principles 3 to 8) appeared to follow a pattern where the hot spots mostly appeared at the principle level, rather than the individual recommendations supporting the principles. This seemed to be related to the nature of the principles, which were narrower in their focus, with the recommendations supporting them tending to prescribe the use of particular policies, programs or committees; that is, the recommendations were more directive than most of the recommendations in Principles 1 and 2.

At the conclusions of questions directly related to the ASXCGC principles and recommendations, the interviewees were asked two final governance questions: ‘What keeps you awake at night?’ and ‘What makes governance easier?’ This chapter will also present the outcomes of the analysis to these questions.

5.2 Principle 2: Structure the board to add value

Principle 2 ‘Structure the board to add value’ states that ‘a listed entity should have a board of an appropriate size, composition, skills and commitment to enable it to discharge its duties effectively’.[590] Recommendations 2.2, 2.3 and 2.6 were hot spots (see discussion below), with Recommendation 2.1 (nominations committee), Recommendation 2.4 (majority independent board) and Recommendation 2.5 (chair should be independent and not the CEO) being not spots (normalised practice), and already discussed in Chapter 4.

[590] ASXCGC (2014), above n 6, 14.

5.2.1 Recommendation 2.2: Skills matrix

Recommendation 2.2 requires that a listed entity should have and disclose a board skills matrix setting out the mix of skills and diversity that the board currently has or is looking to achieve in its membership.[591]

It was clear from the responses that ASX200 boards have broadly adopted skills matrices as a means of identifying the consolidated skills required by the board in order for it to operate effectively. The process of creating, reviewing and using the skills matrix to guide the recruitment process with the aim of having a skills based board was a widely adopted practice.

Despite the wide adoption of the skills matrix across the ASX200 organisations, the value of the skills matrix was only realised when the boards were focused on the skills that the board requires into the future. Directors are acutely aware that 'the skill sets that are needed to compete in the market place are quite different to a few years ago' (Interview 9), and these days 'it's not just skills, it's a profile' (Interview 26). Here the director was observing that the matrix should cover other attributes and values, and the overall profile of the person rather than just their skills and experiences. This, combined with the inherent difficulty of removing directors, makes the identification of skills, values and attributes required by the company into the future the critical point of focus during skill matrix development. As one director noted: 'There is no way to get rid of people who don't have the right skills' (Interview 12). The skills matrix aids as a critical tool for the board generating important discussion, and ultimately seeks to answer 'do we have enough horsepower around the table to mobilise the strategy?' (Interview 28).

Instances where boards had developed skills matrices through self-assessment of their own skill sets were conversely of little value. Directors who had experienced that practice were critical: 'It has become a self-congratulatory catalogue of the directors current skills, real or imagined' (Interview 9). Here the director was highlighting a tendency for directors to over-rate their own abilities.

[591] Ibid 15.

Another interviewee was critical of the recommendation, suggesting that boards should disclose the matrix because it represented ‘a level of mistrust by stakeholders’ (Interview 36).

Overall, the analyses of the responses indicates that skills matrices are widely used as a tool by ASX200 boards for aiding discussion and guiding recruitment processes for new directors. The value of the skills matrices are realised in the discussions of the collective skills required by the board into the future, and not when used as a self-assessment exercise by current directors of their own skills and abilities. It is critical to understand the skills required by the company into the future, as it is very difficult to remove a director who does not have the skills required. Companies also need to take a broader view of the skills matrix, understanding that it needs to encompass values, attributes and the whole profile of the individual in addition to their skills and experiences. This is because the person must be a good cultural fit for the board in order to be able to work with other directors, and have strong working relationships with them.

5.2.2 Recommendation 2.3: Independence of directors

Recommendation 2.3 states that a listed entity should disclose the names of the directors considered by the board to be independent directors and the length of service of each board director.[592]

The interviewed directors had mixed views on what constitutes independence and, frequently, independence was not guided by the indicators suggested by ASXCGC Recommendation 2.3.

There are two distinct and opposing views on tenure as a measure of independence. Some directors had a strong view that a diverse range of tenures across the board is necessary for board effectiveness, and having too many directors with short tenures (and therefore lower combined experience on the board) is detrimental to the effectiveness of the board. Further, these directors considered tenure as associated with personal director effectiveness; as one long-standing director noted: ‘I’m absolutely certain that I was a better director for that company in my last year than I was in my first’ (Interview 5). The view of these directors is that any lack of

[592] Ibid,16.

independence associated with extended tenure is more than compensated for by gained substantial company knowledge, experience, and an ‘ingrained culture’ (Interview 11) of the director.

Some directors railed against stakeholder pressure on the issue of director tenure, such as the strong views held by the Australian Shareholders Association (ASA), Australia’s largest individual investor association. ‘The ASA is not managing the company … they are quite entitled to their voice, but at the end of the day the board needs to do what’s right for the company’ (Interview 19).

Conversely, other directors were of the view that maximum terms should be adhered to by all directors. As one director noted, ‘I get really cranky when people want to hang around past their nine years, because I just don’t think you get the renewal’ (Interview 24). Here, the director was voicing their opinion that regular renewal at the board level provides new thinking and is in the best interest of the board and the company.

In terms of other factors considered to possibly affect the independence of directors, many respondents nominated share ownership (while possibly affecting independence) as important to demonstrate having ‘skin in the game’ (Interview 7). Further, as previously stated, the presence of the founder (who usually has significant ownership in the company and is, therefore not independent) was seen to influence the governance and operations of the board. Despite this influence, directors on boards with founders reflected that the presence of the founder was considered to be advantageous by the shareholders. ‘There is more support by the investors in having the founders on the board’ (Interview 28).

One director defined independence simply as someone without a conflict of interest. They further noted that the ‘biggest conflict was the in case where directors relied on their director fees as income’ (Interview 5). This was aggressively denied by another director who argued ‘that’s really inappropriate, there is nothing wrong with being a professional NED’ (Interview 34). Here, the director was talking about the growing number of directors who pursue a NED career and rely on the directors’ fees to support themselves.

When defining independence in practice, interviewees pointed out that individuals and their behaviour is the key guiding factor, rather than any other factor listed in

Recommendation 2.3. 'I actually think you need to look at the person … their interactions and their behaviour' (Interview 11). One director described an example of how they had 'thrown out the chair because we thought he was too close to the CEO' (Interview 7). Here the director was illustrating how that chair's behaviours and interactions had rendered them non-independent, which was a significant issue for the rest of the board and caused them to take action to remove the chair.

There are, therefore, mixed views on what constitutes director independence, and independence is best determined by examining the individual and their behaviours, rather than taking a suggested definition from ASXCGC Recommendation 2.3. There are distinct and opposing views on director tenure as a measure of independence, while other suggested measures of independence, such as share ownership in the company, may be perceived as advantageous because they demonstrate a director's skin in the game.

5.2.3 Recommendation 2.6: Induction and professional development

Recommendation 2.6 is concerned with induction and professional development of directors and states that 'a listed entity should have a program for inducting new directors and provide appropriate professional development opportunities for directors to develop and maintain the skills and knowledge needed to perform their role as directors effectively'.[593]

Director inductions are almost always conducted as part of ASX200 appointments, and are generally perceived as effective in on-boarding the new directors in preparation for their role on the board. According to the interviewees, the induction process will frequently start prior to the actual appointment of the preferred candidate, and provides an opportunity for the prospective director to perform their own due diligence prior to accepting the role, as well as the other directors the opportunity to further evaluate the preferred candidate.

The responses indicated that induction processes are typically formal, extensive, involve site visits, numerous meetings and can often extend well into the first year of appointment. 'The induction goes on for about a year by the time you get around everywhere' (Interview 19). They can be partially directed by the new director; 'we

[593] Ibid 18.

give them a choice about what they are interested in, they might want to speak to certain direct reports' (Interview 11). New directors often feel overwhelmed by the sheer volume of information provided to them during the process, 'it can be a bit of information overload' (Interview 13). This is further amplified when directors are new to the industry, as one director in this situation noted 'everything seems relevant' (Interview 38).

While ASX200 director inductions are formal and effective, most ASX200 directors reported that professional development is, by contrast, ad hoc and reliant on each director to organise themselves. 'It's up to every director to decide what they want to do' (Interview 8). Given that it is left to each director to identify and arrange their own personal professional development, there is, unsurprisingly, a variation in the uptake and completion of professional development opportunities by directors. Some directors who are active in pursuing their own professional development are critical of those director peers who don't; 'some of the top directors never do anything … they say I am above this, I am on ten boards' (Interview 20). Another director said: 'there are two very different types of directors – those who see themselves as professional NEDs who take it seriously (and seek professional development), and for others it's just their retirement gig' (Interview 12).

Despite conflicting views on professional development, many directors recognise the importance of continual director professional development 'you've got to be doing something to keep yourself fresh' (Interview 9). Some directors believe that companies should take on more of the responsibility for developing their directors 'I think more boards should be doing more in this space' (Interview 20). One director believed that, in the absence of the company leading the development of their directors, directors feared asking for professional development opportunities to be funded by the company. They said: 'For listed companies, it's a case of you are on the board, you should know what you are doing … it creates a fear of putting your hand up' (Interview 24).

The understanding of what director professional development constitutes for listed company directors is varied; 'professional development gets a bit hazy – we class it to include any briefing by an outsider on any subject relating to the company' (Interview 31). Some directors described undertaking briefings by consultants and accounting firms as part of their professional development. Other variations on what constitutes director professional development included site visits, internal briefings and international ‘education weeks’ (Interview 41).

As can be seen, induction is considered by ASX200 directors to be performed well by listed companies in a relatively formal and extensive manner. Directors need to be prepared and ready to join the board, and must have begun to establish relationships with key people in the company such as the chair, other directors, the CEO, company secretary and other key executives in order to start contributing to the team effectively.

While induction is performed well by listed companies, professional development for directors is ad hoc and director driven. The understanding of what actually constitutes director professional development is also confused, inconsistent and interpreted very differently across the ASX200 companies. The willingness of directors to participate in ongoing professional development is varied and inconsistent.

5.3 Principle 3: Act ethically and responsibly

The third principle is concerned with acting ethically and responsibly, and outlines that ‘a listed entity’s reputation is one of its most valuable assets and, if damaged, can be one of the most difficult to restore’. [594] It highlights the expectations of investors and stakeholders that listed entities act ethically and responsibly, and further stipulates that the role of the board is to lead by example and the role of management is to create an appropriate culture that promotes ethical and responsible behaviour.[595] Directors enthusiastically expressed their views on the importance of ethics and responsible behaviours within their ASX200 companies.

As previously noted, the single Recommendation 3.1 (code of conduct) linked to this principle is a not spot (normalised practice).

According to most ASX200 directors interviewed, the ethical behaviour of companies is largely dependent on and reflective of the company culture. The company culture ‘starts right at the top’ (Interview 6), with the chair seen as ‘the

[594] Ibid 19.
[595] Ibid.

keeper of the culture' (Interview 19). The company culture is driven by company values, which are a reflection of the values of the key individuals, in particular the directors. Given the importance of the directors' values in driving the culture of the business, recruitment processes try to examine the individual values of potential candidates in order to determine their cultural fit. One director also outlined how they select which board roles to accept based on an assessment of value alignment; 'its starts with who is in the role as chair, and do I align with them strategically but also from a values point of view' (Interview 6).

Ideally, ethical behaviour at the board level is ingrained and second nature, and the ethical principles and values are frequented in order to make company decisions. 'We do live and breathe that stuff' (Interview 8). One director described the intersection of board values and personal values: 'It's about who you are and being true to yourself' (Interview 7). Another director provided a banking industry example of how the company's values were frequently referred to when making and assessing strategies and decisions: 'when numbers are down they (an executive) suggest offering an interest free period to new customers … how is that good for existing loyal customers or putting customers at the centre of everything we do?' (Interview 12).

Some ASX200 directors reported that companies face additional ethical challenges when operating across different jurisdictions 'ethics across country borders does cause the audit and risk committee nightmares really … and it's pure selfishness – we don't want to get caught' (Interview 11). While investigative processes and practices provide directors with assurance, ethical behaviour monitoring is difficult and requires judgement decisions. From their responses it was clear that ASX200 directors are acutely aware when making such judgements that a zero tolerance approach must be adopted.

Directors are constantly aware and concerned about the significant reputational damage that can occur from unethical behaviour within their ASX200 companies 'the reputation of a company takes years and years to build but can be lost, as we know, in hours … it is a big topic and one should never ever become complacent about it' (Interview 26).

Ethical and responsible behaviour, therefore, is largely about culture, which is set at the board level. In order to ensure the board culture is appropriate, boards pay particular attention to the individual values of potential board members during the recruitment process, and they frequently rely on their values during the board decision-making processes. It is difficult to monitor ethical behaviour across the organisation, but it is imperative that the board acts quickly and appropriately when unethical behaviour is uncovered. Directors are acutely aware of the risks of unethical behaviour within their companies and the potential consequences, both to the company and to themselves as directors.

5.4 Principle 4: Safeguard integrity in corporate reporting

Principle 4 is titled 'Safeguard integrity in corporate reporting' and it states: 'A listed entity should have formal and rigorous processes that independently verify and safeguard the integrity of its corporate reporting'.[596] As discussed in Chapter 4, Recommendation 4.2 (CEO and CFO declaration) and Recommendation 4.3 (external auditor attends AGM) were found to be not spots (normalised practice) in the analysis. Principle 4 (safeguard integrity in corporate reporting) and also Recommendation 4.1 (audit committee) were both found to be hot spots and will now be analysed.

Directors use a variety of measures to assure themselves of the integrity of the corporate reports. Monthly management reporting provides 'a good feel for what's going on' (Interview 22), and then a variety of control systems are used including internal and external audit. As one director noted: 'It's not a case of being able to prevent absolutely everything, it's a case of can you identify when things go wrong and hopefully if they are material, they get caught early' (Interview 26). Here, the director was outlining the criticality of the speed at which the board becomes aware of unethical or inappropriate behaviours within the organisation. Directors rely on internal systems and controls for safeguarding the integrity of corporate reporting 'you have to check, audit, and hold people accountable, and you need a good set of internal controls … hopefully things will get caught early' (Interview 26).

[596] Ibid 21.

According to most of the interviewees, director reflection and judgement is an important mechanism for meeting the requirements of this principle, and involves 'looking back at key events in the year and thinking about whether they are reflected both in what we say, and in the numbers' (Interview 38). Directors also need to be aware of the areas where the executives have been required to make accounting judgements, and then use rigour and their own judgement for making assessments about the appropriateness of such treatments. The process for approving the accounting statements requires detailed review, analysis and rigour by ASX200 directors.

Modern corporate reporting is broader than just the financial statements, corporate reporting 'can mean anything related to financial reporting, such as the media release and investor slides, key regulatory reporting … liquidity reporting and due diligence around an acquisition' (Interview 35). Directors have become aware of the need for consistency and rigour in approving all of the documents under this broader definition of corporate reporting.

As is evident, safeguarding the integrity of the corporate reporting is a major area of risk for directors. Various control mechanisms, together with a rigorous review and sign-off process and the exercise of director judgement, is seen as critical for managing this risk and for executing the responsibilities under this principle.

5.4.1 Recommendation 4.1: Audit Committee

Recommendation 4.1 states that the board of a listed entity should have an audit committee or, if not, disclose the processes it employs that independently verify and safeguard the integrity of its corporate reporting.[597]

As discussed in Chapter 4, of the four recommendations that cover board committees in the ASXCGC principles (being the audit, risk, remuneration and nomination committees), the audit committee recommendation was the only one that emerged as a hot spot. This is probably, at least partially, due to the significant responsibilities and workload of the audit committee. As one director noted: 'No one wants to do it (sit on the audit committee) because its drudged, it's just hard work' (Interview 4).

[597] Ibid 21.

Despite the responsibility of the full board in safeguarding the integrity of the corporate reports, additional rigour and responsibility is placed on the audit committee as part of the annual financial statements sign off. One audit committee chair described how he chaired a rigorous ‘page turn on the financial statements’ (Interview 35), noting that all board directors usually attended, further highlighting how directors perceived the significant risk and responsibilities surrounding Principle 4.

Audit committees generally undertake detailed investigative and probing practices to assure the integrity of the reporting. They typically do this through a variety of methods, which can include having divisional heads come to the committee to ‘present on a what keeps me awake at night basis so the committee can probe issues in their businesses’ (Interview 23). They also require critical relationships with both the internal and external auditors, and have closed sessions (without the executives) with them to discuss matters affecting the audit, the audit process and other concerns.

There was unanimity in the view that the role of the audit committee chair is a critical role within the company. According to the ASX200 directors, the audit chair needs to exercise rigour, have an inquiring manner and have a ‘nose like a ferret’ (Interview 14). The audit chair has a critical relationship with the CFO, and the auditors (both internal and external). The relationship with the CFO is so important that audit committee chairs may often sit on the interview panel for the CFO during the recruitment process. ‘As chair of the audit committee I always interview the CFO during their recruitment, and reserve the right to black wall them if I don’t think they are the right person’ (Interview 35).

Therefore, the audit committee plays a critical role by providing rigour in the annual account sign off process across the ASX200 companies, and on other financial matters. In doing so, the committee provides additional assurance and risk mitigation for the board. The committee (and chair) needs to have a good relationship with both the CFO, and the internal and external auditors in order for it to perform its extensive role successfully.

5.5 Principle 5: Make timely and balanced disclosure

Principle 5 states that 'A listed entity should make timely and balanced disclosure of all matters concerning it that a reasonable person would expect to have a material effect on the price or value of its securities'.[598] As discussed, Recommendation 5.1 (continuous disclosure policy) was found to be a not spot (normalised practice) in the analysis. Principle 5 (make timely and balanced disclosure) was found to be a hot spot and will now be analysed.

Disclosure is front of mind for ASX200 directors, and was evident by the expressions of concern displayed during the interviews. Significant time is spent considering whether matters should be disclosed and, if so, how the disclosure should be drafted to ensure that the message and timing are appropriate. Directors were consistent in their reflections about disclosure, outlining that it is ingrained in their discussions and thinking. Directors further reflected on disclosure as being largely about the integrity of the company, and critical in order to be fair and transparent in the market place to all investors and market participants. Directors reported being very aware of the risks associated with misleading or non-disclosure. 'It's more about that loss of trust than any fine, and how long it will take you to rebuild that trust for those organisations who have breached that' (Interview 17).

In order to ensure disclosure is considered at every meeting, directors reported their ASX200 boards build in an agenda item at the conclusion of each board meeting that is used to reflect whether any item considered or discussed during that meeting requires disclosure. It also informs directors as to whether they are able to trade in the company's shares, which is important for the number of companies who require their directors own shares equal to one year's director fees.

When considering whether to disclose, directors engage in rigorous discussion and need to exercise their judgement. As one director noted: 'It's a bit of an art not a science, knowing what is to be disclosed' (Interview 3). Here, the director was highlighting the subjective nature of disclosure. Directors reported that boards and directors take different approaches when making judgements on disclosure. Many directors reported taking a very conservative approach and, if there is any doubt,

[598] Ibid 24.

disclose; whereas others take a more balanced approach. The difficulty for directors is the reality that disclosure judgements are only ever judged in hindsight. Judgements on disclosure are further complicated by the tendency for the market to overreact. 'We made the announcement, and our share price fell more than it should have … they assume if you are making an announcement that things are a lot worse, it would actually be helpful if the market trusted you' (Interview 14).

The continuous disclosure requirements often mean that mechanisms need to be in place for dealing with disclosure between board meetings. Directors reported ASX200 companies often use delegation structures to manage this, and rely on having strong relationships with these individuals, and being able to trust them to act on their behalf. As one director noted: 'As a board, you are very dependent on management, so you have trust in the CEO and CFO … and they have to trust the board not to overreact' (Interview 26). Here, the director was describing how delegation mechanisms are essential, and rely on the mutual trust and understanding of both parties.

Many ASX200 directors mentioned that one key area for disclosure risk for boards is when company representatives are meeting with major shareholders and analysts. 'You've got to get that out on the ASX just as you are presenting otherwise you are disadvantaging those that are not in the room' (Interview 6). This area was highlighted as risky and, at times, unclear by many directors in how their companies handle it to ensure the information being provided to all market participants is consistent so as not to advantage some over others.

Some NEDs were of the view that the laws on disclosure should be changed because of the inherent difficulties faced with being expected to know everything that must be disclosed without being involved in the day-to-day management of the business. As one director noted: 'If you said to me did I think there was a problem in the way our law is structured, it's that one; that we mustn't operate the business, we must supervise … but we can only supervise what we know' (Interview 5).

Clearly, disclosure is a major area of risk for directors and they, therefore, devote significant time and effort considering whether and how to disclose. Rigorous thinking and discussion occurs around these judgement decisions, which are only really tested in hindsight. Delegation structures are necessary to deal with disclosure between board meetings and, for these to work effectively, the board places significant trust in key executives, and needs a strong understanding and working relationship with them in order to do so.

5.6 Principle 6: Respect the rights of security holders

Principle 6 states: 'A listed entity should respect the rights of its security holders by providing them with appropriate information and facilities to allow them to exercise those rights effectively'.[599] The commentary suggests that security holders should be given information about the company and its governance, that the company should communicate openly and honestly with them and should encourage their participation at meetings'.[600] As discussed, Recommendation 6.1 (information on website), Recommendation 6.2 (investor relations program), Recommendation 6.3 (policies and procedures to encourage meeting participation), and Recommendation 6.4 (options for electronic communications) were all found to be not spots (normalised practice) in the analysis. Principle 6 (respect the rights of security holders) was a hot spot and will now be analysed.

With the increase in size of major investors and the increasing power of proxy advisors, directors reported that the current practice of many ASX200 chairs and CEOs is to meet with the company's largest shareholders and proxy advisors, particularly in the lead up to the AGM. Further, it is not unusual for chairs to make themselves available to speak with the largest shareholders of the company, 'as chair, I make sure the top ten investors have my contact details and they are welcome to contact me at any time, on any matter' (Interview 12). This chair was highlighting the importance they place on fostering appropriate relationships with key investors. Directors were unanimous in the view that 'you've got to work with your investors to make sure they are onside' (Interview 27).

As previously highlighted such meetings create the risk of selective disclosure due to the possibility of providing market sensitive information to these groups. Directors observed variations in how this was managed, with some being very strict around 'sticking to the script' (Interview 14), or disclosing information to the market at the same time as the meetings, and others observing that some companies had more

[599] Ibid 25.
[600] Ibid.

work to do to avoid selective disclosure. ‘Some companies have an AGM and fourteen people come and they don’t put anything on their website… you could argue that that was selective disclosure’ (Interview 30).

The effectiveness of the AGM in today’s modern society was almost universally raised as problematic by the ASX200 directors interviewed. In the current world with increasingly large shareholders and increasingly powerful proxy advisors, together with advances in technology, many ASX200 boards and companies are questioning the relevance of the AGM structure. ‘The AGM is the most vexed one for most companies’ (Interview 23), and ‘is fast approaching its use by date’ (Interview 27). A primary reason for this is due to the reality that the institutional investors and proxy advisors don’t attend the meeting, rather they vote in advance. Directors reported these voters together have a substantial number of votes which usually leads to the matters being resolved before the actual meeting. The view of ASX200 boards is that ‘it doesn’t feel to be doing what it was supposed to be doing… and it puts you in a tricky spot’ (Interview 34). Here the director is referring to the resolution of matters before the meeting, which takes away the leverage of those ‘Mum and Dad retail investors’ (Interview 24) whose vote becomes immaterial at the AGM.

Despite these concerns, the ASX200 directors interviewed recognise the importance of the investors’ ‘democratic right’ (Interview 30), to be able to attend the AGM and the need for a mechanism for holding the company to account. ‘We should respect their (shareholders’) view… we should have a positive dialogue, and respect their opinions’ (Interview 40).

ASX200 directors have also observed increasing shareholder activism at AGMs over recent years, which at times has been diversionary to the core purpose of the meeting. Many ASX200 directors reported also having experienced the non-binding vote on the remuneration report being used as ‘general protest’ (Interview 34) against other non-remuneration matters. In instances where this occurs, directors reported the following year saw these companies spend significant time with remuneration consultants, major investors and proxy advisors in order to avoid a second vote, despite their view that the first strike was not in response to a remuneration concern. As one director outlined it 'is another sign that the AGM isn't meeting the needs of the shareholders' (Interview 34).

Some directors were of the view that a better use of technology might be an appropriate improvement to the current AGM structure by 'embracing the thing that made it obsolete… by going fully electronic and letting shareholders ask questions from all over the world' (Interview 17).

Some ASX200 directors do view their obligations as being owed more broadly to all stakeholders 'it's not just about investors anymore, it's about all stakeholders… the only way I can achieve long term shareholder value is through meeting obligations to employees, customers and other stakeholders' (Interview 35). Here the director was describing the interconnected nature of the system of stakeholders, and that in order for the company to succeed, the needs of all stakeholders must be taken into consideration.

In summary, directors reported there has been a change in the power base of investors in recent years, with major investors becoming larger and proxy advisors wielding more power. This has changed the nature of the relationship between them and the ASX200 chairs (and CEOs). Meeting with these major shareholders and proxy advisors is an important part of the chair and CEO roles, as it is critical that they establish appropriate relationships with their key stakeholders. This in turn raises additional complexities around disclosure, with companies needing to be very cautious in order to avoid selective disclosure. The AGM has become a vexed issue for companies, due to this increasing power of large shareholders (who tend to vote before the AGM and not attend, making the vote of those in attendance immaterial), and advances in technology. ASX200 directors view the rights of the shareholders to have a forum or avenue to hold the company to account as critical, but believe the traditional AGM requires change to improve its relevance in today's society.

5.7 Principle 7: Recognise and manage risk

Principle 7 covers the recognition and management of risk and outlines that 'a listed entity should establish a sound risk management framework and periodically review the effectiveness of that framework'.[601] As outlined, Recommendation 7.1 (risk

[601] Ibid, 28.

committee), Recommendation 7.2 (risk management framework review), and Recommendation 7.4 (exposure to economic, environmental and social sustainability risks), were found to be not spots (normalised practice) in the analysis. Principle 7 (recognise and manage risk) and also Recommendation 7.3 (internal audit) were both found to be hot spots and will now be analysed.

All ASX200 directors interviewed view risk management as a key and critical component of their role of governing ASX200 companies. Directors emphasised the seriousness by which they treat and manage risk; all reported they have clear structures in place, such as risk appetite, risk register, delegations and other tools that form part of their risk frameworks. Risk management and oversight is complex and requires significant time commitment. 'It's a very active area in every board and a source of tension' (Interview 20). Many directors reflected on the significant time allocation and the complexity of managing risk. 'It really is hard for people to get their head around the risk framework, risk appetite, residual and inherent risk' (Interview 11).

While the risk framework and associated tools are important outputs, directors agreed the real value to the board in managing risk is in the rigorous board discussion and reflection. As one director noted '(It's about) making sure controls are in place but also just constantly reflecting … are we thinking about all the things we should be thinking about? … are we truly focusing on all the areas of material risk?' (Interview 35).

In order to effectively manage the risks of the company, the clear message from the directors interviewed was that boards and executives need to be reflexive in thinking about what scenarios could significantly impact the company, how likely they are, how severe they could be and how they should best be managed and mitigated. As one chair stated: 'The risk appetite statement is worth less than the actual getting to the statement' (Interview 5). Directors see real value in having such rigorous discussion, noting they benefit greatly from involving the executive in separately assessing risk, and spending time in assessing these differences. A strong theme to emerge from the interviews was that this exercise requires a strong relationship and level of trust in which the executive can be candid and open in their assessments and discussions.

A number of directors spoke of being exposed to poor risk processes that were conversely focused more on the documentation of risks, ending up with a very lengthy risk register that was ‘over bureaucratised and overly administrative’ (Interview 12), and of minimal use to the board. ASX200 companies seem to be varied in their risk management maturity, with some directors reporting that companies are still being burdened with extensive risk registers of low value to the board. One director expressed their frustration and had wanted ‘a discussion around what should we be on the lookout for, what’s worrying people, what are we dealing with … we are just not having those conversations’ (Interview 24).

The nature of risk management in companies is dependent on the nature of the industry they are in. In certain industries, where safety risk or regulatory risk were higher, respondents reflected this in the discussions around risk management and, often, the company would have specific committee structures in place to provide those critical risks with the required focus and attention. As one director noted: ‘We have safety in a separate committee because we want safety to be what the company stands for’ (Interview 12).

ASX200 directors with international experience reflected that Australian companies focus more on the downside of risk. They viewed ‘the challenge for Australian companies is that if you don’t take a certain level of risk, you can’t enjoy some of the upside’ (Interview 6), and described a resistance from directors to put their own reputations at risk.

Risk management and oversight in ASX200 companies is, therefore, time consuming and complex, and ASX200 companies vary in their maturity levels with respect to risk management. Directors agreed risk management by boards is most effective when rigorous discussion and reflection is undertaken by the board (with the assistance of the executives) in using their judgement to foresee possibilities, understand them and mitigate them. Directors were also consistent in their views that when companies become consumed by documenting many risks within their risk registers, the risk oversight and management is less effective.

5.7.1 Recommendation 7.3: Internal audit

Recommendation 7.3 states that ‘A listed entity should disclose if it has an internal audit function, how the function is structured and what role it performs, or if it does not have an internal audit function, the processes it employs for evaluating and continually improving the effectiveness of its risk management and internal control processes'.[602] The commentary to this principle notes that, in terms of company structure, the head of internal audit 'should have a direct reporting line to the board or to the board audit committee to bring the requisite degree of independence and objectivity to the role'.[603]

Internal audit is widely used by ASX200 companies as a crucial part of their assurance and governance processes. 'I think internal audit is essential … external auditors are very important but they are not there all the time … internal audit is there all the time, understands the culture and where the issues are' (Interview 15). The value of internal audit, however, is not from acting as a policing function (which ASX200 directors are not in favour of) but, rather, as a value-adding part of the business. It does this in a number of ways. Firstly, 'it's a good indicator of culture' (Interview 18) because 'unlike external audit, it can get under the covers and actually find out what's going on' (Interview 28). Secondly, an effective internal audit function can essentially perform the role of an internal consultant, and divisions can invite them in to assist in reviewing process and identifying problems. Effective internal audit has more of a preventative role and examines potential areas of risk. Another benefit of internal audit was realised by some ASX200 companies who used it as an effective training ground for staff because it provides a unique and broad exposure to many company functions and processes.

Most interviewees noted the importance of the internal auditor's relationship with the board, and the need for the internal auditor to have direct access through the audit committee chair in order for them to be able to perform their duties effectively. This dual reporting nature is not dissimilar to the company secretary role and both roles were recognised by directors as requiring nuanced people in order for the relationships to function properly.

In summary, most ASX200 directors reflected that the internal audit function is a critical enabler for the board for providing assurance and enabling them to govern the company. The function is embraced by directors when it operates as a value-

[602] Ibid 30.
[603] Ibid.

adding part of the business that understands the culture, assesses area of risk and assists divisions to enhance their processes. It does not work as effectively when its role is a policing function. Internal auditors need effective relationships with the board, particularly the audit committee chair; this dual reporting requires a nuanced person to manage this reporting structure.

5.8 Principle 8: Remunerate fairly and responsibly

The final principle: 'Remunerate fairly and responsibly' states that 'A listed entity should pay director remuneration sufficient to attract and retain high quality directors and design its executive remuneration to attract, retain and motivate high quality senior executives and to align their interests with the creation of value for security holders'.[604] The commentary to the principles notes that the entity should have a formal and transparent process for developing its remuneration policy and fixing its remuneration packages, and should articulate to investors the relationship between remuneration and performance and how it is aligned to the creation of value for shareholders.[605] As discussed in Chapter 4, Recommendation 8.1 (Remuneration committee), Recommendation 8.2 (Disclosure of remuneration policies and practices), and Recommendation 8.3 (Equity-based remuneration scheme policies), were found to be not spots (normalised practice) in the analysis. Principle 8 (remunerate fairly and responsibly) was found to be a hot spot and will now be discussed.

In 2011, the *Corporations Amendment Act*[606] was introduced. The changes to the *Corporations Act 2001* (Cth) were designed to empower shareholders to hold directors accountable for their decisions on executive remuneration, to address conflicts of interest in the remuneration setting process, and to increase transparency and accountability in executive remuneration matters.[607] These changes implemented many of the recommendations made by the PC in its inquiry into executive remuneration in Australia during 2009.[608] This inquiry into executive remuneration was conducted after strong growth in executive remuneration between the 1990s to

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[604] Ibid 31.
[605] Ibid.
[606] *Corporations Amendment Act (2011)* (Cth)
[607] Ibid 3.
[608] Ibid.

2007 along with instances of large payments despite poor company performance, and the subsequent community concerns that executive remuneration was out of control.[609]

The Act introduced a 'two-strikes and re-election' process in relation to the non-binding shareholder vote on the remuneration report. The 'first strike' occurs when a company's remuneration report receives a 'no' vote of 25 per cent or more and requires the subsequent remuneration report to include an explanation of the proposed action. The 'second strike' occurs when a company's subsequent remuneration report receives a 'no' vote of 25 per cent or more and shareholders vote at the same AGM to determine whether directors will need to stand for re-election. If this 'spill resolution' is passed, the spill meeting will occur within 90 days.[610] This strengthening of the non-binding vote came into effect on 1 July 2011, around five years prior to these interviews being conducted.

Directors expressed frustration during their responses to this principle as they outlined how external pressures and the introduction of the non-binding vote on remuneration have caused them to devote significantly more of their time to working on 'rem' in recent times. 'Rem' is the term frequently used by directors for describing the end-to-end process of setting executive remuneration. It includes significant dealings and discussions with external stakeholders, including remuneration consultants, major shareholders and proxy advisors, and the voting by the security holders at the AGM.

Directors and boards are very consumed in the complex rem process that they must manage. 'Executive remuneration gets such a lot of attention these days' (Interview 20), 'it is absolutely getting more difficult to do remuneration' (Interview 26). The need to set appropriate remuneration structures to attract and retain executives, together with increased external scrutiny and the power of the non-binding vote has made 'getting the executive remuneration structure right is one of the most difficult things we do' (Interview 5). Historically, the audit committee chair had the biggest workload of all the committee chairs, however this has changed, with 'the

[609] Australian Government Productivity Commission, above n 369, XIV.
[610] *Corporations Amendment (Improving Accountability on director and executive remuneration) Bill 2011* (Cth) 6.

remuneration committee chair now having as big a role (as the audit committee chair)' (Interview 29).

The rise in the role of remuneration consultants in rem has, in many cases, proved frustrating for the ASX200 directors interviewed: 'I think boards have become hostage to rem consultants' (Interview 30). They were critical of the tendency of remuneration consultants to over-complicate remuneration structures, and for suggesting structures that were not fit for purpose. As one director suggested, they are 'good at telling you what others are doing … not great at telling you what you should do' (Interview 5). Despite this frustration, directors generally recognised that using the advice of remuneration consultants was often necessary for avoiding a strike in the non-binding vote at the AGM. 'We do get advice from remuneration consultants to make sure that we are not out of whack' (Interview 13). Here, the director was outlining how using external advice supported their position when taking the remuneration structures to the AGM for approval. Directors also expressed frustration with instances of inconsistent year-to-year advice from remuneration consultants, resulting in difficulties for getting approval at the AGM. 'That same rem consultant will change their view next year … so you've got to go back to the AGM and try to convince shareholders what was a great idea last year is not OK this year' (Interview 27).

Directors also highlighted the increase in the power of proxy advisors, and the pressure they exert over the nature of the executive remuneration structures. 'Proxy groups have complicated this with some unrealistic expectations' (Interview 26), '(They) can have quite a say with particularly the super funds as to how they vote … you've really got to go with the mainstream (for remuneration structures), or you are going to get a strike' (Interview 12).

Directors were very concerned that the impact of disclosure of remuneration amounts and structures had put upward pressure on executive remuneration, despite the 'push back around the world over the disparity of top pay and the median of employees' (Interview 26). As one director described: 'All it's done is ratchet up the pay … which is an unintended consequence of full disclosure' (Interview 30). The view of directors was that the current regulations were 'counterproductive' (Interview 21) because 'the government naively thought that would put downward pressure on rem and it's had the opposite effect' (Interview 23). Remuneration consultants provide benchmarking identifying the median and with directors reporting most companies are reluctant to pay less, this in turn ratchets up the remuneration levels and the industry median. The feeling of the ASX200 directors was that 'we are not in a good place broadly, on how we assess and govern pay structures, we have all these consultants whose job is to make sure you conform to averages' (Interview 36).

Companies have further experienced the non-binding vote on the remuneration report being used as 'general protest' (Interview 34) against other (non-remuneration) matters: 'It's the only stick that shareholders have through the strikes and voting, unlike other ones so it's sort of been given that brief' (Interview 22). 'Often, a first strike is not about remuneration anyway, it's about performance and rem is the easiest thing to have a go at' (Interview 19). In order to avoid a second strike, companies then spend significant time on their rem structure in the following year with remuneration consultants, major investors and proxy advisors in order to avoid a second vote, even despite their view that the first strike was not in response to an actual remuneration concern. 'We had our first strike … for no reasons to do with rem, so we were forced to look at remuneration but it wasn't the issue' (Interview 23).

The concerns expressed by the ASX200 directors was exemplified by one interviewee who stated: 'I often wonder whether all we are doing is being complicit in the growth of a whole industry that is questionable in terms of the extent to which it makes the slightest difference' (Interview 2). Here the 'industry' they referred to was the remuneration consulting industry.

NED remuneration doesn't get a lot of attention by comparison. In most cases, benchmarking is undertaken and it usually increases in consumer price index (CPI) increments. As mentioned, it is common practice for directors to own shares in the company, as one director outlined: 'You have to invest to align yourself … it's appropriate' (Interview 17).

In summary, Principle 8 revealed a new and different theme. Dealing with 'rem' was topical, concerning and frustrating for ASX200 directors. The perceived excessive influence of external stakeholders, including remuneration consultants and proxy advisors on the rem process was evident, and directors reported that the unintended consequence has been to ratchet up executive salaries. While directors did not express concern with the existence of the non-binding vote on remuneration per se, they were very concerned with the use of a no vote or strike as a protest by shareholders for other issues they were dissatisfied with such as company performance. The external pressures (including legislative changes) have changed the power bases in the interconnected system of players in the rem process. The view of the ASX200 directors interviewed is that these changes are causing unintended consequences and difficulties in achieving appropriate remuneration and reward structures that attract, motivate and retain their executives who they significantly rely upon.

5.9 What keeps directors awake at night

After the questions on the *ASXCGC Principles and Recommendations* were asked in each interview, ASX200 directors were each asked the question: ‘What keeps you awake at night’ (with respect to governing their ASX200 company).

Many directors focused on risk to the organisation in their responses. Directors feared the possible negative consequences, and the significant impact it can have on the companies they are governing; ‘This risk stuff can kill you’ (Interview 11). In particular, directors feared the risks they had failed to identify and, therefore, mitigate ‘You are constantly fearing what you don’t know’ (Interview 35), ‘the unknown’ (Interview 8). As one director noted: ‘My fear is not what I know and what I decide upon, but what I don’t know’ (Interview 5). Here, the directors were reflecting on potential risks from external factors that they had not adequately identified or mitigated.

Directors were acutely aware of the personal consequences for directors as well as the potential catastrophic consequences for the company. ‘The downside is so great … the responsibility is enormous, and you can lose your house, and you can go to jail’ (Interview 6). ‘Risk is the most important thing because things can come down on your neck if not done properly’ (Interview 4). The catastrophic consequences for the company were also front of mind; significantly, the reputational risk and loss of trust: ‘It’s more about the loss of trust than any fine, and how long it will take to rebuild that trust’ (Interview 17). Despite this, the business judgement rule was clearly not in their thinking as they did not mention it as a protection available to them in their reflections. This was considered to be most likely because of the limited number of cases where this defence has been used successfully.

In relation to this fear of what they don't know, directors strongly rely on the 'flow of information and openness of management with the board' (Interview 5), further emphasising the importance of the relationship between the board and management and trust between them. For preventing 'insufficient foresight on the changes happening around them' (Interview 17), directors relied on exercising rigour and judgement in observing, reflecting and discussing risk, strategy and external influences faced by the organisation.

Directors also listed specific risks for their company that 'kept them awake at night', which were reflective of their industries. Some examples were the fear of fatalities or environmental disasters in the resource industry, and 'the potential disruption to our model' (Interview 25) in the retail industry. Other directors in the financial services industry feared that the 'regulatory overlay was leaving little time to talk about what's happening to the business and whether there were trends that we are missing' (Interview 21).

The increasing power of stakeholders on the organisation was concerning for directors, particularly stakeholders involved in the rem processes. 'I worry because we are not in steady state and there are too many stakeholders impacting this (rem)' (Interview 26). Another director was more critical of 'being held to account by proxy advisors for artificial rules that have no relevance to good governance or our company'. (Interview 12)

To conclude, the things that keep directors awake at night are predominantly related to matters of risk, both to the organisation and the individual directors. Some directors displayed anxiety and concern at times when describing what kept them awake. They were usually quick to respond to this interview question, without needing time to contemplate their answer, indicating that these concerns were front of mind. Further, they were concerned about reputational damage to both the company and personally when describing matters of risk that concern them.

5.10 What makes governance easier

The final question directors were asked in interview was: ‘What makes governing ASX200 companies easier?’ Directors were strongly assisted by and reliant on the executives in the company. In order for directors to be able to perform their governing role successfully, it is essential that they have skilled, intelligent people with the right values and principles in those key executive roles, and have good working relationships with them. There was general agreement that directors rely heavily on executives, and they need to be able to trust them. In order to be able to trust them, a good relationship with them is a pre-requisite. ‘You need to have professional relationships with staff and fellow directors, you need to have the integrity of them all’ (Interview 8). The relationship between the board and executive is complex in that it needs to be strong and based on trust, however ‘you’ve got to keep things arm’s length’ (Interview 22), otherwise the independence of the NEDs can be compromised.

Relationships between board members are equally important given the board acts as a team, and directors need to ‘have people around the table who get it’ (Interview 24), as well as being able to trust and rely on them. This makes the recruitment process critical when securing directors with the right attributes, skills and values. Directors also highlighted the need to balance having respect for each other without being too collegiate. ‘You don’t want a compliant board, but you do want a functional board … you need to get the chemistry right (Interview 19).

In summary, the things that make governing the ASX200 companies easier for directors are predominantly related to the strength of the relationships with key people, including other directors and the executives. While responses to this question were not as detailed as for the question regarding what keeps directors awake at night, directors were unanimous in their responses that the key factor for enabling effective governance is the relationships and trust between key executives and the board.

5.11 Themes emerging from the analysis

During the analysis using the grounded theory approach, the first stage involved listening to the interviews and open coding various quotes within each ASXCGC principle and recommendation within NVivo. The second stage involved the identification of broad categories of themes through a process of axial coding, and this resulted in quotes being segmented and then organised into clusters. Nine sub-themes emerged during the analysis, which can be seen in Figure 5-1. Thirdly, emergent themes were developed in order to develop links between the data through selective coding. Three key themes: relationships, risk and remuneration were derived from the nine sub-themes, and can be seen in Figure 5-1. Throughout this process, the Constant Comparative Method was adopted in the analysis and interpretation of the data, another analytic procedure utilised in grounded theory.[611] Figure 5-1 presents this process, with exemplar quotes to illustrate the typical responses of ASX200 directors, the segmentation into the nine sub-themes and the linkage to the three key themes of relationships, risk and remuneration.

[611] Glaser and Strauss, above n 27, 105.

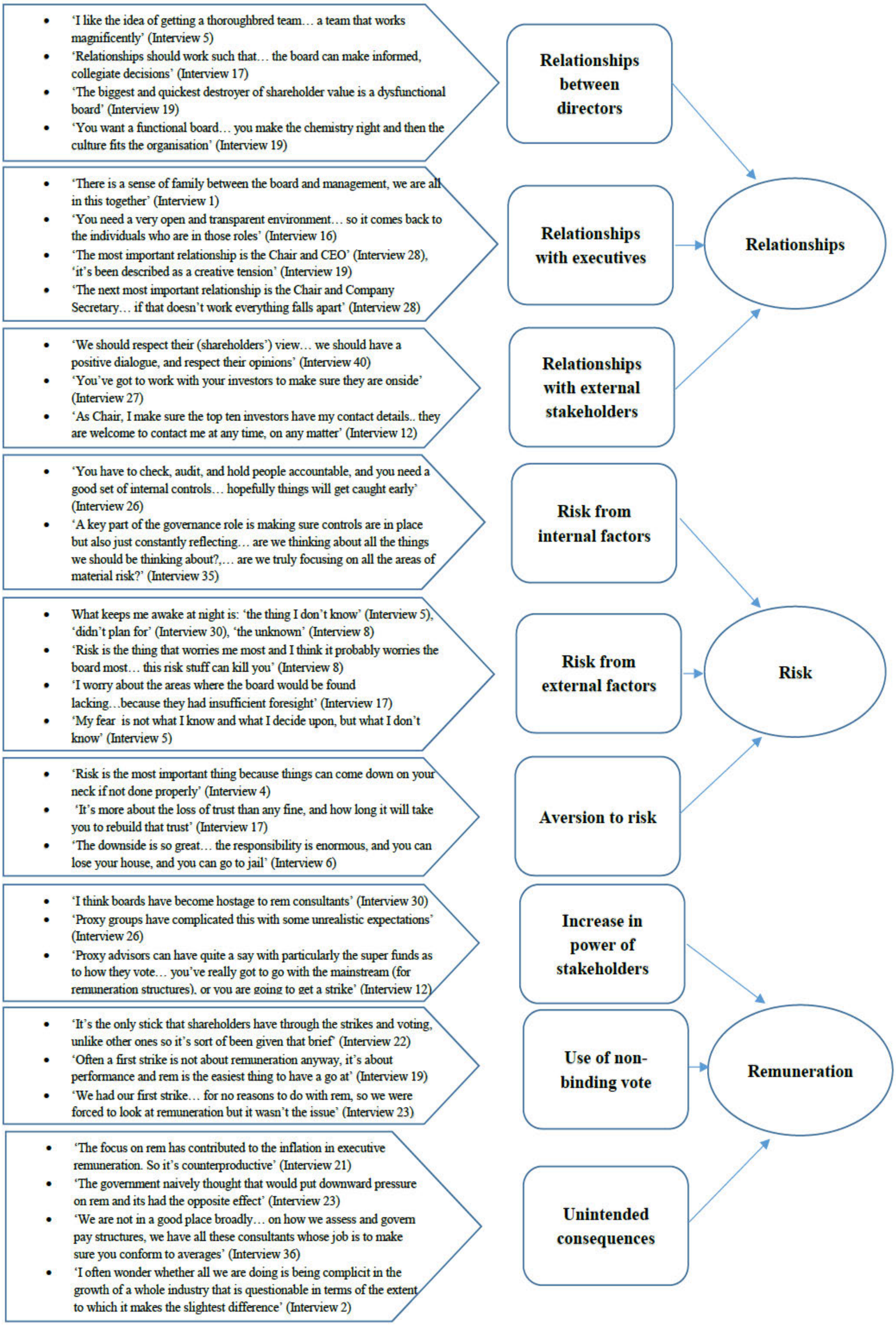

Figure 5.1: Key emergent themes

These three key themes will be examined in Chapter 6, and they will be presented in an ASX200 governance model which also shows their intersections and interrelationships. These key themes of relationships, risk and remuneration will then be examined against the theories underpinning the practice of corporate governance.

5.12 Conclusion

Across the hot spot areas of principles 2 to 8, there were variations in the consistency of governance practices across each principle or recommendation; some were found to have common accepted practices while others differed in their governance practices.

Principle two, ‘Structure the board to add value’, had three hot spots within the six recommendations. These three hot spots are: the skills matrix, independence of directors, and induction and professional development. The principles thereafter (Principles 3 to 8) appeared to follow a pattern where the hot spots mostly appeared at the principle (highest) level, rather that the individual recommendations (supporting) them. This was observed to be related to the nature of principles because principles three to eight were narrower in their focus, and the recommendations supporting them tended to be more prescriptive.

After analysing Principle 2, the key theme of relationships emerged (as it had in Principle 1). Directors reflected on the necessity for strong working relationships with each other, the chair, CEO and company secretary, outlining them as being critical in enabling transparency, openness and trust, which are essential for effective governance.

In analysing the responses to questions concerning Principles 3 (Act ethically and responsibly), 4 (Safeguarding the integrity of in corporate reporting) and 5 (Making timely and balanced disclosure) the theme of ‘risk’ emerged. Directors are always conscious of risk to the company, the possible impacts and the need to use rigour and judgement in identifying, planning for and mitigating significant risks.

Through analysis of Principle 6 (Respecting the rights of security holders) responses, the relationships theme again emerged, with directors focusing on having effective and appropriate relationships with stakeholders that enable effective governance. Principle 7 (Recognise and manage risk), as expected, focused on the risk theme, and the focus and importance placed on risk management, foresight and mitigation for the company.

Principle 8 revealed a new and different theme. Directors used the term ‘rem’ when referring to the end-to-end process of setting executive remuneration. The perceived excessive influence of external stakeholders including remuneration consultants and proxy advisors on the rem process was evident, and directors reported that the unintended consequence has been a ratcheting up in executive salaries. The external pressures (including legislative changes) have changed the power bases in the interconnected system of players in the rem process. The view of ASX200 directors is that these changes were resulting in unintended consequences and difficulties for achieving appropriate remuneration and reward structures, and they are concerned with the perceived use of the non-binding vote for matters other than remuneration.

The two additional governance questions were what keeps directors awake at night and what makes governance easier. The majority of responses to what keeps directors awake at night were related to risk matters; in particular the risk of the unknown. In response to what makes governance easier, many directors referred to having strong working relationships with other directors and executives of the company.

The analysis of the hot spots within the *ASXCGC Principles and Recommendations* revealed three key themes: relationships, risk and remuneration. These three key themes will be examined in Chapter 6, and they will be presented in an ASX200 governance model which also shows their intersections and interrelationships. These key themes of relationships, risk and remuneration will then be examined against the theories underpinning the practice of corporate governance.

CHAPTER 6: Results, findings and implications

6.1 Introduction

The primary research question for the study was ‘How are ASX200 directors reflecting on their practising of the ASXCGC principles and recommendations?’ Detailed analysis of responses to open-ended interview questions revealed hot spot areas (where directors chose to focus their time in interview). Further analysis of the hot spots showed variation in the degree of consistency in their practice across the principles and recommendations. Some recommendations revealed consistently applied accepted practices, while others showed variation in how they were addressed. The analysis, using a grounded theory approach, revealed three themes, here termed the ‘three R’ themes: relationships, risk and remuneration (‘rem’). Each of the principles were predominantly aligned to one of these R themes.

Principle 1 (Lay solid foundations for management and oversight), Principle 2 (Structure the board to add value) and Principle 6 (Respect the rights of security holders) were primarily aligned to the relationships theme. The relationships theme describes how the presence of strong working relationships internally among the board directors and with the executives, and with key external stakeholders are essential to enabling the effective governance of the company.

Principle 3 (Act ethically and responsibly), Principle 4 (Safeguard integrity in corporate reporting), Principle 5 (Make timely and balanced disclosure), and Principle 7 (Recognise and manage risk) were primarily aligned to the risk theme. The risk theme highlights that risk is at the forefront of directors’ thinking in their governing of ASX200 companies.

The last principle, Principle 8 (remunerate fairly and responsibly) aligns to the rem theme. The rem theme highlights a significant tension in the way that remuneration for executives is set, with various (predominantly external) stakeholders playing a significant part in the process.

The three R themes and how they intersect will now be examined in the context of the ASX200 governance model. The themes will then be examined against the corporate governance literature.

6.2 The ASX200 director governance model

The key findings of the research with regard to the themes and the interrelationships of the themes are shown in Figure 6.1. As already explained in Chapter 4, certain recommendations in the ASXCGC emerged as not spots (normalised practice); these recommendations were dismissed by the ASX200 directors as obvious in the governance practices of their companies. Directors viewed them as being so obvious they doubt the recommendations should still be included in the *ASXCGC Principles and Recommendations*. These not spots have been listed along the right-hand side of Figure 6.1.

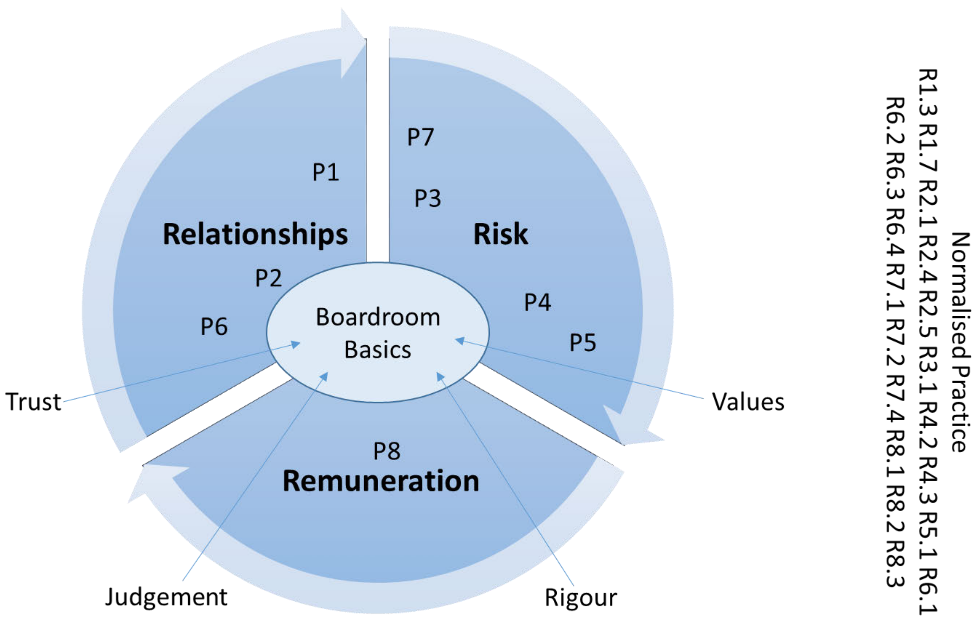

Figure 6.1: ASX director governance model

The analysis of the remaining hot spots in the principles and recommendations revealed that in governing their companies, ASX200 directors reflect on three distinct themes: relationships, risk and remuneration. The role of the modern director is complex, it is no longer 'a retirement or part time job'.[612] ASX200 directors are operating in a highly prescribed context (as is evident in the ASXCGC Principles

[612] Simon Evans and Patrick Durkin, 'AMP, CBA Scandals Threaten "Cosy" Boardroom Club', *Financial Review* (Online), 18 May 2018 <https://www.afr.com/business/boardroom-battles-farewell-cushy-directorships-hello-trouble-20180517-h10668>.

and Recommendations, which contain eight principles and 29 supporting recommendations). This research found that directors do not focus equally on all 29 recommendations but, rather, on three areas: relationships, risk and remuneration. Each of the eight principles aligned predominantly to one of these R themes as shown in Table 6.1.

Table 6.1: The alignment of the ASXCGC principles to the three Rs

Alignment of the ASXCGC Principles to the three 'R's	**Relationships**	**Risk**	**Remuneration**
Principle 1: Lay solid foundations for management and oversight	■		
Principle 2: Structure the board to add value	■		
Principle 3: Act ethically and responsibly		■	
Principle 4: Safeguard integrity in Corporate Reporting		■	
Principle 5: Make timely and balanced disclosure		■	
Principle 6: Respect the rights of security holders	■		
Principle 7: Recognise and manage risk		■	
Principle 8: Remunerate fairly and responsibly			■

■ Primary alignment

The relationship theme emerged strongly in Principle 1 (Laying solid foundations for management and oversight), Principle 2 (Structuring the board to add value), and Principle 6 (Respecting the rights of security holders). The risk theme emerged strongly in Principle 3 (Acting ethically and responsibly), Principle 4 (Safeguarding the integrity of the corporate reporting), Principle 5 (Making timely and balanced disclosure) and Principle 7 (Recognising and managing risk). Finally, the remuneration theme emerged strongly in the last principle, Principle 8 (Remunerate fairly and responsibly).

At the intersection of relationships, risk and remuneration themes, four key attributes emerged: trust, judgement, values and rigour. The ASX200 directors emphasised that these attributes are essential boardroom attributes, and, thus, to the three R themes.

The attributes have collectively been labelled ‘boardroom basics’, shown in Figure 6.1.

Through detailed in-depth analysis of directors’ reflections on the principles (as outlined in Chapters 4 and 5), the ‘creative crafting’ process,[613] an essential element in grounded theory, revealed these key themes of relationships, risk and remuneration. Further, the ‘boardroom basics’ (the key attributes of trust, judgement, values and rigour) continually emerged throughout the development of these three themes. Each of the key components of the ASX Director Governance Model will now be considered in detail.

6.3 The 3 R’s of ASX200 director governance

As outlined from the analysis of the ASX200 directors’ reflections on the ASXCGC principles and recommendations, the ASX200 directors reflect on three key themes: relationships, risk and remuneration. Despite the fact that the central problem identified by the *ASXCGC Principles and Recommendations* is the agency problem, or how best to monitor senior management more effectively, thereby making them more accountable,[614] accountability is only one aspect of good governance.[615] Governance is also concerned with the quality of decision making and with creating value and wealth.[616] These multiple aspects of good governance were evident across the relationships, risk and remuneration themes.

6.3.1 Relationships

The presence of strong working relationships is essential for ASX200 directors to govern effectively. As members of the governing body, directors are collectively responsible for directing the company.[617] The critical nature of the board with various parties is recognised as essential in the OECD definition of corporate governance: ‘(Corporate governance is) a set of relationships between a company’s management, its board, its shareholders and other stakeholders … (it) provides the structure through which the objectives of the company are set, the means of attaining

[613] Maher et al, above n 557, 2.
[614] Grantham, above n 50, 220.
[615] Ibid 225.
[616] Ibid 225.
[617] Tricker, above n 19, 44.

those objectives and monitoring performance'.[618] This definition emphasises the critical nature of the relationships the board has with various parties that are essential in enabling it to meet its responsibilities.

The board acts as a team to fulfil their collective responsibilities, and the team's effectiveness is dependent on the presence of strong relationships that facilitate dependency, reciprocity and trust. This finding of the research supports contingency theory, which highlights that the relative power of the board depends on factors that include relative power and developing relationships between various coalitions of internal and external stakeholders.[619] It also supports stewardship theory, which proposes that long-term contractual relations are developed based on trust, reputation, collective goals and involvement, and where alignment is an outcome that comes from relational reciprocity.[620]

The risk associated with relationship breakdowns is significant because it can have a major impact on the effectiveness of the governance of the company. By contrast, there are exemplary governance examples in cases where relationships were working optimally.

6.3.1.1 Relationships between directors

Board relationships are dependent on 'the individuals who are in those roles' (Interview 16). Directors are cautious during the appointment process, keeping in mind the necessity of finding candidates who are a suitable fit for the board team. The need to be able to work with the person is critical given the negative impact conflict can have on decision making and board effectiveness. This concern and caution heavily influences the appointment process and could potentially have an impact on board diversity. Further, the imperative to appoint directors with the requisite skills into the future required by the company is evident. This is because of the practical difficulty of removing directors who do not have the right skills and attributes or can not work as part of the team.

While individual director evaluations are an effective mechanism to identify director weaknesses, boards can be reluctant to conduct them because of the importance of

[618] OECD (2015), above n 72, 9.
[619] Gabrielsson and Huse, above n 108, 18.
[620] Van Slyke, above n 126, 164.

cohesion and trust among board members for the effective functioning of the board, and the resultant concerns that such appraisals could have a negative impact on this dynamic.[621] The research strongly confirmed this finding, with most ASX200 directors and boards indicating strong reluctance to conduct director evaluations because of the believed potential damage to the relationships between the board members.

ASX200 director discussions in the interviews revealed that the role of the chair is of particular importance for facilitating the effectiveness of the team and fostering the relationships between board members. The chair needs strong interpersonal, social and leadership skills to facilitate discussion and manage the complex nature of the relationships between directors and the executives. The findings further confirmed previous findings that the role of the chair is a particularly nuanced one, with effective chairs being described more as enabling equals rather than strong leaders.[622]

6.3.1.2 Relationships with executives

Decisions are made in a coalition of actors.[623] The role of the large public company board in Australia is not to manage the company's business but to operate through the executives to have the business of the company conducted.[624] Agency theory proposes that the purpose of the board is to control the managers,[625] to curb the behaviours of self-serving managers (agents) that may negatively impact owners (principals) wealth.[626]

The findings of this research, however, show that, in practice, ASX200 boards are mostly made up of NEDs and they rely on the executives for resources and information in order to perform their directing and governing role to protect the interests of the owners. Without a good relationship with key executives, such as the CEO, CFO and company secretary, that enables trust and, thus, the provision of information, the directors are limited in their ability to perform their governing role. Equally, as resource dependency theory suggests, the executives rely on the directors

[621] Ingley and van der Walt, above n 278, 173.
[622] Bezemer, Nicholson and Pugliese (2018), above n 172, 229.
[623] Van Ees, Gabrielsson and Huse, above n 177, 307.
[624] Austin and Ramsay, above n 21, 234.
[625] Sundaramurthy and Lewis, above n 84, 398.
[626] Eisenhardt, above n 82, 60.

in order for them to be able to perform their roles effectively, such as the provision of advice[627] which was reflected by the ASX200 directors interviewed.

Boards and executives must share openness, honesty and trust, all of which are founded on respectful professional relationships, to perform their roles effectively. This finding supports stewardship theory, which emphasises the role of trust and close social ties between managers and board members,[628] noting that managers are team players.[629] As one director stated: '(Directors need) the behaviours and the relationships to work in a way that … enables the board to make informed collegiate decisions' (Interview 17). The findings of the research supported the concept that interpersonal trust between non-executive and executive board members impacts the task performance of boards,[630] and may mitigate the director's perception of relational risk within the board.[631]

The relationship between the board and executives is complex. The research confirmed that directors both challenge and support managers during board discussions, switching behaviours during meetings while maintaining a consistent level of support and scepticism,[632] These interactions also allow for a simultaneous level of trust and verification, both of which are necessary for accountability.[633] The relationship must be strong and trusting, but also distant enough so as not to impact independence and the role of the NED. Directors consider the practical definition of independence as being defined by the behaviours of the individuals and may, therefore, be impacted by proximity to executives. In most cases, directors reported there are protocols around contact between the NEDs and the executives outside board meetings. There is an inherent tension, due to the complexities in determining role separation, when determining the delineation of roles between the board and executives.

The chair plays a critical role in facilitating the working relationships between the board and executives that is largely facilitated by having a close (but arm's length) relationship with the CEO. Directors reported that the company secretary is another

[627] Farrell, above n 94, 94.
[628] Ibid.
[629] Donaldson and Barney, above n 130, 377.
[630] Van Ees, Van der Laan and Postma, above n 192, 471.
[631] Ibid 472.
[632] Nicholson, Pugliese and Bezemer, above n 183, 222.
[633] Ibid.

critical role and relationship that is essential for board effectiveness. The company secretary must be nuanced in their understanding of the board and executive relationships and understand when and how to present matters to the board for their attention. Other key relationships that enable the board to effectively conduct its governance responsibilities include those between the audit committee chair and the CFO, and internal and external auditors.

6.3.1.3 Relationships with external stakeholders

Relationships that the board has with key stakeholders are also critical enablers of good governance and board effectiveness. The purpose of the board is to enable cooperation,[634] and a key component of this cooperation is with outside stakeholders and the company itself. This is as proposed by stakeholder theory, and requires attention to be paid to those who can affect or are impacted by an organisation's purpose, on the grounds that these actors can enable or prevent the organisation from achieving its purpose.[635] Social contract theory also highlights the interrelationship of social groups; that is, emphasising that society is a series of social contracts between the members in society and society itself.[636] Likewise, legitimacy theory asserts that a social contract exists between society and an organisation.[637]

Stakeholder groups are varied, depending on the organisation and industry, but usually include shareholders, proxy advisors, consultants and regulators. Boards of directors need to identify and understand their major stakeholders and create and maintain respectful and appropriate relationships with them in order to be able to govern effectively. This finding is consistent with resource dependency theory, which proposes that organisations require resources in order to survive, and to acquire these resources they must interact with others who control those resources.[638] Interviewees made clear that modern ASX200 board governance requires that chairs and CEOs have closer proximity to certain stakeholders, including proxy advisors, who can be key enablers in governance processes, such as the setting of executive remuneration.

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[634] Van Ees, Gabrielsson and Huse, above n 177, 308.
[635] Freeman, above n 98, 25.
[636] Gray et al, above n 134, 10.
[637] Yusoff and Alhaji, above n 135, 58.
[638] Pfeffer and Salancik, above n 111, 258.

In respecting the rights of investors, boards must facilitate open and fair communications and an avenue for investors to be able to hold the company to account. Participants made it clear that the traditional AGM format is becoming less effective as a mechanism for facilitating an appropriate avenue for this purpose. Having an appropriate avenue is critical for ensuring that the relationship with investors is effective and to ensure that they are being respected as owners of the company.

Directors reported that boards are also increasingly recognising the benefits of being able to connect effectively with organisational employees, which is another key stakeholder group. Some companies have used their board diversity strategy to enable a closer resemblance to the employee base in order to be able to better connect with them and foster that relationship.

6.3.1.4 Summary

In summary, the relationships theme emerged strongly in the analysis of interview responses, particularly in principles 1 (Laying the foundations for management and oversight, Principle 2 (Structuring the board to add value), and Principle 6 (Respecting the rights of security holders). According to the interviewees, effective relationships between key individuals (both internal and external) are imperative for enabling the ASX200 directors and boards to perform their roles effectively. The relationships theme supports contingency theory, which proposes that the relative power of the board depends on factors including the relative power and developing relationships between various coalitions of internal and external stakeholders,[639] and stewardship theory, which proposes that long-term contractual relations are developed based on trust, reputation, collective goals, and involvement where alignment is an outcome that comes from relational reciprocity.[640]

Good relationships among board members is critical for the board to be able to carry out its collective duty to govern the company. This, in turn, affects other key board processes, such as recruitment and performance evaluation, which are managed in ways that preserve and enhance these critical relationships. Relationships with the board and executive are equally important, as the board places heavy reliance and

[639] Gabrielsson and Huse, above n 108, 18.
[640] Van Slyke, above n 126, 164.

trust in the executive to provide them with information in order to carry out their governance role. Equally, the executive relies on the board for their judgement and rigour in decision making and other required resources, such as the provision of advice. This finding supports stewardship theory, which places an emphasis on trust and close social ties between managers and board members,[641] describing managers as team players.[642]

Stakeholder relationships are becoming equally important, because the proximity to certain stakeholders is increasing as is the need for respectful appropriate relationships between the board and these groups. Stakeholder theory requires attention to be paid to those who can affect or are impacted by an organisation's purpose, on the grounds that these actors can enable or prevent the organisation from achieving its purpose.[643] The importance of stakeholder relationships with the board is also supported by social contract theory, which proposes that society is a series of social contracts between the members in society and society itself.[644] Further, the importance of stakeholders is emphasised by legitimacy theory, which is based on the assertion that a social contract exists between society and an organisation.[645] The importance of relationships is also consistent with resource dependency theory, which proposes that organisations require resources in order to survive, and to acquire these resources they must interact with others who control those resources (in this case, the stakeholders).[646]

6.3.2 Risk

Risk is at the forefront of the ASX200 directors' minds, and was prominent in their reflections on governing their companies. Agency theory underpins the role of board in risk oversight management, highlighting the consideration that the principal and agent have different attitudes toward risk, and the agent may prefer different actions because of different risk preferences.[647] Agency theory explains that the essence of the agency problem is the separation of ownership and control and, therefore, owners

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[641] Farrell, above n 94, 94.
[642] Donaldson and Barney, above n 130, 377.
[643] Freeman, above n 98, 25.
[644] Gray et al, above n 134, 10.
[645] Yusoff and Alhaji, above n 135, 58.
[646] Pfeffer and Salancik, above n 111, 258.
[647] Eisenhardt, above n 82, 58.

have a problem, which is to ensure their funds are not expropriated or wasted, another key risk to the company.[648]

The third edition of the *ASXCGC Principles and Recommendations* enhanced the number of recommendations concerning risk, and it is clear that this, combined with other external pressures and corporate collapses has resulted in a significant increase in the focus on risk by ASX200 directors.

6.3.2.1 Context

After considerable focus across the world on corporate governance practices in light of the events leading up to the GFC, the 2014 ASXCGC 3rd edition substantially enhanced recommendations related to reducing risk in corporations.[649] At the same time, the ASXCGC provided strong advice to listed company directors, encouraging all listed entities to review the enhanced risk recommendations carefully and to consider whether they need to upgrade their corporate governance practices in the risk area.[650]

The commentary included with Principle 7 (Recognise and manage risk) states that: 'Recognising and managing risk is a crucial part of the role of the board and management', and 'failure by a listed entity to recognise or manage risk can adversely impact not only the entity and its security holders but also many other stakeholders, including employees, customers, suppliers, creditors, consumers, taxpayers and the broader community in which the entity operates'.[651]

In recent times, discussions in Australia about corporate governance have covered various issues, including the ethical standards of directors, and ways to improve internal audit effectiveness and external auditor independence.[652] The increased focus on risk management since the GFC and various corporate collapses has translated into directors becoming very focused on risk management for their organisation. It is at the forefront of their thinking and is what keeps them awake at night.

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648 Shleifer and Vishny, above n 79, 740.
649 ASXCGC (27 March 2014), above n 350, 2.
650 Ibid.
651 ASXCGC (2014), above n 6, 28.
652 Austin and Ramsay, above n 21, 379.

6.3.2.2 Risk from internal factors

Directors interviewed for this research focused on various risks that stem from breakdowns in internal controls when they reflected on their governance practices in relation to the ASXCGC Principles and Recommendations. These risks included unethical behaviours within the organisation, failure to disclose appropriately to the market and inaccurate corporate reporting.

The significant risk of unethical or inappropriate behaviour by staff is ever present, as was highlighted in the ASX200 directors' reflections on Principle 3. This risk of having staff act unethically is a prediction of agency theory, which concludes that the purpose of the board is to control organisational managers[653] and curb the behaviours of self-interested managers (agents) that may negatively impact owners' (principals') wealth.[654] Stakeholder theory further proposes that ethical behaviour requires treating stakeholders in a manner deemed acceptable by society.[655]

From the interviews, it was clear that directors are constantly aware that regardless of the 'tone from the top' (Interview 26) and regardless of how effective their controls are, there is always the risk of an employee acting inappropriately or fraudulently. Directors are very focused on the culture of the organisation in order to minimise unethical behaviour. They are equally aware of the potential for reputational damage of unethical practices in the company. Directors are extremely conscious that it takes a long time to build the reputation of the organisation and that reputation can be destroyed very quickly if the organisation is found to be acting unethically.

The risk of maintaining the integrity of corporate reporting is taken very seriously by directors. They are focused on having extensive and varied levels of assurance, such as those under the responsibility of the audit committee. Directors are conscious of examples in which companies have failed in these responsibilities, and the significant ramifications, including company collapses and lengthy legal processes. They reflected in interview on the potential for severe ramifications of making mistakes in reporting, both for the company and for the directors.

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[653] Sundaramurthy and Lewis, above n 84, 398.
[654] Eisenhardt, above n 82, 60.
[655] Hopkins, above n 99, 1.

The risk surrounding disclosure is significant for directors. Extensive judgement is required to determine whether to disclose information and, if so, how, in order to meet disclosure requirements which are only ever tested in hindsight. Directors further have the complication of timing, and often need to delegate some of their disclosure responsibilities to ensure that disclosures take place between board meetings as required. This delegation requires substantial trust to be placed in the executives involved, for which strong, open and transparent relationships between the board and executive are a prerequisite. Some NEDs were of the view that the laws on disclosure should be changed because of the inherent difficulties faced in being expected to know everything that must be disclosed without being involved in the day-to-day management of the business.

6.3.2.3 Risk from external factors

Directors also focused on various risks that stem from external factors when they reflected on their governance responsibilities; these external factors were also the prominent issues that kept directors awake at night.

In particular, directors are concerned about potential areas of risk they failed to identify; the ‘thing they don’t know’ (Interview 5), or ‘didn’t plan for’ (Interview 30). Unknowns that they are concerned about include becoming obsolete in the market place or being faced with a catastrophic incident that they have not planned adequately for.

Some boards use scenario planning to attempt to identify these unknowns; however a number of directors are of the view that this has not worked particularly well. The risk of the unknown relates to directors having insufficient foresight, (which directors partially rely on executives for), and inaccurate judgement. Directors need to rely on their judgement and apply rigour in predicting, analysing and understanding possible scenarios and outcomes for their organisation and industry. Directors need to be aware that ‘people naturally filter things … and you (the director) are getting a slightly biased presentation of facts’ (Interview 9). They, therefore, need to consider this in applying their own judgement in determining what are the likely scenarios that could occur and impact the company into the future.

6.3.2.4 Aversion to risk

When reflecting on their various governance responsibilities directors were conscious that 'this risk stuff can kill you' (Interview 8). Here, this director was outlining that, when failing to identify and mitigate a risk, the consequence could cause a company to collapse from the reputational, financial or other damage.

In recent decades much debate has occurred in Australia regarding whether directors' duties lead to directors being risk averse.[656] ASX200 directors with international experience and perspective shared the view that in Australia directors 'are not willing to take a lot of risk, they are not willing to put their reputation on the line' (Interview 36). They further noted the cultural differences in other jurisdictions where there is a greater degree of tolerance when something does go wrong in governing and managing companies. In these jurisdictions, where the markets and stakeholders appeared to be more forgiving, companies were able to enjoy the benefits or upsides of risk taking more frequently.

As explained above, protection does exist for directors in Australia under the Business Judgement Rule, under section 180(2) of the *Corporations Act 2001* (Cth);[657] However, the interviewed ASX200 directors did not mention this protection in their reflections, and, thus, it was not clearly embedded into their thinking when considering risk to themselves or the organisation, or their broader governance responsibilities. The researcher reflected that this could be because there have been few cases in which the business judgement rule has been successful,[658] and the requirements of the business judgement rule when applied to particular business judgements are high.[659]

6.3.2.5 Summary

In summary, risk is at the forefront of the thinking and reflections of ASX200 directors when considering their governance. Agency theory emphasises the need for the board to provide risk oversight management because of the inherent problem of

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[656] Young QC, above n 216, 216.
[657] *Corporations Act 2001* (Cth), s 180(2)
[658] Austin and Ramsay, above n 21, 502.
[659] Ibid 503.

the principal and agent having different attitudes toward risk with the agent possibly preferring different actions because of different risk preferences.[660]

Possible risks arising from internal factors emerged strongly in the analysis of directors' responses, such as in Principle 3 (acting ethically and responsibly), in which directors showed significant concern around the challenge of minimising and monitoring unethical behaviour in the organisation. This risk of unethical behaviour is predicted by agency theory, which recommends that the purpose of the board should be to control the managers,[661] and to curb the behaviours of self-interested managers (agents) that may negatively impact owners' (principals') wealth.[662] Stakeholder theory further proposes that ethical behaviour requires treating stakeholders in a manner deemed acceptable by society.[663]

The risk theme also emerged as central to Principle 4 (Safeguarding the integrity of the corporate reporting), Principle 5 (Making timely and balanced disclosure) and Principle 7 (Recognising and managing risk). Matters of risk were the most common item that kept directors awake at night, particularly risks from external factors. ASX directors are acutely aware of the potential significant consequences that various risks can bring to bear on the company, and to them personally. The existence of the business judgement rule, under section 180(2) of the *Corporations Act 2001* (Cth),[664] providing some protection for directors is not embedded in their thinking. Some directors with international experience and perspective felt that, in Australia, directors were more risk averse than in other jurisdictions where the stakeholders and markets were more forgiving of risk taking.

6.3.3 Remuneration

Analysis of Principle 8 (Remunerate fairly and responsibly) revealed the theme, remuneration (rem). Directors used the term 'rem' to describe the process of setting executive remuneration, including the necessary stakeholder negotiations right up to shareholder approval at the AGM. The remuneration theme illustrates a significant tension and contention around current practices that have emerged following a period of scrutiny and legislative change. As one director noted: 'It's the most

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[660] Eisenhardt, above n 82, 58.
[661] Sundaramurthy and Lewis, above n 84, 398.
[662] Eisenhardt, above n 82, 60.
[663] Hopkins, above n 99, 1.
[664] *Corporations Act 2001* (Cth), s 180(2)

emotive part of any organisation … externally it's the thing that most people are interested in' (Interview 28).

The OECD states that corporate governance involves 'a set of relationships between a company's management, its board, its shareholders and others … (providing) the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance'.[665] This definition recognises the importance of the role of stakeholders in governance, with the remuneration theme reflecting the significant role of stakeholders and the broader role they play in influencing the governance of the company.

6.3.3.1 Context

An inquiry by the PC into executive remuneration was conducted after strong growth between the 1990s to 2007, including instances of large payments despite poor company performance, giving rise to community concerns that executive remuneration was out of control.[666] The idea of accountability to the general community for levels of executive remuneration aligns with both social contract theory, which proposes that society is a series of social contracts between the members in society and society itself,[667] and legitimacy theory, which is based on the assertion that a social contract exists between society and an organisation.[668]

The inquiry resulted in recommendations by the PC,[669] which led to the two-strikes and re-election process in relation to the non-binding shareholder vote on remuneration introduced in the *Corporations Amendment Act*.[670] This legislative amendment aligns with assumptions in stakeholder theory that the role of the board is to represent the interests of client groups (stakeholders) served by the board members,[671] and in doing so it is the board's role to manage the competing interests of stakeholder groups.[672]

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665 OECD (2015), above n 72, 9.
666 Australian Government Productivity Commission, above n 369, XIV.
667 Gray et al, above n 134, 10.
668 Yusoff and Alhaji, above n 135, 58.
669 *Corporations Amendment (Improving Accountability on director and executive remuneration) Bill 2011* (Cth), 3.
670 Ibid.
671 Farrell, above n 94, 94.
672 Evan and Freeman, above n 103, 83.

6.3.3.2 Increase in the power of stakeholders

The board's role in managing rem involves balancing the interests of shareholders with executive employees. Agency theory aligns with this and addresses the inherent conflict arising from individuals with differing preferences undertaking cooperative effort,[673] and describes the board's role in setting remuneration for the executives (agents) while acting on behalf of the shareholders (owners).

Research on the impact of such governance structures and the impact they have on executive remuneration is supported by stakeholder theory. For example, institutional investors have been found to have a significant and negative impact on CEO compensation,[674] and institutional investors significantly enhance the accountability of CEOs.[675]

Stakeholder theory requires attention to be paid to those who can affect or are impacted by an organisation's purpose on the grounds that these actors can enable or prevent the organisation from achieving its purpose.[676] Since the change in legislation and with increased external pressures, directors have experienced and become increasingly concerned about the significantly altered power structures in the rem process in relation to obtaining stakeholder support and approval. Contingency theory also supports the significant role of stakeholders in governance, and proposes that the relative power of the board depends on diverse factors, including the relative power and developing relationships between various coalitions of internal and external stakeholders.[677] Further, the role of the board is influenced by these internal and external contexts which consequently shape governance decisions.[678]

The role of remuneration consultants has risen dramatically in recent years, with directors and boards feeling obliged to use them to provide external validation of their remuneration structures. This is seen as an effective mitigant to the risk of getting a strike; however, many directors were of the view that boards have become beholden to the advice of remuneration consultants. One director was critical of the current role of remuneration consultants: 'They now do statistical sampling … the

[673] Eisenhardt, above n 82, 63.
[674] Ozkan, above n 375, 349.
[675] Mangel and Singh, above n 376, 339.
[676] Freeman, above n 98, 25.
[677] Gabrielsson and Huse, above n 108, 18.
[678] Ibid.

system defeats them, and they agree with me' (Interview 36). Here, he was outlining that boards require external validation in the form of benchmarking to industry medians in order to support their rem proposals when taking them to proxy advisors and the shareholders at the AGM. The complexity of the remuneration report was also of great concern to directors. As one director noted: 'I can't understand rem reports, I don't understand what they are earning, I don't understand the genuine risks they take, the motivations' (Interview 36).

The power of proxy advisors has also risen dramatically in recent years, and a key strategy for boards in avoiding a strike has been to establish relationships with them and engage with them (particularly in the lead up to the AGM) on executive remuneration. Directors were critical of them for forcing boards to design remuneration structures that centre to norms that may not necessarily be suitable for their organisation, industry or individual executives. This has resulted in increased complexity and, at times, unrealistic expectations being placed on boards by the stakeholders when setting appropriate remuneration structures for their executives.

Directors are concerned about the significant amount of time being devoted to rem when managing various stakeholders to minimise the risk of a strike. In particular, the role of the remuneration committee chair has increased significantly because they spend significant time engaging with internal and external stakeholders. This finding is consistent with resource dependency theory, which proposes that, in order to acquire the resources it needs to survive, organisations must interact with others who control those resources.[679] Organisations will seek stability and certainty in their own resource exchanges, as it is in the interests of all participants to stabilise organisational resource exchanges and ensure the organisation's survival.[680]

6.3.3.3 Use of the non-binding vote

Directors reflected that the non-binding vote is the only vote with the power to force directors to stand for re-election and, therefore, it is a powerful mechanism for shareholders. Directors reflected having experienced and observed various AGMs where the non-binding vote has been used by investors to express their

[679] Pfeffer and Salancik, above n 111, 258.
[680] Ibid 261.

dissatisfaction with matters other than remuneration, and they feel stymied by the use of the mechanism in this way.

The consequence of attracting a strike in the non-binding vote was a key risk for directors. As one director noted: ‘You get a strike and then your board gets unstable’ (Interview 36). Here, the director was describing how, after the first strike, the board becomes very unsettled in the 12 months following, fearing a second strike. Once a strike has occurred, significant time needs then to be allocated in the following year up to the AGM in resetting remuneration, including meeting extensively with stakeholders in order to avoid a second strike.

As already discussed above, investors are now displaying an increasing interest in the strategic decisions of the companies they invest in.[681] Further, shareholder activism can be assumed to demonstrate a lack of confidence in company governance mechanisms, including the board that exist to protect shareholders.[682] The use of the non-binding vote as a general protest mechanism is evidence of this increased interest and activism by shareholders in ASX200 companies.

6.3.3.4 Unintended consequences

Directors reflected on some unintended consequences as a result of the rem process (under the current regulations); most significantly the effect that it has had on putting upward pressure on executive remuneration.

As a result of the increased transparency of executive remuneration, directors were concerned that the actual impact has been to place upward pressure on executive remuneration. This effect is counterproductive to the original intention of the legislative change of the non-binding vote. Directors noted that, in their view, there is no indication of this trend abating in the current environment, even in subdued economic times. ASX200 directors were uneasy about excessive remuneration for executives, and the increasing disparity with the average wage in Australia.

6.3.3.5 Summary

In summary, the remuneration theme emerged during analysis of the final principle, Principle 8 (Remunerate fairly and responsibly) as a contentious theme, focusing on

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[681] Ingley, Mueller and Cocks, above n 179, 557.
[682] Ingley et al, above n 182, 45.

the tensions surrounding the process of setting executive remuneration. In recent times, there has been an increase in community concerns that executive remuneration is out of control.[683] The idea of accountability to the general community for levels of executive remuneration supports both social contract theory, which proposes that society is a series of social contracts between the members in society and society itself,[684] and legitimacy theory, which is based on the assertion that a social contract exists between society and an organisation.[685] The two-strikes and re-election process in relation to the non-binding shareholder vote on remuneration was introduced in the *Corporations Amendment Act*.[686] This legislative amendment supports stakeholder theory, which proposes that the role of the board is to represent the interests of the client groups (stakeholders) served by the board members[687] and, in doing so, it is the board's role to manage the competing interests of the stakeholder groups.[688] Agency theory points to the inherent conflict arising from individuals with differing preferences undertaking cooperative effort,[689] and further describes the board's role in setting remuneration for executives (agents) while acting on behalf of shareholders (owners).

Since then, the influence of stakeholders (such as remuneration consultants and proxy advisors) in the rem process has increased dramatically. Directors have become increasingly concerned about the significantly altered power structures in the rem process relating to obtaining stakeholder support and approval. This tension is consistent with contingency theory, which proposes that the relative power of the board depends on diverse factors, including the relative power and developing relationships between various coalitions of internal and external stakeholders.[690] The role of the remuneration committee chair has increased exponentially because they spend significant time engaging with both internal and external stakeholders. This finding was supported by resource dependency theory, which proposes that, in order to acquire the resources it needs to survive, organisations must interact with others

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683 Australian Government Productivity Commission, above n 369, XIV.
684 Gray et al, above n 134, 10.
685 Yusoff and Alhaji, above n 135, 58.
686 *Corporations Amendment (Improving Accountability on director and executive remuneration) Bill 2011* (Cth).
687 Farrell, above n 94, 94.
688 Evan and Freeman, above n 103, 83.
689 Eisenhardt, above n 82, 63.
690 Gabrielsson and Huse, above n 108, 18.

who control those resources,[691] and organisations will seek stability and certainty in their own resource exchanges because it is in the interests of all participants to stabilise organisational resource exchanges and ensure the organisation's survival.[692]

ASX200 directors are concerned that the influence of these groups has counterproductively caused upward pressure on remuneration, and that the pressure to centre to norms has taken away some of their judgement in setting appropriate structures that attract, motivate and retain their critical executive staff.

6.4 The intersection

The three themes: relationship, risk and remuneration, intersect with each other and are, thus interdependent, as depicted in Figure 6.1.

From these elite directors' responses, it became clear that effective risk management relies on the existence of strong board and executive relationships that are built on trust and openness. Effective rem management requires appropriate relationships with key stakeholders, both internal and external (such as remuneration consultants and proxy advisors). The failure of critical board and executive relationships significantly increases certain risks to the company and can impact judgement at the board level. The existing literature also highlights that interpersonal relationship failure is one of the four categories of governance failure within companies (the others being strategic failure, control failure and ethical failure), and results from boardroom battles between the board and executives.[693] Further, the directors interviewed identified that failing to build effective relationships throughout the rem process with stakeholders and shareholders can increase the risk of obtaining a strike in the non-binding vote on remuneration, which can be very unsettling for the board.

Through the analyses of the three themes of relationships, risk and remuneration, four common elements emerged: trust, values, judgement and rigour. During the analysis, it was found that these four elements (trust, values, judgement and rigour) were frequently described by a number of interviewees when describing the three prominent themes of relationships, risk and remuneration. These four elements have

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[691] Pfeffer and Salancik, above n 111, 258.
[692] Ibid, 261.
[693] Kiel and Nicholson, above n 195, 614.

been termed boardroom basics and are depicted at the intersection in figure 6.1. They will now be examined.

6.4.1 Trust

Trust is fundamental to the relationships theme. It is critical for the board and executive to be able to trust one another in order for to carry out their respective roles. In situations where the board does not trust the executive, the ability of ASX200 directors to carry out their governance responsibilities is severely impacted. This, in turn, increases various risks to the company (and directors) because it can impair the ability to make decisions appropriately and effectively. Directors need to be able to trust the executives to present information in a way that enables them to adequately foresee, mitigate and manage risks to the company. Trust and cooperation between board members is also critical, and chairs and boards are careful to preserve this. Trust is an essential component of effective board dynamics and allows directors to voice opposing views and have rigorous debate in a respectful manner.

Trust is critical in rem, and board chairs and remuneration committee chairs spend considerable time building trust with both internal and external stakeholders in order to navigate the contentious rem process. Further, the board seeks to hold the trust and confidence of shareholders and the market through appropriate disclosures and conduct; a critical aspect attracting further investment, the absence of which can be very detrimental to the share price.

6.4.2 Values

Values emerged as a key driver behind the decisions of directors, and across the three R’s of relationships, risk and remuneration. ASX200 directors exercised caution in the appointment process for new directors, ensuring that candidates had the right personal values that would enable them to fit in with the board team and culture. Having the right values enables trust and the development of important relationships with board members and executives. While the analysis revealed some alternative views about the dangers of groupthink, most interviewees prioritised the importance of cohesion. Values also presented as a prominent driver in the thinking of some directors when discussing the AGM and how to respectfully treat their shareholders.

Values and culture are the drivers behind ethical behaviour across the organisation, which, if breached, can pose significant reputational risk. Directors see their role as setting the ethical culture of the organisation through the example of their own values and behaviours and 'calling people on it' (Interview 33). Values also drive other matters of risk, including disclosure and corporate reporting, and risk management frameworks and practices.

When reflecting on executive remuneration, some directors were concerned about the disparity of executive pay and the average wage, which did not meet their personal values. Further, they were uncomfortable with outside influences on the rem process, which, at times, impacted their ability to provide fair and appropriate remuneration structures and levels.

6.4.3 Judgement

Boards are faced with significant judgement issues. Having a diverse board of people with the right skills and good working relationships is important for the board to appropriately exercise its judgement when making decisions. ASX200 directors reflect on board diversity in terms of having a diversity of views, knowledge and understanding to enable the board to exercise rigour when making complex decisions requiring significant judgement.

Judgement and rigour are applied when identifying and assessing risk to the organisation; board directors rely on these attributes when reflecting on possible scenarios that may present threats or opportunities for their organisations. Minimising group think through diversity of thought was reported by most to aid this decision-making process and leads to better judgement decisions by the board. Judgement impacts all matters of risk, such as ethical issues, disclosure matters and corporate reporting, and drives well-founded, appropriate governance and decision making.

Rem is heavily reliant on the judgement of directors to set appropriate structures to incentivise and retain executives, as well as manage the expectations of key stakeholders during the consultation process, and, finally, to manage the AGM process in trying to avoid a strike in the non-binding vote.

6.4.4 Rigour

Rigour was used by all directors when exercising their governance responsibilities and making decisions. Directors used rigour in key processes relating to relationships, such as designing the skills matrix, recruitment processes, considerations around diversity and when establishing the roles and responsibilities of the board and management across various matters. From the directors' responses, it emerged that when relationships are strong, trust is present and the culture is right, rigour can be exercised by board members through uncompromising questions; under such conditions, directors feel they have the freedom to challenge views and to foster robust debate.

Matters of risk are front of mind for ASX200 directors. Rigour is exercised when challenging and assessing risk appetites and key risks on the risk register, as well as when using their judgement to determine if all key risks have been identified and addressed. Rigour is applied throughout the rem process when setting appropriate structures and when working with stakeholders in order to come to an acceptable outcome while avoiding selectively disclosing information to major shareholders.

As discussed, the ASX200 governance model developed from the analysis of interview data shows that the 3 R themes intersect and, at the intersection, four common elements are present: trust, values, judgement and rigour (termed boardroom basics). While the emergence of these ideals could be expected from the interviewees as a sense of self representation, their common emergence suggests that ASX200 directors believe these attributes represent how they believe they should behave as officeholders in their positions. After all, as identified in the literature, in the interview environment, the interviewer and interviewee work to construct themselves as certain types of people in relation to the topic and reflexively the interview itself.[694]

6.5 Normalised practice

The emergence of 'normalised practice' was evident in the analysis. As stated, there were a number of not spots in the principles and recommendations that ASX200 directors chose not to spend their time focusing on. The responses to these questions

[694] Rapley, above n 40, 303.

were dismissive, and their tone would often change when discussing these recommendations. These areas are reflected as normalised practice in Figure 6.1, and at the margin of the three R model as they were considered obvious, basic or given.

6.6 Agency theory in practice

Agency theory states that the purpose of the board is to control the managers[695] and, specifically, to curb the behaviours of self-serving managers (agents) who may negatively impact owners' (principals') wealth.[696] Agency theory sits at the core of the risk theme identified in the analysis, as the role of the board is to monitor and control the agents (executives) in ensuring that they act in the best interests of the shareholders (owners). In performing its role, the board works to reduce the risk of unethical behaviours by executives and managers and further play a major role in minimising the likelihood of other types of risk to the organisation. ASX200 directors confirmed this as being a major part of their role when they reflected that risk is at the forefront of their mind; they worried about potential risks they had not planned for and risk was the matter that kept them awake at night.

Agency theory addresses the inherent conflict arising from individuals with differing preferences undertaking cooperative effort.[697] This conflict underlies the rem theme, in which the board, acting on behalf of owners, plays a significant role in setting the remuneration of the executives (agents). The board's role in rem is to manage the competing interests of the owners, managers and other stakeholders involved, in an environment in which power bases have significantly changed over recent times.

Despite the risk and remuneration themes demonstrating strong alignment to agency theory, the relationships theme was not as strongly aligned to this ideology. Agency theory outlines that the purpose of the board is to control the managers,[698] to curb the behaviours of self-serving managers (agents) that may negatively impact owners (principals) wealth.[699] The relationships theme demonstrates, however, that, in practice, ASX200 boards are mostly made up of NED, and they, therefore, must rely on the executives for resources and information in order to perform their directing

[695] Sundaramurthy and Lewis, above n 84, 398.
[696] Eisenhardt, above n 82, 60.
[697] Ibid 63.
[698] Sundaramurthy and Lewis, above n 84, 398.
[699] Eisenhardt, above n 82, 60.

and governing role and thus protect the interests of the owners (shareholders). Without trusting relationships with key executives, such as the CEO, CFO and company secretary, information would be harder to obtain and the directors' ability to perform their governance role would be curbed.

Despite this, the findings on the founder factor and the independence of directors strongly supported agency theory.

6.7 Stakeholder theory in practice

Stakeholder theory strongly supports the remuneration theme, proposing that the role of the board is to represent the interests of the client groups (stakeholders) served by the board members[700] and, in doing so, it is the board's role to manage the competing interests of the stakeholder groups.[701] The remuneration theme described the complex role of the board in balancing the interests of shareholders with executive employees and various other stakeholders in the rem process. The introduction of the two-strikes and re-election process in relation to the non-binding shareholder vote on remuneration introduced into the *Corporations Amendment Act*[702] further followed the ideology of stakeholder theory and gave shareholders a formal vote in the rem process, further formalising the need for the board to manage competing interests of the managers and owners of the company.

Stakeholder theory requires attention to be paid to those who can affect, or are impacted by, an organisation's purpose, on the grounds that these actors can enable or prevent the organisation from achieving its purpose.[703] This theory supports both the remuneration and relationships themes, as it emphasises the significance of boards in establishing effective relationships with key stakeholders outside the company.

Elements of stakeholder theory are also found in the risk theme because it states that ethical behaviour requires treating stakeholders in a manner deemed acceptable by society.[704] This highlights the risk to the organisation of unethical behaviour by

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[700] Farrell, above n 94, 94.
[701] Evan and Freeman, above n 103, 83.
[702] *Corporations Amendment (Improving Accountability on director and executive remuneration) Bill 2011* (Cth).
[703] Freeman, above n 98, 25.
[704] Hopkins, above n 99, 1.

managers, and stresses that a company's duty to act ethically is not only owed to the shareholders but also to stakeholders more broadly.

6.8 Contingency theory in practice

Contingency theory strongly supports the remuneration theme, pointing out that the relative power of the board depends on various factors including the relative power of the various coalitions of internal and external stakeholders, and the relationships the board has with those stakeholders.[705] The remuneration theme was found to be vexed, with directors becoming increasingly concerned about the significantly altered power structures in the rem process in relation to obtaining stakeholder support and approval. The power of the board in relation to executive remuneration setting had altered since the legislative change which increased the relative power of external stakeholders and shareholders.

This significance of relationships between various coalitions of internal and external stakeholders in determining the power of the board[706] also strongly supports the relationships theme. Contingency theory further proposes that the role of the board varies depending on the internal and external contexts, and these contexts consequently shape decisions surrounding corporate governance.[707] The relationships theme underpinned the role delineations between the board and executives, and highlighted that the role delineation is contextual and depends on various factors such as the matters being addressed and the capability of management.

6.9 Resource dependency theory in practice

Boards of directors need to create and maintain respectful and appropriate relationships with management and external stakeholders. The finding concerning the importance of relationships is as predicted by resource dependency theory, which states that organisations need resources to survive and, to acquire these resources, they must interact with those who control those resources.[708] Boards are aware they need to develop strong relationships with each other and key members of the executive team in order to facilitate trust, openness and transparency. Boards rely on

[705] Gabrielsson and Huse, above n 108, 18.
[706] Ibid.
[707] Ibid18.
[708] Pfeffer and Salancik, above n 111, 258.

relationships with executives that facilitate the provision of information and resources in order to perform their governance and monitoring role. Likewise, executives rely on board members to provide the resources and approvals they need to perform their roles effectively. Boards also spend considerable time considering the skills and attributes required by the board into the future. This guides the skills matrix and appointment processes, and the observations support the assumptions of resource dependency theory, which highlights the importance of the resources that directors bring to the board when carrying out their collective governance responsibilities.

The remuneration theme is also supported by the propositions of resource dependency theory. Directors were concerned about the significant amount of time being devoted to rem in managing the various stakeholders and minimising the risk of a strike. Resource dependency theory confirms this likelihood, proposing that, given organisations do not control the resources they need, resource acquisition can be problematic and uncertain.[709] The theory further proposes that organisations seek stability and certainty in their own resource exchanges, as it is in the interests of all participants to stabilise organisational resource exchanges and ensure the organisation's survival,[710] this is evident in the significant effort now being undertaken by boards to liaise with rem consultants, proxy advisors and major shareholders in the lead up to the non-binding vote at the AGM.

6.10 Stewardship theory in practice

Stewardship theory underpins the finding of the relationships theme. The relationships found that ASX200 boards act as a team to meet their collective responsibilities, and the team's effectiveness is dependent on the presence of strong relationships that facilitate dependency, reciprocity and trust. Stewardship assumes that long-term contractual relationships are developed based on trust, reputation, collective goals and involvement where alignment is an outcome from relational reciprocity.[711]

[709] Ibid.
[710] Ibid 261.
[711] Van Slyke, above n 126, 164.

Stewardship theory emphasises trust and close social ties between managers and board members.[712] From the directors' responses, it was clear that the importance of the relationships between the board and executive on ASX200 boards was critical in order for the board to fulfil its monitoring and governance role, and the executive to effectively manage the business. Boards and executives must have strong relationships that enable them to share openness, honesty and trust.

6.11 Social contract and legitimacy theories in practice

Both social contract and legitimacy theories extend the obligations of the organisation to the whole of society, rather than just to the shareholders or stakeholders. Social contract theory proposes that society is a series of social contracts between the members in society and society itself,[713] and legitimacy theory is based on the assertion that a social contract exists between society and an organisation.[714]

The remuneration theme highlights the accountability of the organisation to the general community for levels of executive remuneration, supporting social contract theory and legitimacy theory. The inquiry into executive remuneration was conducted after community concerns over the strong growth in executive remuneration between the 1990s to 2007,[715] and led to the legislative change which introduced the non-binding vote on remuneration. Directors were found to share community concerns over executive remuneration levels and are concerned that the current rem process is producing the unintended consequence of ratcheting up executive remuneration.

The relationships theme found that a key enabler of good governance and board effectiveness is the presence of strong relationships with key internal and external parties. This finding supports social contract theory and legitimacy theory, which

[712] Farrell, above n 94, 94.
[713] Gray et al, above n 134, 10.
[714] Yusoff and Alhaji, above n 135, 58.
[715] Australian Government Productivity Commission, above n 369, XIV.

assume that companies have obligations that exist through social contracts[716] between the members in society (including organisations) and society itself.[717]

6.12 Conclusion

One criticism of good governance codes has been that placing significant emphasis on compliance with these codes can lead to box ticking through the use of uninformative statements about compliance.[718] Despite the criticism that the codes' voluntary nature limits their ability to improve governance practices, research suggests that codes of good governance appear to have generally improved the governance of companies in countries that have adopted them.[719] Contingency theory suggests that not all situations will be best served by the same model of governance, and that good governance in one situation might look quite different in another context.[720] This was found in the study, with directors outlining that they felt the comply or explain model worked well, and that what was appropriate for one ASX200 company may not be appropriate for another. They expressed this in the frequency by which they used the expression 'horses for courses' in their reflections and responses.

The principles were found to largely be embedded in the governance practices of ASX200 companies. Some of the areas highlighted in the recommendations were so embedded that they were normalised (the not spots). The other hot spot areas of the ASXCGC principles and recommendations were found to vary in the extent of agreed approaches (or accepted practice). Across the hot spot principles and recommendations, governance practices of the ASX200 companies align to one of three R themes: relationships, risk and remuneration. These three R themes emerged from the ASX200 director responses when analysing response data using the grounded theory approach; the themes represent how directors reflect on their practice of governance under the *ASXCGC Principles and Recommendations*.

Relationships between key roles in the company were found to be critical in the successful governing of the company. These roles included the board directors and

[716] Yusoff and Alhaji, above n 135, 58.
[717] Gray et al, above n 134, 10.
[718] Keay, above n 163, 289.
[719] Aguilera and Cuervo-Cazurra (2009), above n 16, 1.
[720] Bennington, above n 107, 317.

chair, CEO, CFO, company secretary and other key executives. Relationships with outside stakeholders were also viewed as critical for enabling the effective governance of ASX200 companies. Emerging from the directors' responses, the relationships theme was consistent with various corporate governance theories, including contingency, stewardship, stakeholder, social contract, legitimacy and resource dependency theories.

Risk was found to be front of mind for directors. Matters of risk were what kept directors awake at night, and directors are particularly concerned about the risks they have not identified, mitigated or planned for. Risks to key relationships and other risks inherent in their industries were also prominent in their thinking and reflections. The risk theme was strongly supported by agency theory, as well as stakeholder theory.

Remuneration (or 'rem') was the third theme to emerge from the analysis. The remuneration theme found significant tension in the way that remuneration for executives is set, with various stakeholders playing an increasingly significant role in the process. The concern of ASX200 directors was that the current process was overly complex, difficult and producing unintended consequences. The complexity of the remuneration theme was supported by various corporate governance theories including social contract, legitimacy, stakeholder, agency, contingency and resource dependency theories.

The ASX200 governance model developed from the analysis illustrated that the three R themes intersect and, at the intersection, four common elements were present: trust, values, judgement and rigour (termed boardroom basics). The common emergence of such ideals suggests that ASX200 directors believe these attributes represent at least how they believe they should behave as officeholders in their positions, and such ideals could be expected in their reflections and self-representation. The researcher was conscious that in the interview environment the interviewer and interviewee work to construct themselves as certain types of people in relation to the topic and in the interview itself.[721]

[721] Rapley, above n 40, 303.

The role of the modern director is complex, it is no longer ‘a retirement or part time job’.[722] The ASXCGC principles and recommendations are fairly prescriptive in their nature, the current (3rd) edition contains eight principles and 29 supporting recommendations. The model in Figure 6.1 depicts where ASX200 directors place their focus when governing, and the attributes they see as necessary in the effective governance of the ASX200 companies.

[722] Evans and Durkin, above n 612.

CHAPTER 7: Conclusions, considerations for regulators and opportunities for further research

7.1 Introduction

The aim of this research was to understand 'How are ASX200 directors reflecting on their practising of the ASXCGC principles and recommendations?' In order to answer the question, it was critical to understand the directors who sit on them.[723]

It was determined that the use of qualitative research methods for this study would be the most appropriate strategy to understand how ASX200 directors reflect on the governance practices of ASX200 companies. The adoption of a qualitative research methodology allowed for the use of grounded theory, in which no up-front theory is proposed and no hypotheses are formulated for testing ahead of the research.[724] A snowball sampling approach and the use of insider status was adopted to access this elite population, enabling access to otherwise inaccessible data. The use of open-ended questions in interviews that asked about each principle was determined to be the most effective approach for understanding how directors reflect on their governance responsibilities under the eight ASXCGC principles (and associated recommendations).

Through analyses of the interview data, it emerged that certain principles and recommendations attracted more reflection and attention that others, which in turn caused the researcher to make adjustments to the research interviews, following the grounded theory approach. These areas were labelled as the hot spots, contrasting with the areas that the directors chose not to focus on, being the not spots. The hot spots were analysed in detail and showed variation in the degree of consistency in practices across the principles and recommendations. Some recommendations showed consistency in the form of clear accepted practices, whereas others found varied practices in meeting the requirements of the recommendation. From the directors' responses three key themes emerged: relationships, risk and remuneration. Each of the principles were predominantly aligned to one of these R themes. At the

[723] Adams, above n 20.
[724] Glaser and Strauss, above n 27, 6.

intersection of relationships, risk and remuneration, four key attributes emerged: trust, judgement, values and rigour. These three key themes and four key attributes that appeared at the intersections were captured in the ASX200 director governance model developed from this analysis.

In this chapter, the origin of the research question and research method are revisited and a summary of the ASX200 director governance model is presented. This model of ASX Director Governance Model provides a valuable addition to the existing governance theory in Australia by presenting an understanding of how ASX200 directors practice their governance responsibilities under the ASXCGC *Principles and Recommendations,* which has not been understood prior to this research being conducted.

The limitations of both the model and the study itself are examined, and the practical potential, implications for governance practice and considerations for regulators are outlined. Finally, the implications of the Royal Commission into the financial services industry (which was underway at the time of writing this thesis) is discussed and opportunities for further research are identified.

7.2 The research question and why it was asked

The research question for this study was: 'How are ASX200 directors reflecting on their practising of the ASXCGC principles and recommendations?'

The effective practice of corporate governance of ASX200 companies is critical to the reputation and conduct of wealth and prosperity in the Australian economy. Since the original introduction of the ASXCGC principles and recommendations in 2003, there has been no research conducted to understand how ASX200 directors reflect on their governance practices in line with this non-mandatory 'if not, why not' good governance code.

This study provides valuable insight for governance practitioners, regulators and other interested parties into the reflections of those responsible for governing some of Australia's largest companies. As boards are the focus of considerable policy-making, there is scope for board literature such as this to have policy impact.[725] Such

[725] Adams, above n 20, 1.

insights are also invaluable for non-listed companies given that there is some guideline creep into non-listed companies who elect to use the ASXCGC principles and recommendations as best practice guidelines in their governance models.[726]

7.3 The research method and why it was adopted

The adoption of an interpretive approach was determined to be appropriate for this study because interpretation embodies the idea that reality is socially constructed rather than objectively determined.[727] Interpretivism supports a qualitative approach, which attempts to make sense of or interpret phenomena in terms of the meanings people bring to them.[728] Given that qualitative research is known to enable the researcher to get closer to an individual's perspective (through methods such as interviewing),[729] it was determined that using qualitative research methods for this study would be the most appropriate strategy to determine how ASX200 directors reflect on the governance practices of ASX200 companies. Adopting a qualitative research methodology allowed for the use of grounded theory, where no up-front theory is proposed and no hypotheses are formulated for testing ahead of the research.[730]

A snowball sampling approach and the use of insider status was adopted to access the elite population of ASX200 directors and otherwise inaccessible data. Snowball or chain sampling is a design strategy that can be employed in purposeful sampling and involves starting with one or a few relevant and information-rich interviewees and then asking for additional relevant contacts.[731] The use of open-ended interviews focused on each principle was determined to be the most effective approach to obtaining information on how directors reflect on their governance responsibilities under the eight ASXCGC principles (and associated recommendations).

7.4 Summary of the model

As discussed, in the analysis of the responses of directors in interviews, three key themes emerged: relationships, risk and remuneration. The relationship theme

[726] Laverty, above n 31, 6.
[727] Easterby-Smith, Thorpe and Lowe, above n 24, 24.
[728] Denzin and Lincoln (2011), above n 25, 3.
[729] Denzin and Lincoln (2005), above n 26, 10.
[730] Glaser and Strauss, above n 27, 6.
[731] Patton, above n 28, 270.

emerged strongly in Principle 1 (laying solid foundations for management and oversight), Principle 2 (structuring the board to add value), and Principle 6 (respecting the rights of security holders). The risk theme emerged strongly in Principle 3 (acting ethically and responsibly), Principle 4 (safeguarding the integrity of the corporate reporting), Principle 5 (making timely and balanced disclosure) and Principle 7 (recognising and managing risk). Finally, the remuneration theme emerged strongly in the last principle, Principle 8 (remunerate fairly and responsibly).

The relationships theme highlighted that effective relationships between key individuals (both internal and external) are imperative for enabling ASX200 directors and the board to perform their roles effectively. Risk was found to be at the forefront of thinking and reflections of ASX200 directors in governing their companies, and can come from both internal and external sources. The contentious remuneration theme emerged during an analysis of the final principle, and focused on the tensions surrounding the process of setting executive remuneration and the influence of external stakeholders.

At the intersection of relationships, risk and remuneration, four key attributes emerged: trust, judgement, values and rigour. These attributes were found to be prominent in each of the three R themes, as reflected on by ASX200 directors.

This model of ASX200 Director Governance provides a valuable addition to the existing governance theory in Australia by presenting an understanding of how ASX200 directors practice their governance responsibilities under the ASXCGC *Principles and Recommendations,* which has not been understood prior to this research being conducted.

7.4.1 Practical potential

This study provides valuable insight for listed company directors, governance practitioners and other interested parties into the reflections of those responsible for governing some of Australia's largest companies. The analysis of directors' responses showed little difference across GICS sectors and GICS industry groups, and the model is therefore relevant for use by listed companies across all sectors. Such insights are also valuable for non-listed companies given that there is known guideline creep into non-listed companies who use the ASXCGC principles and recommendations as best practice guidelines in their governance models.[732]

The research was also very timely, because the interviews were conducted prior to the announcement of the Royal Commission into the financial services industry in Australia, established in December 2017, and were, therefore, not influenced by it. The Royal Commission was established to inquire into whether any conduct of the financial services entities amounted to misconduct, whether any conduct fell below community standards and expectations and whether the use of superannuation did not meet community standards or expectations or was not in the interest of the members.[733] In assessing these findings, the Royal Commission was also to inquire as to whether misconduct is attributable to the culture and governance practices of a financial entity, the industry or sub-sector, or other practices, including risk management, recruitment and remuneration practices of the financial entity, the industry or sub-sector.[734] While the Royal Commission was still being conducted at the time of this study's completion, the governance practices of entities in the financial sector are in the scope of the Royal Commission, and irrespective of the nature the final report, the findings of this study are timely and relevant.

7.4.2 Limitations

The model was developed from the analysis of data collected from a sample of current directors from ASX200 companies. The ASX200 companies are some of the largest companies in Australia, as measured by market capitalisation and other factors.

Despite the model being appropriate for use across listed companies in all sectors given that the responses were consistent across all GICS sectors and GICS industry groups, it was recognised that ASX200 companies are larger and may, therefore, have better access to internal and external resources to assist in their governance. They may, for example, have more employees within the company and, therefore, may be able to better resource the provision of services to the board to assist in their governance; this may also change the nature of relationships with internal

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[732] Laverty, above n 31, 6.
[733] Elizabeth the Second Queen of Australia and Head of the Commonwealth, above n 32, 2.
[734] Ibid 2.

executives. Smaller listed companies may not have these attributes and, thus, the model may not be directly applicable.

Another limitation of the model is that it is relevant at the point in time that the study was undertaken. Therefore, the findings on remuneration, for example, are applicable in the current environment under the current regulatory provisions and market sentiment. Over time, this part of the model may become less relevant to practitioners if these conditions change. The same applies to the risk finding, which is clearly influenced by the current regulatory environment, economic climate and history which gave rise to these regulations. Again, the relevance of the risk finding may change in future as the regulatory and external environment changes.

7.5 Limitations of the study

As explained, one risk of the snowball sampling method is that the way the sample is chosen by target people makes it liable to various forms of bias.[735] The researcher was not aware of how many or which ASX200 directors were 'non-respondents', being those directors who were contacted by their colleagues to be interviewed but declined and, therefore, this degree of this error is unknown. Despite this, due to this research being qualitative, grounded research,[736] using elite interviews,[737] the degree of non-response error was deemed to be relatively insignificant. Further, the analysis of the responses showed relative homogeneity of the group interviewed, further decreasing the risk of non-response error.

The relative homogeneity across the group of interviewees in their responses further reduced concern over the differing proportion of women in the sample when compared to the overall ASX200 population (48.8% of the sample were female whereas only 17.7% of the population were female, although females held 21.2% of the total ASX200 director roles). As mentioned, the researcher reflexively viewed this as being at least partially due by the fact that the researcher was a female.

In the interview environment, the interviewer and interviewee work to construct themselves as certain types of people in relation to the topic and reflexively the

[735] Patton, above n 28, 298.
[736] Leblanc and Schwartz, above n 30, 849.
[737] Goldstein, above n 34, 672.

interview itself.[738] A reflexive writing strategy was adopted where the researcher examined how their presence and stance in the interviews functioned in relation to the subject itself.[739] Despite the relative homogeneity of the group, the researcher was conscious of possible differences between men and women ASX200 directors in terms of their situation, experiences and discrimination,[740] and the need to take this into account during the analysis and writing. Further, being a female researcher in what is typically a male dominated environment (ASX200 boards), the researcher was careful to be particularly conscious of this during the interviews and the effects it may have had on certain responses.

7.6 Considerations for regulators

Given that the areas of normalised practice are so ingrained in the governance practices of ASX200 directors, the ASXCGC could consider reducing the emphasis on these recommendations during its deliberations on future editions. These 'normalised practice' areas of the ASXCGC principles and recommendations in the ASX200 director governance model represented the recommendations that the directors chose not to focus on, and included various board committees and policies. Because these are normalised, accepted and even considered obvious by ASX200 directors, it is clear that their presence in the 3rd edition is of limited value in their current detailed form.

As discussed, the ASXCGC principles and recommendations and other listed company regulations are producing some unintended consequences as perceived by ASX200 directors, which warrant consideration.

The remuneration finding outlined the difficulties for ASX200 directors in achieving appropriate remuneration and reward structures that attract, motivate and retain executives upon whom they rely. Most significantly, directors are very concerned that the actual effect of the rem process within the current regulatory environment has been to put upward pressure on executive remuneration, which is contrary to the intention of the non-binding vote on remuneration as stated at the time of its introduction. Directors were concerned that the transparency of executive

[738] Rapley, above n 40, 303.
[739] Denzin and Lincoln (2011), above n 25, 662.
[740] Alvesson and Skoldberg, above n 43, 211.

remuneration and benchmarking in remuneration reports was contributing to this upward pressure, and that the gap between the average wage and executive remuneration was widening. Further, directors expressed concern over the non-binding vote on the remuneration report, which, in some instances, was being used as a general protest against other non-remuneration matters. Given the significance of the remuneration finding as a critical and unexpected element in the ASX200 director governance model, regulators should direct attention to the nature of the interactions in the complex remuneration process and determine whether regulatory change would improve remuneration outcomes.

It would also appear appropriate and timely to review the structure and nature of the AGM. Directors questioned the effectiveness of the current AGM structure in the modern world with increasingly large shareholders and increasingly powerful proxy advisors, together with advances in technology. Directors expressed the desire to modernise the AGM into a more appropriate forum that utilises modern technology and provides owners with an appropriate avenue to hold the board and executives to account. ASX200 directors view the rights of the shareholders to have a forum or avenue to hold the company to account as critical, but believe the traditional AGM requires change to improve its relevance in today's society.

The relationship theme highlighted the importance of being able to function collectively and work together as a board. This has an impact on the recruitment processes (with some boards preferring to appoint from their existing networks) and, potentially, board diversity. This is further influenced by the difficulty of performance managing directors individually. Regulators and interested organisations should be aware of these complex dynamics and the interrelationships between recruitment, performance management and diversity, particularly in their push to achieve more diversity on listed boards into the future.

7.7 Implications for governance practice

The ASX200 director governance model offers insight and understanding for directors and governance practitioners into how ASX200 directors reflect on their practising of their governance responsibilities. It highlights the key themes and their interrelationships and intersections, and also highlights areas for consideration by regulators and other interested parties.

The findings from the analysis of responses enabled the separation out of normalised practice and then a focus on those recommendations that exhibited forms of accepted practice and those that did not. The analysis further shows that while there are a number of prescriptive requirements placed on listed company directors, (the *ASXCGC Principles and Recommendations* have eight principles and 29 supporting recommendations), ASX200 directors' attention is directed by the three Rs: relationships, risk and remuneration. This information is anticipated to be useful to directors and boards in their governance considerations, both in listed companies and other organisations because of known instances of guideline creep into non-listed companies who choose to adopt the ASXCGC principles and recommendations.[741]

Given the lack of evidence in this space because of the inherent difficulties in interviewing ASX200 directors directly, this research is unique and will inform practitioners and regulators alike. This thesis has added new understanding to an otherwise sparse field of research. It is hoped that the collective understanding this analysis provides will assist the members of the ASXCGC in their deliberations of the next edition of the principles and recommendations. Further, it will provide the ASX200 population with a collective view and understanding, which they can use in presenting their concerns and views to the ASXCGC and other regulators, in terms of the prioritisation given to the different dimensions of their roles.

7.8 The Royal Commission

As mentioned, the interviews for this research were completed nine months before the establishment of the Royal Commission and were, therefore, not influenced by it. Had the research been conducted later (during the Royal Commission), the researcher potentially would have found it significantly more difficult to secure a sufficient sample size in this already hard to access elite group.

The Royal Commission was established in December 2017 to inquire into whether any conduct of financial services entities amounted to misconduct, whether any conduct fell below community standards and expectations and whether the use of superannuation did not meet community standards or expectations or was not in the interest of those members.[742] In assessing these findings, the Royal Commission was

[741] Laverty, above n 31, 6.
[742] Elizabeth the Second Queen of Australia and Head of the Commonwealth, above n 32, 2.

also to inquire into whether the conduct is attributable to the culture and governance practices of a financial entity, the industry or sub-sector, or other practices, including risk management, recruitment and remuneration practices of the financial entity, the industry or sub-sector.[743]

At the time of writing the thesis, the Royal Commission was still underway, and, therefore, the final report had not been published releasing the findings. Despite this, at that time, the media were reporting on various aspects of the Royal Commission hearings including governance issues in companies within the financial sector.

Board diversity was topical in some opinion pieces on the Royal Commission, with writers asserting that some ASX200 directors were concerned that board members are being drawn from too narrow a pool, and that there was a lack of direct industry experience on boards.[744] Other media articles quoted some directors who were critical of the push to increase diversity on boards, questioning whether diversity was in fact good for business.[745] Some directors were quoted sharing their concerns regarding directors who focused more time on building their profile and networks rather than on their current board responsibilities.[746] Certainly, some similar findings were outlined in the analysis within this research, with a tendency of some boards to prefer selecting new directors from existing networks to minimise the risk of appointing a director who they may not be able to work with, and the importance of effective relationships between board members.

Further, writers had interviewed some ASX200 directors who asserted that some of their board colleagues lacked the required dedication for the role,[747] outlining the increasingly complex role of a board director, stating it is ‘no longer a retirement or part time job’.[748] This research found that some of the interviewees had also

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[743] Ibid 2.
[744] Simon Evans et al, ‘Too Many Lawyers, Accountants “surfing” boards’, *Financial Review* (Online), 18 May 2018 <https://www.afr.com/business/banking-and-finance/financial-services/too-many-lawyers-accountants-surfing-boards-20180518-h108ep>.
[745] Evans and Durkin, above n 612.
[746] Karen Maley, ‘Catherine Brenner's Formula for Climbing the Corporate Ladder’, *Financial Review* (Online), 1 May 2018 <https://www.afr.com/business/banking-and-finance/catherine-brenners-formula-for-climbing-the-corporate-ladder-20180429-h0zf3p>.
[747] Evans et al, above n 744.
[748] Evans and Durkin, above n 612.

complained about ‘part time’ directors who lacked sufficient dedication, instead fitting their board activities around their recreational and other business interests.

Other writers have focused on some of the ethical behaviours of financial institutions, with some quoting ethicists who have accused these companies of avoiding asking hard questions about ethical behaviour because of a reluctance to resolve problems they might find.[749] This was contrary to the findings in this research regarding ethical behaviours, which highlighted the significant concerns directors had with monitoring closely and uncovering rapidly unethical behaviours and inappropriate cultures within their companies.

As discussed, this research was conducted at an opportune time, being just before the announcement of the Royal Commission, which has part of its scope examining the governance of financial institutions. While the final report from the Royal Commission is not yet available at the time of writing, recent media is demonstrating the timeliness and relevance of some findings of this research.

7.9 Opportunities for further research

As noted, the Royal Commission is currently in process at the time of writing this thesis and will cover the governance practices of financial institutions, some of which are ASX200 companies. Some of the media covering matters from the Royal Commission hearings at the time of writing this thesis have revealed themes that are both consistent and inconsistent, with the reflections of the ASX200 directors on their practising of governance under the ASXCGC principles and recommendations. This unique research, which has interviewed this difficult-to-access group (ASX200 directors) just before the Royal Commission, together with the eventual findings of the Royal Commission presents significant opportunities for further research. The reflections of ASX200 directors and resultant findings in this research were not impaired by the knowledge that the Royal Commission would be conducted shortly after the interviews were conducted. Such reflections and findings may also provide insight into the findings of the Royal Commission when it is handed down.

[749] Edmund Tadros, 'Banking Royal Commission: Where the Banks have Gone Wrong', *Financial Review* (Online), 8 May 2018 <https://www.afr.com/business/accounting/companies-avoid-asking-staff-about-ethics-20180426-h0z9cf>.

As outlined, ASX200 companies are more likely to have better access to internal resources to assist with governing (for example they may have a larger number of employees than smaller listed companies). The study found that ASX200 directors focused on three key themes (relationships, risk and remuneration), and that outside of these themes, normalised areas of the principles and recommendations existed. This model was not tested on other listed company (ASX200+) directors, however, an understanding of whether there are differences in the governance of smaller listed companies would be useful to understand and better inform directors and governance practitioners.

The remuneration theme was strongly supported by stakeholder theory, which specifies that the role of the board is to represent the interests of the client groups (stakeholders) served by the board members,[750] and in doing so it is the board's role to manage the competing interests of the stakeholder groups.[751] The remuneration theme highlights the complex role of the board when balancing the interests of shareholders with executive employees, and the various other stakeholders in the rem process. Stakeholder theory further highlights that attention must be paid to those who can affect or are impacted by an organisation's purpose, on the grounds that these actors can enable or prevent the organisation from achieving its purpose.[752] Directors were very concerned that the current regulatory environment is providing a power imbalance to external stakeholders in the rem process that is both counterproductive and even detrimental to the companies they are governing. For this reason, further research on the point at which a stakeholder orientation and the role of directors in serving the interests of stakeholder groups becomes detrimental to the owners would be beneficial. Such research could examine the interplay between agency theory and stakeholder theory, particularly with respect to the remuneration theme finding, and the relevance within the current Australian regulatory context.

Further, quantitative research on the impacts on executive salaries since the introduction of the non-binding vote together with instances and reasons for strikes would assist regulators in further exploring the current concerns of the rem process that ASX200 directors have in the current regulatory context.

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750 Farrell, above n 94, 94.
751 Evan and Freeman, above n 103, 83.
752 Freeman, above n 98, 25.

7.10 Conclusion

The research sought to determine how ASX200 directors reflect on their governance responsibilities under the *ASXCGC Principles and Recommendations* (3^{rd} ed.). The study findings answered that question, finding three key areas that directors focus on in their governing: relationships, risk and remuneration. This thesis provides both researchers and governance practitioners with new knowledge on a relatively unstudied elite group: the ASX200 directors. Further, it provides the first known understanding of director reflections on their governing under the *ASXCGC Principles and Recommendations* since their original introduction in 2003. In doing so, it offers new knowledge in the form of an ASX200 director governance model that shows how the directors of some of Australia's largest companies reflect on their governing in the current regulatory environment.

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Appendices

Appendix A: ASXCGC Principles and Recommendations (3rd edition)

Pages 207 – 259 have been redacted as they contain material copyrighted by the "2014 ASX Corporate Governance Council".

Appendix B: Original list of ASXCGC Members (2002)

The following 21 organisations were the initial members of the ASXCGC when it was convened by the ASX in 2002.

- Association of Superannuation Funds of Australia Limited
- Australasian Investor Relations Association
- Australian Council of Superannuation Investors
- Australian Institute of Company Directors
- Australian Institute of Superannuation Trustees
- Australian Shareholders' Association
- Australian Stock Exchange Limited
- Business Council of Australia
- Chartered Secretaries Australia
- CPA Australia
- Group of 100
- Institute of Actuaries of Australia
- Institute of Chartered Accountants in Australia
- Institute of Internal Auditors Australia
- International Banks and Securities Association of Australia
- Investment and Financial Services Association
- Law Council of Australia
- National Institute of Accountants
- Property Council of Australia
- Securities and Derivatives Industry Association
- Securities Institute of Australia

Appendix C: List of ASXCGC Members at the time of the third edition release (2014)

The following 22 organisations were the initial members of the ASXCGC when it was convened by the ASX in 2002.

- Actuaries Institute
- Association of Superannuation Funds of Australia
- ASX
- Australasian Investor Relations Association
- Australian Council of Superannuation Investors
- Australian Financial Markets Association
- Australian Institute of Company Directors
- Australian Institute of Superannuation Trustees
- Australian Shareholders' Association
- Business Council of Australia
- CPA Australia
- Financial Services Council
- Financial Services Institute of Australasia
- Governance Institute of Australia
- Group of 100
- Institute of Chartered Accountants in Australia
- Institute of Internal Auditors Australia
- Institute of Public Accountants
- Law Council of Australia
- Property Council of Australia
- Stockbrokers Association of Australia

Appendix D: Interview questions

(The interviews were semi-structured, allowing for flexibility during the interview. Probing questions may be asked on certain issues as they arise, questions may be reordered, and the interviewer may make clarifications).

1. How does your board address the ASXCGC Principle 'Lay Solid foundations for management and oversight'? ('Respective roles and responsibilities of the board and management' and 'how their performance is monitored and evaluated'- *Principle 1*). What policies and processes (if any) have your board adopted to manage board diversity?

2. How does the board ensure that it has the appropriate composition, skills, commitment and size to discharge its duties? *(Principle 2)*

3. In terms of ensuring that the board acts ethically and responsibly, have you adopted a code of conduct for the organisation? Are there other ways in which the board discharges this responsibility? *(Principle 3)*

4. How does the board ensure the integrity of the corporate reporting? Can you tell me about your audit committee? (Composition, charter, functions, role in reporting process?) *(Principle 4)*

5. Clearly a distinguishing and stringent requirement for listed boards relates to timely and balanced disclosure. What has the board put in place to ensure it complies with this requirement? *(Principle 5)*

6. In respecting the rights of your shareholders, how does the board provide them with information and facilities to enable them to exercise their rights? *(Principle 6)*

7. How does your organisation recognise and manage risk? What committee structures and frameworks have you adopted, and how do you review their effectiveness? *(Principle 7)*

8. In terms of remuneration for directors and senior officers of the company, how does the board design the remuneration to ensure it can attract, retain and motivate (officers) of the company? *(Principle 8)*

9. What do you consider to be the key concerns for corporate governance (as related to your role on this board)?

10. In implementing the ASXCGC Principles and Recommendations, what (if any) factors facilitate their implementation? What (if any) factors constrain their implementation?