

Effective Corporate Governance: **the history, the landscape and the forces at play**

Lynn Ralph

Managing Director, Cameron Ralph Pty Ld

July 2007

In the beginning.....

Vereinigste
Oostindische
Compagnie 1606

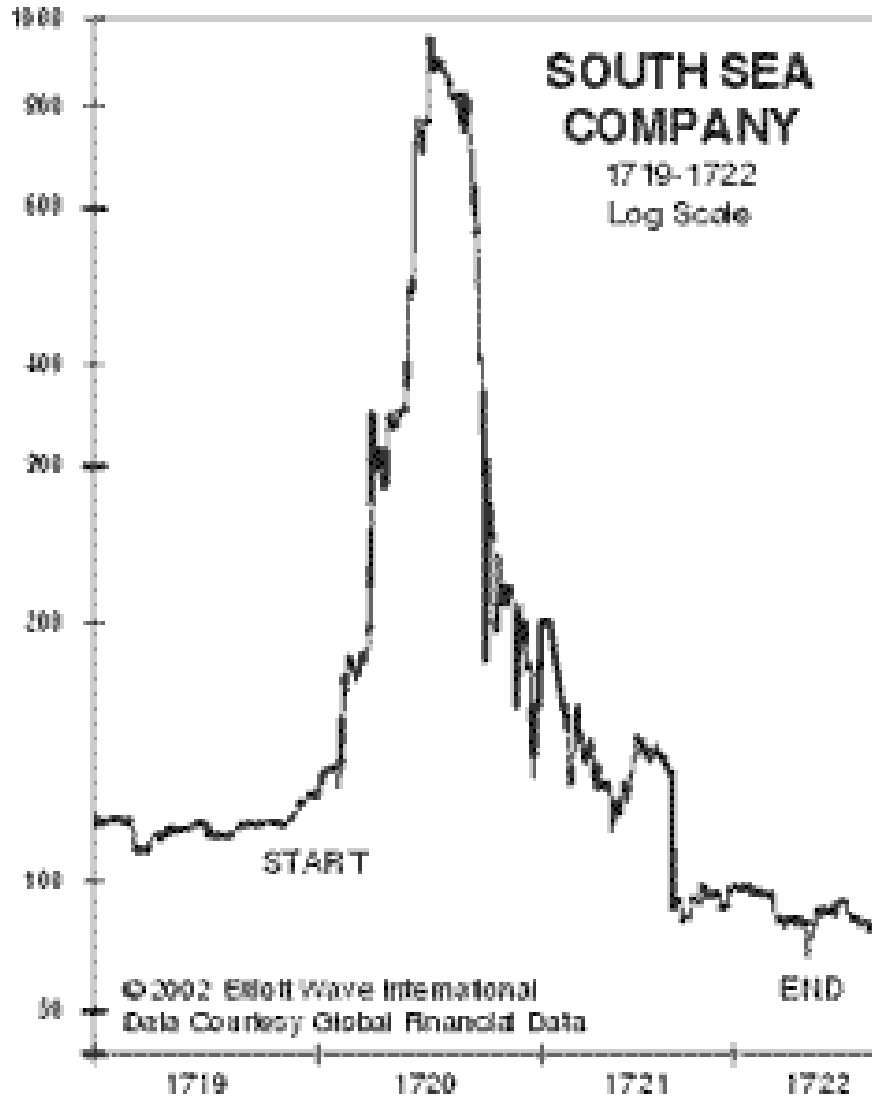


VOC became the acronym for :
Vergann Onder Corruptie ("Ruined By Corruption")

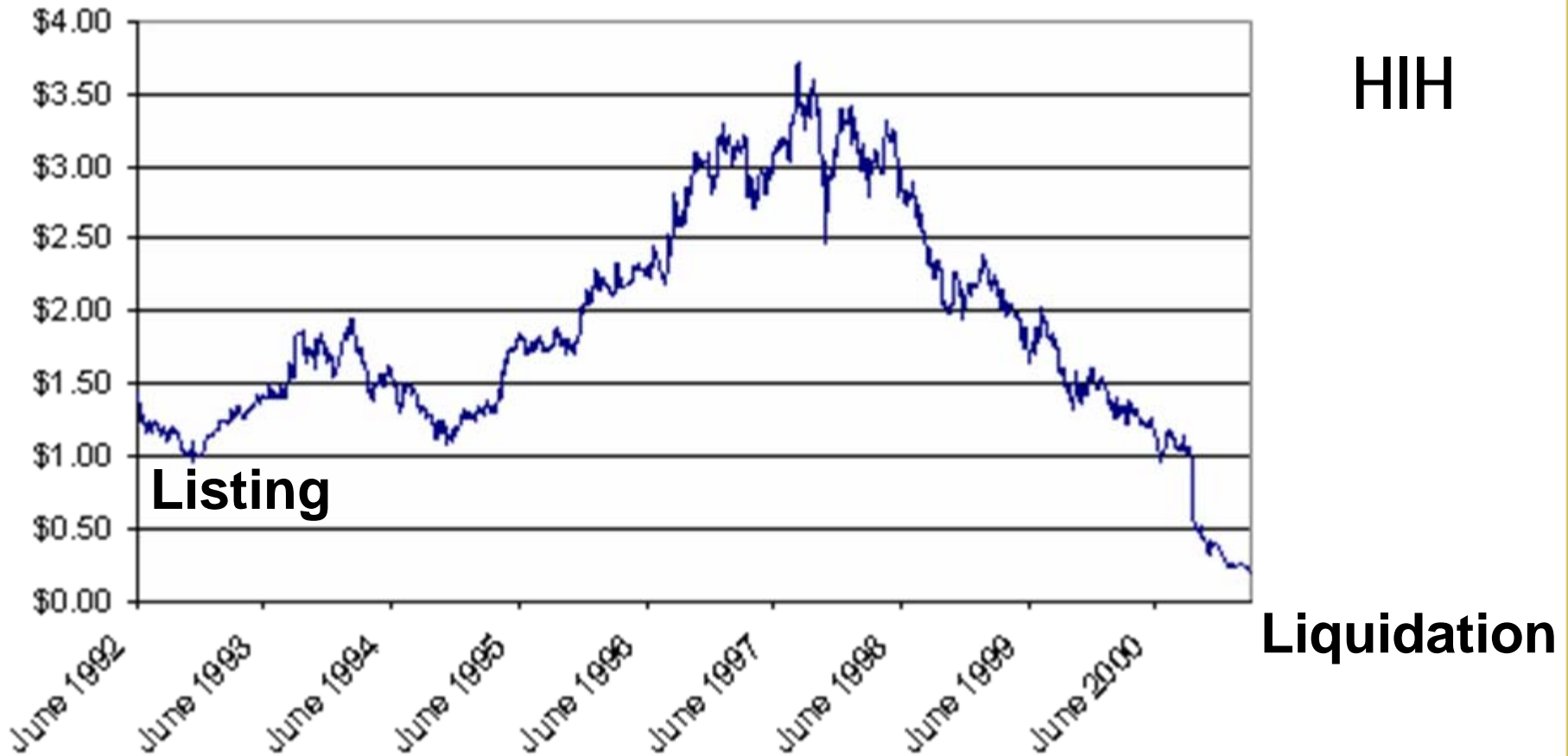
Today's topics

- ◆ What is governance?
- ◆ The elements of good governance
 - What is governance risk?
 - What makes for an effective board?
 - What goes wrong?
- ◆ The governance landscape
 - The players
 - Holding boards accountable
 - The hot issues

The more things change....



The more things stay the same



Definitions of governance

- ◆ To improve corporate performance through the minimisation of agency costs or conflicts of interest
 - ensuring that conditions apply whereby a firm's directors and managers act in the interests of the firm and of its shareholders
 - ensuring the means exist to hold managers accountable to members for the use of assets

- ◆ A system by which companies are directed and managed.
 - It influences how the objectives of the company are set and achieved
 - how risk is monitored and assessed, and
 - how performance is optimised. (ASX Guidelines)

“Governance Risk”

- ◆ The risk that decision(s) or action(s) taken (or omitted to be taken) by the board results in significant negative impact on shareholder value and/or the achievement of the organisation’s goals
- ◆ What it’s not:
 - The sole predictor of share price, earnings or creditworthiness
 - The only contributor to good or bad results

Board functions



Source: Hilmer, F. and Tricker, R. 1994, 'An effective board', *International corporate governance: Text, readings and cases*, p. 286.

How a board adds value

Direct Actions

- ◆ significant decisions
 - eg CEO selection, material transactions
- ◆ liaison w stakeholders
- ◆ crisis control

Via Management

- ◆ guidance, perspective
 - eg strategy, development of the CEO & mgmt team
- ◆ creating opportunities
- ◆ accountability/monitoring
- ◆ guardian of values & culture
 - eg Setting policy, risk mgmt

Key components for effective boards



Justice Neville Owen

Report of the Inquiry into the collapse of HIH

‘By and large the people who were involved were not inherently bad or in some way set upon being part of a corporate disaster.’

HIH is a reminder, if one is needed, that a drastic fall from corporate grace can occur if those in charge lose their way.’

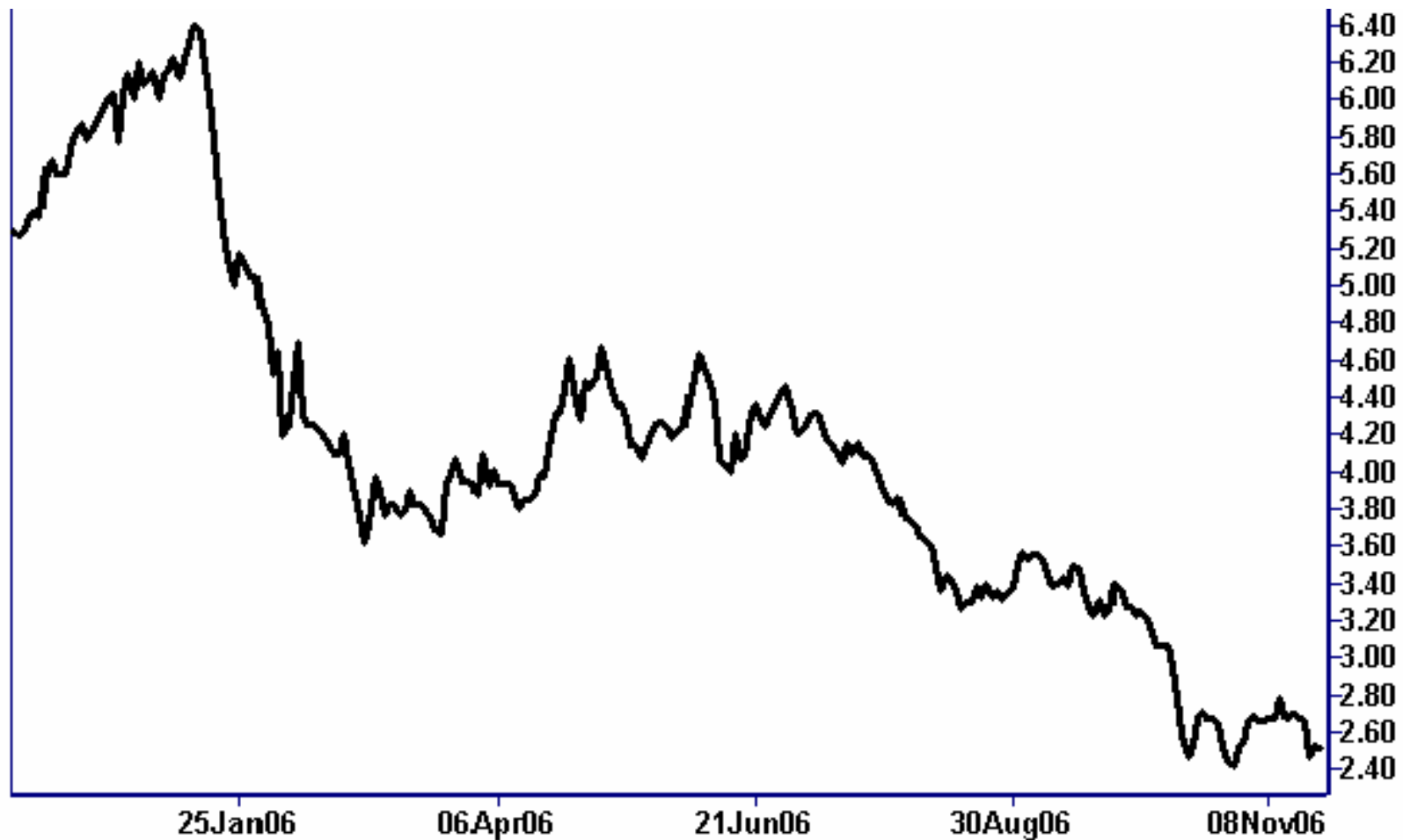
What goes wrong with boards?

- ◆ People
 - Knowledge levels; lack of understanding of values
 - Lack of integrity, courage, diligence, social skills, etc.....
- ◆ Behaviour (individual or group behaviours)
 - A myriad of toxic group behaviours including: denial, escalation, group think, politics
 - Greed, cronyism, denial
 - Dominant personality
- ◆ Processes
 - Making poor decisions
 - Failing to monitor / learn from past mistakes
 - Lack of clarity of roles between mgmt and board

History repeats.....

- 1970's Collective investing – pension funds, mutual funds; conglomerates
- 1980's Booming market; M&A
- 1987-91 Black Tuesday; property crash (Pyramid, Estate Mortgage)
- 1990's National Corporations Law; ASIC established;
- News super shares; Coles 'Yannon' affair; CEO heads start to roll
 - suppliers drive activism esp. proxy voting services
 - governance codes (Cadbury, IFSA)
 - continuous disclosure
 - stakeholders with specific agendas – environmental, union, etc
 - increasing individual share ownership drives political interest
- 1995+ Dot-com mania; share buybacks; cult of the CEO
- 2000's Tech wreck, HIH, Enron, One-Tel, corporate and audit scandals; Govt (CLERP, SOX, Combined Code) & Exchanges respond
CEO tenure <5 years; 'independence'; Non-binding shareholder votes
- 2006 ACSI Superfunds sign the UNPRI
- 2007 Private Equity / M&A / "Just say 'no' becomes "Just say 'yes'"

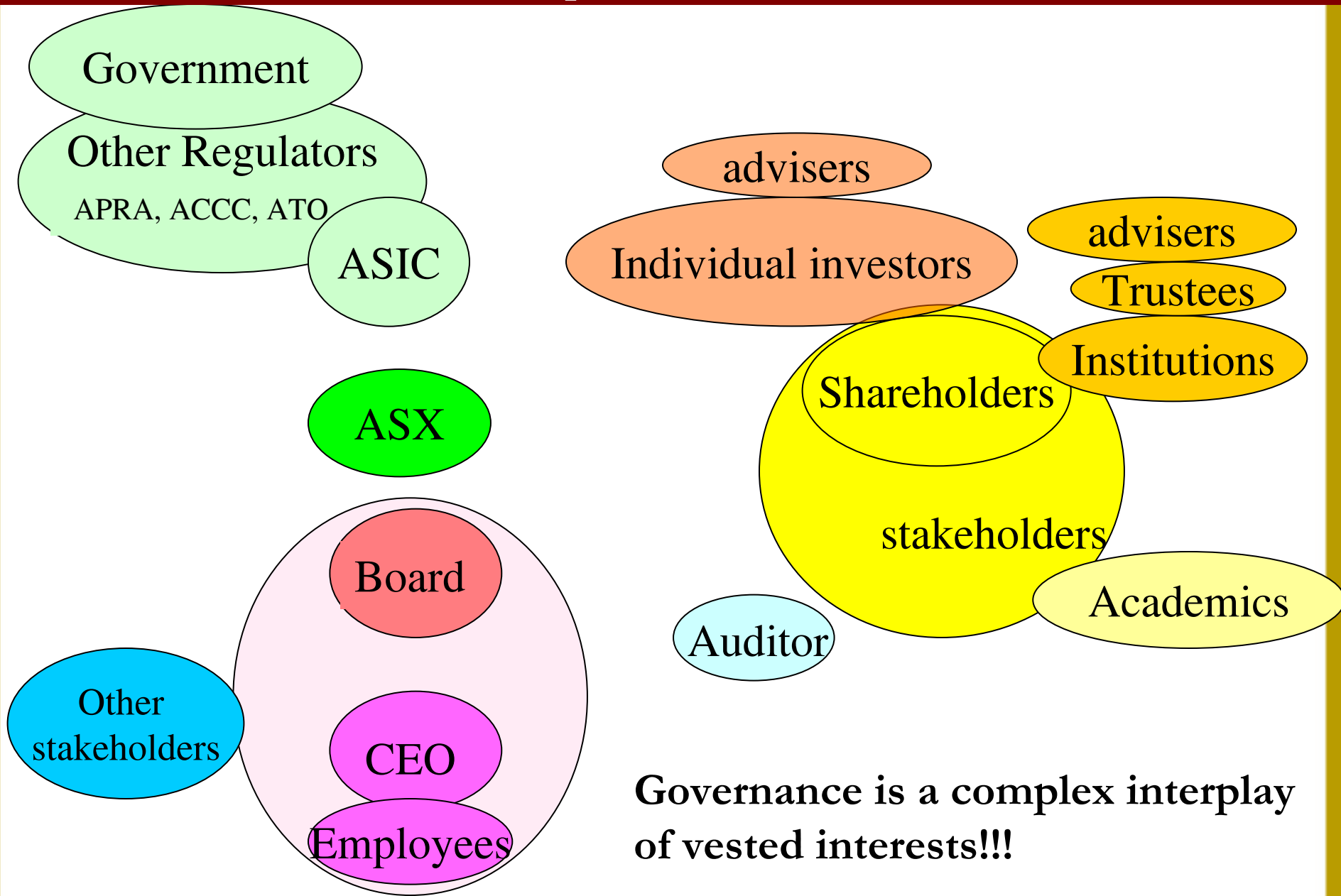
AWB share price



What is accountability?

- ◆ Provision of information on performance to those persons/bodies who can act on that information
 - Stephen Bartos, 2004

The public (voters)



Media

Is the power of shareholders a myth?

“From the standpoint of the community, the welfare of the community, and the welfare of the workers in the company, what is called the democratisation in the ownership through the distribution of stock is positively harmful. Such a wide distribution of the stock dissipates altogether the responsibility of the shareholders..... They recognise that they have no influence in a corporation of hundreds of millions of dollars capital. Consequently they consider it immaterial whatever they do, or omit to do.

The net result is that the men who are in control of it become almost impossible to dislodge, unless there should be such a scandal in the corporation as to make it clearly necessary for the people on the outside to combine for self-protection. Probably even then that necessity would not be sufficient to ensure a new management. That comes rarely except when those in control withdraw because they have been found guilty of reprehensible practices resulting in financial failure.”

Institutional Investors: owners or another layer of agency risk?

- ◆ Delivery of the promised style
- ◆ Delivery of performance within risk parameters
 - time frame
 - relative to benchmark
- ◆ Liquidity
- ◆ Predictability
- ◆ Minimise research/other costs (acting as an owner is expensive)
- ◆ Don't publicise one's opinion (IP)

Are market forces are enough to keep boards honest and effective?

- ◆ Market for corporate control
- ◆ Market for new capital
- ◆ Product market
- ◆ Wall street walk
- ◆ Pressure from institutional investors & hedge funds

The latest tools to drive better governance

- ◆ Transparency & Accountability
 - Continuous disclosure
 - Independent directors
 - Independent auditors
 - Executive Remuneration disclosure
 - Making management (not just board) liable
 - Shareholder non-binding votes
 - Improving scope and quality of financial disclosure
 - Board performance evaluation
- ◆ Responsible owners holding for long term
- ◆ Given the regulator more powers and more money
- ◆ Focus on business ethics
- ◆ The circling sharks.....

GovernanceMetrics International

Updated January 14, 2005

	Global Rating	Home Market
Overall Rating	8.0	8.0
Board Accountability	8.0	7.5
Financial Disclosure and Internal Controls	9.0	8.5
Shareholder Rights	8.5	8.5
Remuneration	6.5	6.5
Market for Control	7.0	8.0

Institutional Shareholder Services

Updated May 3, 2005

Index	Industry ranking
57.9	96.7

TSG outperformed 57.9% of companies in the S&P 500 Index and 96.7% of companies in the software & services group

Example of Governance Ratings from Sabre Corp Annual Report

The Corporate Library

Updated May 2, 2005

Overall Board Effectiveness	B
Overall rating	B
Board Composition	C
CEO Compensation	B
Shareholder Responsiveness	B
Litigation and Regulatory Problems	B
Takeover Defenses	D
Accounting	C
Strategic Decisionmaking	B
Analyst Adjustment	B
Best Practices Compliance Score	93%

Interested in reading more?

- ◆ The Corporate Library <http://www.thecorporatelibrary.com/>
- ◆ Jeffrey Sonnenfeld “What Makes Boards Great”, HBR 2002
 - www.mckinsey.com/governance
- ◆ Colin Carter and Jay Lorsch, ‘Back to the Drawing Board’, 2003
- ◆ Prof Lucian Bebchuk, Harvard Law School “The Myth of the Shareholder Franchise”
http://papers.ssrn.com/sol3/papers.cfm?abstract_id=829804
- ◆ Quote on Slide #18 is from Testimony of Supreme Court Justice Louis Brandeis Senate Committee on Interstate Commerce December 1911



Thank you for your time!

For more information about improving board performance

p: (02) 9004 7200

www.cameronralph.com.au