

# **CORPORATE GOVERNANCE AND COMPLIANCE**

## **PREVENTIVE MEASURE OR JUST ANOTHER FAD?**

Angus Young

Faculty of Law & School of Management, University of Technology, Sydney

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# **CORPORATE GOVERNANCE AND COMPLIANCE: PREVENTIVE MEASURE OR JUST ANOTHER FAD?<sup>+</sup>**

Angus Young\*  
Faculty of Law & School of Management,  
University of Technology, Sydney

## **Abstract:**

In the wake of recent corporate collapses, ‘corporate governance’ had received unprecedented levels of attention. It can be narrowly defined as how a company is directed and steered. The responsibility of steering a company is entrusted with the board of directors, who becomes the focus of governance mechanisms. Yet this is not as straightforward concept. In tandem, over the last two decades Australia had experienced massive shifts in business regulations. One innovation in Australian business regulation is ‘enforced self-regulations’ combining the benefits of voluntary self-regulation with the coercive power of the State implemented via a compliance program. A possible hazard of compliance systems is that management might treat this responsibility as a ‘box ticking’ exercise. Therefore effective governance and compliance entails more than setting up internal and regulatory mechanisms, the willingness of various stakeholders to collaborate is crucial. This suggests that managing relationships between stakeholders of an organization is the key to averting corporate collapses.

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\* Contact email: [Angus.Young@uts.edu.au](mailto:Angus.Young@uts.edu.au)

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## **Introduction:**

When major corporations collapse, behave inappropriately or caused determinant to employees and shareholders, often the media would stir public sentiments and compel politicians to regulate. Yet increasing volumes of business regulation appears to contradict neo-classical economic policy reforms of the past two decades, where markets and not government should ultimately decide to faith of the economy. Even if there are compelling arguments to regulate the question then becomes, does it work? And how do governments regulate businesses? Is regulation a means to an end or an end in itself?

Another issue interconnected to regulation is the issue of corporate governance, which has become rather topical. Governance has been sensationalised particularly when major corporations collapse. Consequently many publications and so called standards offer solutions and benchmarks for corporations to model their governance with claims lessen instances of corporate collapses due to poor governance. But is it practicable or just a fad? This paper would attempt to sift through the debates that encircle the issue of regulation and governance so as to provide some insights as to the validity of some of these claims and deduce the key to regulating and governing corporations.

## **The Trail of Corporate Collapses and Growth in Regulations:**

Corporate collapses are frustrating blot in commercial intercourse. Regardless of the number of regulations, zealous regulators, and managerial (or entrepreneurial) vigilance, corporate collapses cannot be eliminated. It is part and parcel of business cycles and risk. In 1991, there were over 800,000 companies incorporated across Australia, by 2004, the number grew to over 1.3 million (see table one), out of which approximately 1.4 percent (1999-2004) were insolvent (including external administration). Though the percentages were relatively small, the number of collapses grew by about 5000 during this period (see table two). More important, corporate collapses cost the economy billions of dollars, not to mention the social cost of unemployment, physiological impact from lost of retirement savings invested in these companies, and the lost of business confidence in general,<sup>1</sup> all of which calls for some sort of governmental and corporate mechanism to reduce (or prevent) the number of collapses.

**Table One**

<b>Year</b>	<b>Total no. of companies</b>
1991	891680
1994	883955
1995	832466
1998	1087703
2000	1172414
2002	1244960

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<sup>1</sup> White, A. (2001) 'Flow on effects of recent collapses, in *CCH Collapse Incorporated: Tales, Safeguards & Responsibilities of Corporate Australia*, CCH, Sydney, pp.41-70.

2003	1230667
2004	1319977

Sources: ASIC Annual Reports

**Table Two**

	1999	2000	2001	2002	2003	2004
<b>External administration</b>	4314	4922	6634	6208	6661	6618
<b>Insolvency appointments</b>	7678	8258	10504	10220	11042	10823

Sources: ASIC Annual Reports

Even in pre-federation Australia, business failures like the Bank of New South Wales, the Australian Auction Company, the Royal Bank of Australia, and many others, have cautioned investors, authorities and the public against overzealous business returns, lax practices, temptation of self-dealings, and fraudsters.<sup>2</sup> However, it is interesting to note that the causes and symptoms of collapses had been somewhat comparable throughout history. Sykes (1988) found some common ‘tell tale signs’ in over two Centuries of major corporate collapses in Australia namely, creative accounting, excessive risk and speculation, overzealous business expectations, diminishing margins, and adverse political /economic conditions (domestic and international).<sup>3</sup> Yet there is no sure way to accurately predicting or preventing corporate collapses from both business and regulatory perspectives.<sup>4</sup>

What had changed overtime? In short, the context had altered. With the rapid pace of change in domestic and international business environment driven predominantly by technological progress, financial innovations, overzealous expectations, socio-economic transformation and political changes, all of which tempted business executives and entrepreneurs to ‘push the envelop’ and ‘raise the stakes of the game’.<sup>5</sup> Leaving legislators and regulators to be in pursuit,<sup>6</sup> Freeman and Adams (1991) argued that regulation initiatives in the securities market had largely been reactive.<sup>7</sup>

The boom bust cycle in the 1980s was particularly volatile. Clarke et al. (2003) hailed, “[t]he 1980s in Australia has been described as a decade of dreams – ‘dream

<sup>2</sup> Sykes, T. (1988) *Two Centuries of Panic: A History of Corporate Collapses in Australia*, Allen and Unwin, Sydney, pp. 1-223.

<sup>3</sup> Id., pp. 549-556

<sup>4</sup> Clarke, F. and Dean, G. (2001) ‘Corporate collapses analyse’, in *Collapse Incorporated: Tales, Safeguards & Responsibilities of Corporate Australia*, pp. 78-84. On causes of corporate collapses also see Morris, R. (1997) *Early Warning Indicators of Corporate Failure: A critical review of previous research and further empirical evidence*, Aldershot, Ashgate.

<sup>5</sup> See Cohen, B. and Lipson, C. (ed.) (1999) *Issues and Agents in International Political Economy: An International Organization Reader*, MIT Press, Cambridge, Hill, C. (2002) *International Business: Competing in the Global Market*, 3<sup>rd</sup> ed., McGraw Hill, Boston, and Meredith, D. and Dyster, D. (1999) *Australia in the Global Economy*, Cambridge, Melbourne.

<sup>6</sup> Breyer, S. (1998) ‘Typical Justifications for Regulation’, and Hancher, L. and Moran, M (1998) ‘Organizing Regulatory Space’, in Baldwin R., Scott C., and Hood, C. (ed.), *A Reader on Regulation*, Oxford University Press, Oxford, pp. 59-92 and 148-172

<sup>7</sup> Freeman, M. and Adams, M. (1991) ‘Industry’s Choice: Rules or Ethics – Behave or we’ll be made to behave’, in *JASSA*, June 1991, p. 6

time casino', a time when the financial system went crazy, when a nation was wooed by the 'decade of the deal', by the call that 'greed was good'.<sup>8</sup> In addition, Sykes (1996) notes, "[w]hile Australia has seen plenty of minor booms and busts, that of the 1980s was particular damaging. Give or take a billion dollars, the bold riders mentioned in this book lost around \$16 billion."<sup>9</sup> and asserts, "[i]t is difficult to believe that the legal system of any westernised country in the modern world could operate as slowly, inefficiently and inequitably as that applying to the corporate world in Australia...The criminal justice system worked very slowly, expensively and erratically...The conduct of civil proceedings was, by and large, no more efficient than that of the criminal proceedings."<sup>10</sup>

Even though economic reforms in the 1980s did not caused corporate collapses, policy changes created opportunities for new entrepreneurs and 'high flyers' like Alan Bond who turned from rags to riches through 'shonky' business ventures to prosper until his over inflated and speculative profits began to crumble.<sup>11</sup>

Corporate collapses in the 1990s resinate some familiar themes of the past like high levels of risk, dishonestly, hiding thinning corporate profits, bad investment decisions, overseas subsidiary losses, adverse economic environment, intense competition, and creative accounting.<sup>12</sup> Justice Owen states in the Report of the failure of HIH insurance,

Corporate regulation in Australia in the late 1990s and into the present decade was replete with mechanisms designed to detect danger signs and promote the financial health and longevity of commercial entities...Despite these mechanisms, the corporate officers, auditors and regulators of HIH failed to see, remedy or report what should have been obvious. And some of those who were in or close to the management of the group ignored or, worse, concealed the true state of the group's steadily deteriorating financial position.<sup>13</sup>

In essence, the business and economic realities in the 1990s and beyond will push Australian companies to innovate and increase their productivity to keep with an ever more globalising market place where competition is intense, increasing the risk of future corporate collapses.<sup>14</sup> Since profit without risk is 'wishful thinking' with the rapid changes in international business environment and technological innovations,<sup>15</sup>

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<sup>8</sup> Id., Op. Cit., 145

<sup>9</sup> Sykes, T. (1996) *The Bold Raiders: Behind Australia's Corporate Collapse*, 2<sup>nd</sup> ed., Allen and Unwin, Op. Cit., p. 569

<sup>10</sup> Id., Op. Cit., pp. 581, 583

<sup>11</sup> Id., p. 5

<sup>12</sup> Jay, C. (2001) 'The Day of Reckoning', in *Collapse Incorporated: Tales, Safeguards and Responsibilities of Corporate Australia*, CCH, Sydney, pp. 9-40

<sup>13</sup> The HIH Royal Commission (2003), *The Failure of HIH Insurance: Volume I A Corporate Collapse and its Lessons*, April 2003, AGSP, Canberra, Op. Ct., p. xiii

<sup>14</sup> Meredith, D. and Dyster, D. (1999) *Australia in the Global Economy*, Cambridge, Melbourne, pp. 301-38.

<sup>15</sup> Dean G. and Clarke, F. (2001) 'Distressed businesses – predicting failure', in *Collapse Incorporated: Tales, Safeguards and Responsibilities of Corporate Australia*, CCH, Sydney, pp. 147-184, Meredith, D. and Dyster, D. (1999) *Australia in the Global Economy*, Cambridge, Melbourne, pp.281-339, and Gottlieb, R. (2003) *10 Best and 10 Worst Decisions of Australian CEOs 1992-2002*, Viking, Melbourne, pp. 279-8

the major difficulty is how investors could and regulators differentiate between ‘pie in the sky deals’ and visionary enterprise?<sup>16</sup>

Since the 18<sup>th</sup> Century this colony had experienced rapid and sometimes volatile economic growth, spurred by entrepreneurial ventures and foreign investments.<sup>17</sup> Therefore regulating commerce is vital to Australia’s economic stability and long run growth prospects. The roots of Australian corporation laws and regulations dates back to the *Bubble Act* (1720) introduced following the speculative excesses of the early 18<sup>th</sup> Century in England.<sup>18</sup> By and large, Australia’s changes in corporate regulation were prompted by either economic challenges (including corporate collapses), or policy reforms, but early attempts prior to the 1960s were marred by political wrangling between Federal and State governments.

For decades constitutional limitations had inhibited the Federal government from adopting a centralised approach company laws were State-based.<sup>19</sup> Moreover, the statutes affecting the operation of companies in some States predated Federation.<sup>20</sup> By the late 1950s many companies operated beyond state borders the differences between state legislations gave raise to more ‘red tape’ and increased the cost of compliance prompting uniform regulations to be negotiated between states.<sup>21</sup> Notwithstanding the expectations of the *Uniform Companies Act* 1961, the Act only managed to provide uniformity for several years.<sup>22</sup> A standing committee of Attorneys-General was subsequently set up in 1967 in the aftermath of the specular failures of some finance companies.<sup>23</sup> Whilst some States adopted some of the recommendations of the reports produced by the Committee, others have not.<sup>24</sup>

The mineral boom in the late 1960s spearheaded the catalyst for change. The boom facilitated the growth of public companies seeking capital injection. This induced

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<sup>16</sup> See One.Tel’s story by Barry, P. (2002) *Rich Kids: How the Murdochs and Packers lost \$950 million in One.Tel*, Bantam Books, Sydney, pp. 163-184 and 292-320

<sup>17</sup> See Meredith, D. and Dyster, D. (1999) *Australia in the Global Economy*, Cambridge, Melbourne, and Fleming G, Merrett D, and Ville S, (2004) *The Big End of Town: Big business and corporate leadership in Twentieth-Century Australia*, UK, Cambridge University Press.

<sup>18</sup> Redmond, P. (2000) *Companies and Securities Law: Commentaries and Materials*, LBC, Sydney, pp. 32.

<sup>19</sup> In the case of *Huddart Parker and Co Pty Ltd v Moorehead* (1909) 8 CLR 330, the High Court adopted a narrow interpretation of the power in s. 51 (xx) of the Constitution that inhibited the Federal government from enacting laws with respect to the creation of companies. See Lipton, P. and Herzberg, A. (2003) *Understanding Company Law*, Lawbook Co., Sydney, p. 4

<sup>20</sup> Yorston, R. and Brown S. (1962) *Company Law*, The Law Book Company, Sydney, p. 2, and Yorston, R. and Fortescue, E (1940) *Australian Secretarial Practice and Manual of Company Law*, The Law Book Company, Sydney, pp. 3 and 586

<sup>21</sup> Following a series of conferences, a committee made up of State and Commonwealth Attorneys-General drafted identical company legislations in each State with the aim of enacting a uniform legislation across all States. See Lipton, P. and Herzberg, A. (2003) *Understanding Company Law*, Lawbook Co., Sydney, p. 5

<sup>22</sup> Even though the 1961 legislation maintained the traditions of the Companies Act 1948 (UK). The Act did not contain any provision for on-going co-operations. Despite efforts in 1974 by NSW, QLD and VIC to form an Interstate Corporate Affairs Commission maintaining uniformity, other States were not involved. See Baxt, R., Fletcher, K., and Fridman, S. (1999) *Afterman and Baxt’s Cases and Materials on Corporations and Associations*, 8<sup>th</sup> (ed.), Butterworths, Sydney, p. 163, and Lipton, P. and Herzberg, A. (2003) *Understanding Company Law*, Lawbook Co., Sydney, p. 5

<sup>23</sup> This committee was also known as Eggleston Committee. It produced seven interim reports from 1967 to 1972.

<sup>24</sup> Lipton, P. and Herzberg, A. (2003) *Understanding Company Law*, Lawbook Co., Sydney, p. 5

greater speculation and the volume of shares traded rocketed. Allegations of improper trading practices in the wake of a severe stock market crash in the early 1970s led to the Senate Committee to recommend the establishment of a national commission to regulate the securities market.<sup>25</sup> However a change in government delayed the introduction of a national scheme.<sup>26</sup>

Another attempt at the Federal-State co-operative scheme commenced in 1976. It took two years before a formal agreement was reached,<sup>27</sup> which led to the enactment of the *Companies Act* 1981 (Cth), and the establishment of the National Companies and Securities Commission (NCSC).<sup>28</sup> This new spirit co-operative began to fade by the late 1980s.<sup>29</sup> In part, the co-operative scheme produced lengthy delays, as compromises amongst States were often unavoidable. The newly established NSCS also found co-ordination with the State Corporate Affairs Commission inefficient and frustrating at times.<sup>30</sup> Along with the rapid changes in the financial and corporate environment,<sup>31</sup> the Federal government took the opportunity to argue that the co-operative regime had outlived its usefulness.<sup>32</sup>

In 1989 the Federal parliament enacted the *Corporations Act* 1989 (Cth),<sup>33</sup> however, the Act was not proclaimed as the States launched a high court challenge.<sup>34</sup> The

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<sup>25</sup> This committee, also known as the Rae Committee, produced a report that led the Whitlam government to introduce two Bills in an attempt to enact a national scheme for regulating securities industry. See Redmond, P. (2000) *Companies and Securities Law: Commentary and Materials*, 3<sup>rd</sup> ed., LBC, Sydney, pp.49-51

<sup>26</sup> Ford, H., Austin, R. and Ramsay, I. (2001) *Ford's Principles of Corporations Law*, 10<sup>th</sup> ed., Butterworths, Sydney, p. 44

<sup>27</sup> The State and Federal government adopted the placitum in s. 51 (xxxvii) of the Constitution, where the State could refer the power to the Federal government to legislate, so as to get 'around' Constitutional limitation for a Federal legislation and national scheme to regulate companies and securities industry. Redmond, P. (2000) *Companies and Securities Law: Commentary and Materials*, 3<sup>rd</sup> ed., LBC, Sydney, pp. 51-52, and Hanrahan, P., Ramsay, I. and Stapleton, G. (2000) *Commercial Applications of Company Law*, 2<sup>nd</sup> ed., CCH, Sydney, p. 30

<sup>28</sup> Hanrahan, P., Ramsay, I. and Stapleton, G. (2000) *Commercial Applications of Company Law*, 2<sup>nd</sup> ed., CCH, Sydney, p. 30

<sup>29</sup> Oddly the Hawke government attempted to build on the notion of 'new Federalism', where the Federal-State governments were relations shifted towards a more consensual process in many areas of inter-State and Federal-State government policy co-ordination and formulation. See Capling, A and Galligan, B. (1992), pp. 260-262

<sup>30</sup> Ford, H., Austin, R. and Ramsay, I. (2001) *Ford's Principles of Corporations Law*, 10<sup>th</sup> ed., Butterworths, Sydney, p. 45 (Also see Bosch, H. (1990) *The Workings of a Watchdog*, William Heinemann Australia, Melbourne – about the problems experienced by NCSC.)

<sup>31</sup> Lipton, P. and Herzberg, A. (2003) *Understanding Company Law*, 11<sup>th</sup> ed., Lawbook Co., Sydney, p. 6

<sup>32</sup> Ford, H., Austin, R. and Ramsay, I. (2001) *Ford's Principles of Corporations Law*, 10<sup>th</sup> ed., Butterworths, Sydney, p. 45

<sup>33</sup> The Federal government exploited the Senate Standing Committee on Constitutional and Legal Affairs report in 1987 to assert that the co-operative system outlived its usefulness. Furthermore there were two factors that led the Federal government to the conclusion that earlier reservations of constitutional limitation no longer applied. First, the case of *Strickland v Rocla Concrete Pipes Ltd* (1971) 124 CLA 468 found that the view held in *Huddart Parker and Co Pty Ltd v Moorehead* (1909) 8 CLR 330 was too restrictive and should be overruled. Second, the Placitum s51 (xxxvii) of the Constitution empowered the Federal government to intervene directly. See Ford, H., Austin, R. and Ramsay, I. (2001) *Ford's Principles of Corporations Law*, 10<sup>th</sup> ed., Butterworths, Sydney, p. 45, Redmond, P. (2000) *Companies and Securities Law: Commentary and Materials*, 3<sup>rd</sup> ed., LBC, Sydney, pp. 51-54, and Baxt, R., Fletcher, K., and Fridman, S. (1999) *Afterman and Baxt's Cases and Materials on Corporations and Associations*, 8<sup>th</sup> (ed.), Butterworths, Sydney, pp. 163-167

adverse judgements of the High Court challenge compelled the Federal government to re-negotiate with the States. A new agreement was reached in June 1990, the Corporations Amendment Act 1990 (Cth) synchronised corporations law with the States and Territories.<sup>35</sup>

Setting aside the issue of another wave of High Court challenges,<sup>36</sup> from 1991 to 2004, there were a number of occasions where major corporate laws (including Financial Services Reform Act) were amended.<sup>37</sup> The two major schemes for change came from the Corporations Law Simplification Program, under the Hawke/Keating government, and Corporate Law Economic Reform Program under the Howard government.<sup>38</sup>

Since 1991 the aims of corporate law reforms could be summed up as: (1) to improve market governance and efficiency and (2) to enhance the accountability of management towards various stakeholders, in part motivated by reactive policies in the aftermath of financial and corporate collapses. Arguably, these changes were driven by a mishmash of political, economical and administrative validation, while some of these factors are beyond the scope of this paper, much could be linked directly or indirectly to the era of deregulation in the mid 1980s.

The government established an advisory group on corporate law (Corporations Law Simplification Program in 1993, and later Corporate Law and Economic Reform Program in 1997). In addition, the Corporations and Markets Advisory Committee (CAMAC) was set up in 1989 with the aim to provide advice to the government on corporations and financial markets law and practice. CAMAC members are appointed based on knowledge and experience in business, financial markets, law, economics or accounting. They are mainly recruited from the business community, legal profession, and academia. Many of CAMAC's consultative reports and discussion papers had been incorporated into corporate legislations.<sup>39</sup> Other bodies like the Takeovers Panel (previously Corporations and Securities Panel), the Companies Auditors and Liquidators Disciplinary Board, the Australian Accounting Standards Board, and Financial Reporting Council were also set up by the government in the last few years to act as quasi-regulatory and policy advisory capacity.

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<sup>34</sup> Redmond, P. (2000) *Companies and Securities Law: Commentary and Materials*, 3<sup>rd</sup> ed., LBC, Sydney, pp. 54-55 (Mason CJ, Brennan, Dawson, Toohey, Gaudron, and McHugh JJ held, "The power conferred by s 51 (xx) to make laws with respect to artificial legal persons is not a power to bring into existence the artificial legal persons upon which laws made under the power can operate." *NSW v Commonwealth of Australia* (1990) 169 CLR 482; 90 ALR 355 at 497; 357)

<sup>35</sup> As the result of the High Court decision, the States and Territorial government had to enact legislations mirroring the Corporations Amendment Act 1990 (Cth). For further details see Lipton, P. and Herzberg, A. (2003) *Understanding Company Law*, 11<sup>th</sup> ed., Lawbook Co., Sydney, pp. 9-10, and Redmond, P. (2000) *Companies and Securities Law: Commentary and Materials*, 3<sup>rd</sup> ed., LBC, Sydney, pp. 56-63

<sup>36</sup> In essence, the High Court challenges the referral powers under the Constitution, see *Re Wakim* (1999) 17 ACLC 1055, *Bond v R* (2000) 169 ALR 607 and *R v Hughes* (2000) 171 ALR 155.

<sup>37</sup> *The New Corporations Act and Related Legislation* (2001), Butterworths, Sydney, pp. 23-25, and *Australian Corporations Legislations* (2004) Mid-Year Edition, Butterworths, Sydney, pp. 23-28

<sup>38</sup> Hanrahan, P., Ramsay, I. and Stapleton, G. (2000) *Commercial Applications of Company Law*, 2<sup>nd</sup> ed., CCH, Sydney, p. 31

<sup>39</sup> [www.camac.gov.au](http://www.camac.gov.au)

Between 1997-8 six CLERP papers were produced, subsequently five out of six papers (1 to 5) were incorporated into *Corporate Law Reform Program Act 1999* (Cth).<sup>40</sup> Briefly, CLERP No. 1 proposed to aid, “[t]he development of accounting standards that enhance efficiency, expansion and international competitiveness of Australian business while at the same time sustaining investor confidence.”<sup>41</sup> CLERP No. 2 proposed to provide, “[a] better framework for capital raising by small, medium and large enterprises; investors with relevant, comprehensible and cost-effective information for informed investment decisions; and improve opportunities to fund new and growing business.”<sup>42</sup> CLERP No. 3 “[r]eviews whether the current rules regulating company directors inhibit sound business judgement.”<sup>43</sup> CLERP No. 4 “[a]im to remove regulatory impediments to an efficient market for corporate control subject to ensuring a sound investor protect regime.”<sup>44</sup> CLERP No. 5 “[p]roposes a number of reforms to Australia’s business laws to facilitate electronic commerce.”<sup>45</sup>

CLERP 6 proposed to, “[t]ake into account of the realities of the modern commercial environment and permits market participation to respond to the challenges presented by financial innovation and globalisation in a timely and sensitive manner. The regulatory regime should facilitate the mobilisation and investment of saving by the development of new and diverse markets and financial products, while at the same time enhancing efficiency, integrity and investor confidence.”<sup>46</sup> This report was subsequently enacted as *Financial Services Reform Act 2001* (Cth), and now is found in Chapter 7 of the *Corporations Act 2001* (Cth). CLERP 7 became the *Corporations Legislation Amendment Act 2002* (Cth) it was “[p]art of the Government’s objective of cutting the costs for business and developing a pro-enterprise system of corporate law...by simplifying document lodgement and compliance procedure for companies under the Corporations Law.”<sup>47</sup> CLERP 8 has yet to be drafted into legislation the paper was intended to work towards the UN’s UNCITRAL model law on cross boarder insolvency, as many Australian businesses have financial interest beyond domestic jurisdictions.<sup>48</sup>

CLERP 9 was enacted this year as *Corporate Law Economic Reform (Audit Reform and Corporate Disclosure) Act 2004* (Cth), the two main provisions of the Act relates to disclosure and auditor independence. The Explanatory Memorandum of the Bill notes, “[t]he underlying objective of the reforms is to improve the operation of the market by promoting transparent, accountability and shareholder activism...In

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<sup>40</sup> Baxt, R., Renard, I., Simkiss, R., Webster, J. and Ramsay, I. (2000) *CLERP Explained*, CCH, Sydney, pp.1-2

<sup>41</sup> CLERP Proposals for Reform Paper No. 1 (1997) *Accounting Standards*, AGPS, Canberra, Op. Cit., p. 9

<sup>42</sup> CLERP Proposals for Reform Paper No. 2 (1997) *Fundraising*, AGPS, Canberra, Op. Cit., p. 7, 8

<sup>43</sup> CLERP Proposals for Reform Paper No. 3 (1997) *Directors, Duties and Corporate Governance*, AGPS, Canberra, Op. Cit., p. 5

<sup>44</sup> CLERP Proposals for Reform Paper No. 4 (1997) *Takeovers*, AGPS, Canberra, Op. Cit., p. 5

<sup>45</sup> CLERP Proposals for Reform Paper No. 5 (1997) *Electronic Commerce*, AGPS, Canberra, Op. Cit., p. 5

<sup>46</sup> CLERP Proposals for Reform Paper No. 6 (1997) *Financial Markets and Investment Products*, AGPS, Canberra, Op. Cit., p. 7-8

<sup>47</sup> CLERP Proposals for Reform Paper No. 7 (2000) *Simplified Lodgements and Compliance*, AGPS, Canberra, Op. Cit., p. 5

<sup>48</sup> CLERP Proposals for Reform Paper No. 8 (2002) *Cross-border Insolvency*, AGPS, Canberra, p. 7-9

addition, the Bill implements a number of recommendations of the HIH and Cole Royal Commissions.”<sup>49</sup>

Much of the changes in corporate regulations occurred in the last twenty years (for detail see diagram one), amidst market led policy reforms. Whilst recent series of legislations attempt to address many of the causes and symptoms of corporate collapses such as lacking of financial disclosure, creative accounting, executive accountability, fraud, and insider-trading. On the same token, there are many other causes and symptoms were beyond legislative reach, for instance adverse economic conditions, bad management, intense competition, over optimistic expectations, and high risk ventures. Much of which are part and parcel of entrepreneurship.<sup>50</sup> More important, despite changes in corporate legislations the magnitude of corporate collapses and litigation has not abated (see diagram two). Therefore it is not the amount of legislation or even policy reforms could prevent or halt corporate collapses rather, the key to moderate or lessen such occurrences could lie with the regulatory approaches and strategies adopted.

### **The Evolution and Devolution of Regulatory Strategies:**

Regulation can be viewed as a form of state or government intervention coercing the masses towards certain desirable outcomes.<sup>51</sup> This preposition assumes that human interactions would be unruly without an overarching authority to impose social order.<sup>52</sup> In contrast, regulations could be understood as a voluntary enterprise to endorse and instil certain values of a community.<sup>53</sup> This stems from the Hayekian notions of rule making as an outcome based on individual decisions motivated by the furtherance of personal benefits.<sup>54</sup> Yet these two distinctive justifications do not necessarily reflect the dynamics and the complexities of human interactions, whether it maybe between individuals or groups. Thus a more robust and viable economic regulatory framework would need to be flexible and adaptive to dynamic and ever changing international business reality.

Breyer (1998) argues that the growth of regulation has made the definition of the term more complex. He differentiates regulation into three categories; “[r]egulation as targeted rules, regulation as direct state intervention in the economy more generally and regulation as encompassing all mechanisms of social control, by whomsoever exercised.”<sup>55</sup>

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<sup>49</sup> CLERP Proposals for Reform Paper No. 9 (2003) *Audit Reform and Corporate Disclosure*, AGPS, Canberra, Op. Cit., p. 1

<sup>50</sup> Dean G. and Clarke, F. (2001) ‘Distressed businesses – predicting failure’, in *Collapse Incorporated: Tales, Safeguards and Responsibilities of Corporate Australia*, CCH, Sydney, pp. 147-184, Meredith, D. and Dyster, D. (1999) *Australia in the Global Economy*, Cambridge, Melbourne, pp.281-339, and Gottlieb, R. (2003) *10 Best and 10 Worst Decisions of Australian CEOs 1992-2002*, Viking, Melbourne, pp. 279-8

<sup>51</sup> Butt P. (ed.) (2004), *Butterworths Concise Australian Legal Dictionary*, 3<sup>rd</sup> ed., LexisNexis Butterworths, Sydney, pp. 371, 384

<sup>52</sup> Tuck R. (1996) *Thomas Hobbes: Leviathan*, Cambridge University Press, Cambridge, p. 484

<sup>53</sup> Parisi F. (1996) ‘Law as a Voluntary Enterprise’, in Ratnapala, S. and Moens G A (ed.), *Jurisprudence of Liberty*, Butterworths, Sydney, pp. 111-128

<sup>54</sup> Vanberg V. (1996) ‘Hayek’s Theory of Rules and the Modern State’, in Ratnapala, S. and Moens G A (ed.), *Jurisprudence of Liberty*, Butterworths, Sydney, pp. 47-66

<sup>55</sup> Baldwin, R. Scott, C. and Hood C. (1998), ‘Introduction’, in Baldwin, R. Scott, C. and Hood, C. (ed) *A Reader on Regulation*, Oxford University Press, Oxford, Op. Cit., p. 3

Targeted business regulations range from anti competitive behaviour, social cost, inadequate information, and market failure.<sup>56</sup> Critics point out that this imperative produce certain shortcomings. Regulatory economics are often incentive systems that are drawn from many normative assumptions.<sup>57</sup> In contrast, broader social control utilise different means to shape social norms and modify behaviour of the market. This could range from professional ethics, code of practices, to criminal prosecution.<sup>58</sup>

Furthermore, targeted regulations are often prescriptive with a set of codified rules. Rules are prescribed standards of conduct.<sup>59</sup> Black argues that there are problems associated with the use of rules, “[r]ules are generalizations group together particularly instances or attributes of an object or occurrence and abstract or generalize from them to build up a category or definition which then forms the operative basis of the rule.”<sup>60</sup> Hence rules are vulnerable to over and under-inclusiveness.<sup>61</sup>

The other end of the spectrum in business regulation is criminalisation. Regulating corporate misbehaviour of individuals was presumed to reduce undesirable conducts, as the penalty of infringement would be severe punitive punishments. The objective of criminalising corporate wrongdoing is to deter, rather than merely granting justice. Imprisonment, shaming, financial penalty, and social condemnation were expected to deter or at least reduce corporate wrongs, reinforcing the popular saying ‘crime doesn’t pay’.<sup>62</sup>

Much emphasis has been placed upon criminalising individual conduct. The landmark court decision of *Salmon v Salmon & Co. Ltd* [1897] AC 22 reinforced the corporation as a separate entity, creating a ‘veil’ in allocating moral responsibility to the corporate entity,<sup>63</sup> accentuating Lord Dennings’s assertions that a corporation has ‘no souls to be damned, no body to kick’. Clough and Mulhern (2002) argue that, “[a] corporation is merely an aggregation of individuals and cannot commit crimes in its own right. Responsibility should therefore be brought home to the individual.”<sup>64</sup> In spite of this, according to an American criminologist Sally Simpson, empirical evidence in the US had produced contradictory findings in the impact of prosecution individuals in corporate cases.<sup>65</sup>

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<sup>56</sup> Breyer, S. (1998) ‘Typical Justifications for Regulation’, in Baldwin, R. Scott, C. and Hood, C. (ed.), *A Reader on Regulation*, Oxford University Press, Oxford, pp. 60-74

<sup>57</sup> Fisse, B and Braithwaite, J. (1993) *Corporations, Crime and Accountability*, Cambridge University Press, Cambridge, Op. Cit., p. 99

<sup>58</sup> Grabosky, P. and Braithwaite, J. (1986) *Of Manner Gentle: Enforcement Strategies of Australian Business Regulatory Agencies*, Oxford University Press, Melbourne, pp. 183-231, and Simpson, S. (2002) *Corporate Crime, law and Social Control*, Cambridge University Press, New York, pp. 1-21

<sup>59</sup> Black J (1997) *Rules and Regulators*, Clarendon Press, Oxford, pp. 5-9

<sup>60</sup> Id., Op. Cit., p. 7

<sup>61</sup> Id., 8-9

<sup>62</sup> Simpson, S. (2002) *Corporate Crime, Law, and Social Control*, Cambridge, Cambridge University Press, pp. 22-42.

<sup>63</sup> McSherry, B and Naylor, B (2004) *Australian Criminal Law: Critical Perspectives*, Melbourne, Oxford University Press, p. 366.

<sup>64</sup> Clough J and Mulhern C (2002) *The Prosecution of Corporations*, Melbourne, Oxford University Press, Op. cit., pp. 4.

<sup>65</sup> Id., p. 43.

Current legal theories and legislations have placed too much focus upon decision makers and accountability of their decisions, actions or inactions.<sup>66</sup> This does not reflect the fact that decision-making is complex and implementing new policies could be thwarted by a rigid corporate culture.<sup>67</sup> The dynamics of business decisions are often hostage to competitive pressures, as well as filtered by organisational politics varying the outcomes.<sup>68</sup> These intricacies suggest that it could be difficult for the regulators and the courts to clearly identify parties at fault. So a recent NSW Law Reform Commission supported the notion of imposing criminal sanctions upon the corporate entity as a whole, if the crime results from, “[c]orporate organisational processes and policies rather than actions of an individual; and where both the corporation and certain individuals within those organizations.”<sup>69</sup>

Yet Simpson (2002) notes, “[c]riminal law is an inefficient deterrent for corporate criminals.”<sup>70</sup> Unlike conventional crimes where the motivation is for individual needs, corporate manager perceive their decisions and actions are for the organisational ends, thus the organisation should be responsible.<sup>71</sup> Another added complexity is that purported illegal activities could often be view by both regulator and regulatee as usual course of behaviours or acts of business until detriment to other parties has been brought about.<sup>72</sup>

An alternative in Australia is to adopt civil law for regulatory ends. The advantage of adapting civil law with elements of criminalisation allows regulators more options to prevent or punish corporate offenders.<sup>73</sup> Arguably reputation and financial losses are more effective in deterrence, because it imposes a tax on corporate offences.<sup>74</sup> In addition, the prospect of securing a conviction is less onerous than the criminal process. Aggrieved parties could also seek compensation for losses as a result of corporate wrongdoing.<sup>75</sup> However one of the major weaknesses to adapting civil law for corporate offences is the lack of moral sanction.<sup>76</sup> Another issue arising is the growth of litigation or the use of litigation to drive policy changes does not

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<sup>66</sup> Id., pp. 17-63

<sup>67</sup> NSW Law Reform Commission (2003) ‘Sentencing: corporate offenders’, *NSWLRC Report 102*, June 2003, p. 2.

<sup>68</sup> Hancher L. and Morgan M. (1998) ‘Organizing Regulatory Space’, in Baldwin, R. Scott, C. and Hood, C. (ed.), *A Reader on Regulation*, Oxford University Press, Oxford, pp. 148-172 and Berns, S. and Baron, P. (1998) *Company Law and Governance: An Australian Perspective*, Oxford University Press, Melbourne, pp. 109-198, Clarke, T and Clegg, S (1998) *Changing Paradigms: The Transformation of Management Knowledge for the 21<sup>st</sup> Century*, London, Harper Collins, pp. 241-294.

<sup>69</sup> NSW Law Reform Commission (2003) ‘Sentencing: corporate offenders’, *NSWLRC Report 102*, June 2003, Op. Cit., p. 36.

<sup>70</sup> Simpson, S. (2002) *Corporate Crime, Law, and Social Control*, Cambridge, Cambridge University Press, Op. cit., pp. 60.

<sup>71</sup> Id., p. 57.

<sup>72</sup> McSherry, B and Naylor, B (2004) *Australian Criminal Law: Critical Perspectives*, Melbourne, Oxford University Press, pp. 364-367.

<sup>73</sup> Australian Law Reform Commission (2002) ‘Principled Regulation: Federal Civil and Administrative Penalties in Australia’, *ALRC Report 95*, December 2002, pp. 74-78.

<sup>74</sup> Simpson, S. (2002) *Corporate Crime, Law, and Social Control*, Cambridge, Cambridge University Press, p. 74.

<sup>75</sup> Id., p.73.

<sup>76</sup> Australian Law Reform Commission (2002) ‘Principled Regulation: Federal Civil and Administrative Penalties in Australia’, *ALRC Report 95*, December 2002, p. 87.

necessarily yield permanent solutions.<sup>77</sup> Regulating through courts has its drawbacks, decisions may be appealed and the final outcome maybe deferred for years.

The ALRC report on *Federal Civil and Administrative Penalties in Australia* in 2002 found that adapting the civil law system do not yield desirable results in deterrence or alter corporate behaviour in a substantial way.<sup>78</sup> Since February 1993, civil penalties had been codified in Australia. Anecdotal evidence from recent major corporate collapses does not show this approach is any more effective than criminal law (also see diagram two). Experiences in America had echoed similar results.<sup>79</sup> Furthermore, both the Business Council of Australia and the Australian Chamber of Commerce and Industry have recent stated in their position papers that business are confronted with heavier and heavier burden to comply with the multitude of business regulations. Apart from the high cost of compliance, the administrative hassle alone is enough to hinder businesses with multiple regulatory demands on virtual all aspect of commercial dealings.<sup>80</sup>

Hence given the nature of corporate life and the fallibility of imposing and prescribing rules, criminalisation, and civil litigation, socio-legal theorists argue that enforced self-regulation would a more efficient and effective compared to the traditional approaches, which are based on external or state imposed 'command and control' typecasting.<sup>81</sup>

Enforced self-regulation is a set of rules developed by regulatees and implemented via a compliance program. These rules are ratified by governmental agency and a violation could be an offence or censured. The formulation of these rules is ideally an interactive process, where regulators seek inputs from industry groups and professional bodies to develop self-regulatory principles, with the expectations that each corporation would implement an adequate internal compliance system overseen by either compliance professionals or management monitored by the board.<sup>82</sup> The advantages are:

- Flexible and adaptive,
- More efficient,
- Far reaching and comprehensive,
- Less resistant from corporations to implement,
- Easier to amend.

Whilst this regulatory approach has been an important contribution to the regulatory topography in Australia, particular in regulating businesses, because companies have

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<sup>77</sup> Viscusi, W. (2002) 'Overview', Regulation through Litigation, Brookings Institute Press, Washington, pp.1-20.

<sup>78</sup> Australian Law Reform Commission (2002) 'Principled Regulation: Federal Civil and Administrative Penalties in Australia', *ALRC Report 95*, December 2002, p. 88.

<sup>79</sup> Simpson, S. (2002) *Corporate Crime, Law, and Social Control*, Cambridge, Cambridge University Press, pp. 116-152.

<sup>80</sup> See Business Council of Australia (2005) 'Business Regulation Action Plan for Future Prosperity', *BCA Discussion Paper*, May 2004 and Australian Chamber of Commerce and Industry (2005) 'Holding Back the Red Tape Avalanche', *ACCI Position Paper*, Nov. 2005.

<sup>81</sup> Ayres I and Braithwaite J (1992) *Responsive Regulation: Transcending the Deregulation Debate*, Oxford University Press, New York, pp. 19-53 and 101-132

<sup>82</sup> *Id.*,

superior investigative and punitive capabilities to those of the government to regulate themselves. Such approach seems to be based upon an assumption or expectation that corporate actors are either virtuous or rational actors.<sup>83</sup> It is also overly dependent on the regulatees' willingness to co-operate and comply. Smith (2003) finds however serious frauds in Australia and New Zealand are not motivated by rational factors or logical deductions. In fact, their data suggest these crimes were driven more by irrational and personal factors.<sup>84</sup> Besides if corporate actors were virtuous and rational, would there be a need to regulate?

It is not inconceivable to insinuate that corporations might not be rigorously enforce various regulatory obligations, because corporations tended to concentrate their resources on yielding profits for their shareholders, and regulatory compliance could be somewhere else in the 'to do' list.

Suppose compliance is desirable, the system is still very much a top down affair.<sup>85</sup> Though nurturing compliance culture is expected to foster better enforcement ethos amongst executives and employees.<sup>86</sup> From an organisational perspective, this regulatory approach resembles the functionalist/contingence theories.<sup>87</sup> Postmodernist theories would challenge the effectiveness and practicability of such approach.<sup>88</sup> Compliance programs could also lead corporations to the trappings of complying at a superficial level, since it would be easier and cheaper to comply with the 'terms' stipulated in a selective manner, or 'blinkered' approach, rather than to reform the corporate 'culture' at every level of the organisation.<sup>89</sup>

Moreover, instituting an incentive regulatory structure was assumed to encourage corporations to implement a rigorous self-regulation plan, because regulators would adopt a 'tit for tat' enforcement strategy, where an escalation of reward-punishment structure creates greater incentives for corporations to comply (this is also known as pyramid of enforcement strategies).<sup>90</sup> Then again, delegating regulatory responsibilities would not actually eliminate certain business frailties like mismanagement, or failing to meet competitive pressures. Under pressure, corporate actors would be tempted to practice 'creative compliance' if they think they could get away with it or, believe that it could give them a competitive edge over other business competitors. This regulatory strategy does not bring into play an on going collaborative framework for the stakeholders and regulators to respond swiftly to abrupt predicaments or to crisis. Research by Bird *et al.* (2003) concluded that not

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<sup>83</sup> Regulatory Institutions Network (2004) *Rethinking Regulation: Ideas for Better Governance*, ANU, Canberra, p. 28

<sup>84</sup> Smith, R. (2003) 'Serious Fraud in Australia and New Zealand' *Australian Institute of Criminology Research and Public Policy Series No. 48*, Australian Institute of Criminology, Canberra, pp. 34-46

<sup>85</sup> See Standards Australia (1998) 'Compliance Program: AS 3806-1988'

<sup>86</sup> Parker, C. (2002) *The Open Corporation: Effective Self-regulation and Democracy*, Oxford University Press, Melbourne, pp. 62-167

<sup>87</sup> Donaldson, L. (2002) 'The Normal Science of Structural Contingency Theory', in Clegg, S. and Hardy, C. (ed.), *Studying Organization, Theory & Method*, Sage Publication, London, pp. 51-70

<sup>88</sup> Martin, J. and Frost P. (1999) 'The Organisational Culture War Games: a struggle for intellectual dominance', in Clegg, S. and Hardy, C. (ed.), *Studying Organization, Theory & Method*, Sage Publication, London, pp. 345-367

<sup>89</sup> Haines F (1997) *Corporate Regulation; Beyond 'punish or persuade'*, Clarendon Press, Oxford, pp. 93-159

<sup>90</sup> Ayres I and Braithwaite J (1992) *Responsive Regulation: Transcending the Deregulation Debate*, Oxford University Press, New York, pp. 38-51

only corporate prosecutions have been on the rise, the predominant enforcement preference of ASIC has been civil and criminal litigations in the middle to upper strata of the regulatory pyramid,<sup>91</sup> which suggests that this regulatory innovation might not as potent as the theory propose.

Alternatively, the notion of co-regulation has been suggested as hybrid regulatory concept. Co-regulation is not about regulatory outcome for a certain individuals or groups. The proposed notion of co-regulation is a cooperative, collaborative and inclusive framework. It draws from a stakeholder's approach and adapts into regulatory objectives, which has the capacity to address the concerns of affected parties or groups.

The government would therefore be a mediator for conflicting interests and consolidator of common and negotiated interests. Regulation should thus be an opportunity for stakeholders to work towards a collective outcome, rather than adversarial system. Except there are many unsolved operational concerns. For instance, communication amongst various stakeholders can be quite complex and drawn out if no consensus could be found.<sup>92</sup> Furthermore, participation of each stakeholder could be influenced by his or her own experiences and expertise. If the topic at hand was highly specialised certain professionals could dominate the deliberation process. The dynamics within these policy groups could evolve into highly political rather than problem solving entities.<sup>93</sup>

At this point, the paper has discussed the shortfalls of various regulatory strategies. The traditional 'command and control' regimes appear to have many limitations. More important, this approach has not yielded the desired outcome in deterring corporate offences or undesirable conduct. While enforced self-regulation has many merits, it appears to hinge upon on many behavioural assumptions to entice corporations to conform. Co-regulation also does not appear to be a viable alternative, much of the vulnerabilities suggest this approach is 'neither here nor there'. Barring an externally led or induced regulatory approach, an internally led mechanism not from a regulatory perspective, but rather an organisational perspective might be more effective in delivering the desired outcomes.

### **Complexities in Governing Corporations and Vested Interests:**

Farrar (1998) argues that, "[c]orporate governance...is a fashionable concept but like most fashionable ideas it is remarkably imprecise."<sup>94</sup> This imprecision fuelled mounting publications laying claim to its meaning, interpretation and applications. The rush to publish on a topical subject like corporate governance can often confuse and at times obscure the discussion of the subject altogether.

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<sup>91</sup> Bird, H., Chow, D., Lenne, J. and Ramsay, I. (2003) 'ASIC Enforcement Patterns', *Research Report*, Centre for Corporate Law and Securities Regulation, The University of Melbourne, pp. xiii-xiv

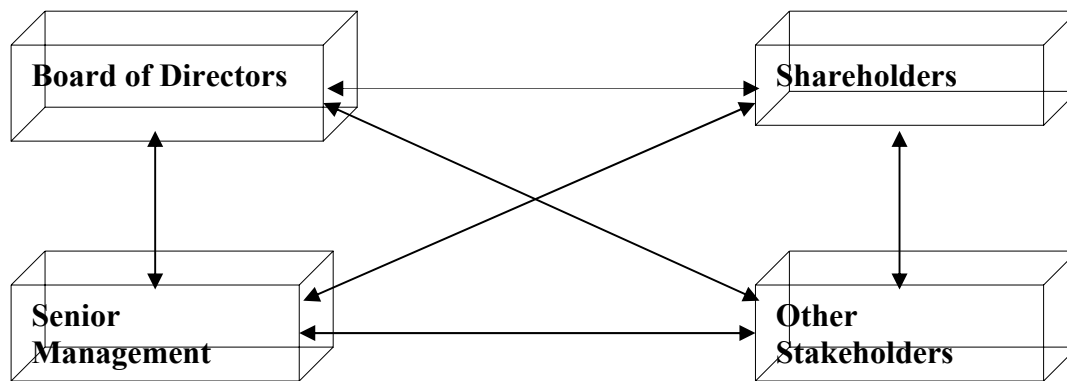
<sup>92</sup> Young, A. (2004) 'Co-regulation: a new form of interactive approach in collaborative business governance?' *Paper presented at the Annual Governance Network and Regulatory Institutions Network Conference*, 6-8 December, Canberra

<sup>93</sup> de Leon, P. (1994) 'The policy Sciences Redux: New Roads to Post-positivism', *Policy Studies Journal*, 22 (1), pp. 176-184

<sup>94</sup> Farrar, J. (1998) 'Opinion, Corporate Governance', *Bond Law Review, Special Issue: Corporate Governance*, Vol. 10, No. 2, Dec. 1998, Op. Cit., p. 141.

It is important to note at the outset that governance is interconnected and entwined with management, but one should be cautious not to interchange governance for management and vice versa, though in practice these two issues and personnel often overlap. Management concerns the day-to-day affairs and routines in running a corporation.<sup>95</sup> Corporate Governance narrowly defined concerns how a company is directed and steered,<sup>96</sup> or broadly understood as a system of checks and balances, both internal and external to companies, which ensures that companies discharge their accountability to all their stakeholders.<sup>97</sup> du Plessis et al. (2005) defined the concept as, “[t]he process of controlling management and balancing the interest of all stakeholders and other parties who can be affected by the corporation’s conduct in order to ensure responsible behaviour by corporations and to achieve the maximum level of efficiency and profitability for a corporation.”<sup>98</sup> In sum, governing is a balancing act between stakeholders, with particular emphasis on the interrelationships and roles between the board and management, where ultimate someone or body would be held accountable. (See diagram below)

Corporate Governance Matrix



*Source: Cochran and Wartick, (1988)*

But who should be accountable to whom, which group of stakeholder has priority, and where does the ‘buck stop’? These are complex issues not always apparent or easy to resolve within the context of governance.

Several theories of corporate governance have evolved. They are agency (Transaction-Cost), stewardship, resource network, and managerial hegemony.<sup>99</sup> Each theory draws from different perspectives and approaches, much of the claims draw from distinct ways in conceptualising the issue, hence how problems are envisaged and prescriptions are acquired varies. One certainty has emerged from these theories

<sup>95</sup> According to Clegg et al. (2005) management is the process of communicating, coordinating, and accomplishing action in the pursuit of organizational objectives while managing relationships with stakeholders, technologies, and other artefacts, both within as well as between organizations. Clegg, S., Kornberger, M. and Pitsis, T (2005) *Managing and organizations: An Introduction to Theory and Practice*, London, Sage Publication, p. 500.

<sup>96</sup> Farrar, J (2001) *Corporate Governance in Australia and New Zealand*, Melbourne, OUP, pp. 3

<sup>97</sup> Solomon, J and Solomon, A. (2004) *Corporate Governance and Accountability*, England, John Wiley & Sons, pp. 12-15.

<sup>98</sup> Du Plessis, J., McConvill, J., and Bagaric, M. (2005) *Principles of Contemporary Corporate Governance*, Melbourne, Cambridge University Press, Op. Cit., pp. 6-7.

<sup>99</sup> See Clarke, T. ed. (2004) *Theories of Corporate Governance; The Philosophical Foundations of Corporate Governance*, England, Routledge.

is that corporate governance is a multi-dimensional issue.<sup>100</sup> Why multi-dimensional? Even though corporations vary in size, type and purpose, they are complex, ever changing, interactive, and adaptive.<sup>101</sup> Accordingly, governance and governing a corporation is relative. The question is relative to what and whom?

The importance of corporate governance is often thrown into the limelight amidst corporate collapses, when regulators, shareholders, creditors, affect parties, and even commentators, ‘bay for blood’ and ‘look for people to blame’. Thus, it would be fair to look upon governance as a system of accountability, especially on matters concerning corporate collapses.

It is equally important to note that governance is not merely procedural or process oriented activity, nor should be conceive as ‘things to do’ or ‘to have’. Justice Owens states in the *Report of the HIH Royal Commission* that

I am becoming less and less comfortable with the phase ‘corporate governance’ – not because of its content but because it has been so widely used that it may become meaningless. There is a danger it will be recited as a mantra, without regard to its real import. If that happens, the tendency will be for those who have pay regard to it to develop a ‘tick the box’ mentality.<sup>102</sup>

Corporate governance can be further classify into two broad categorise, external and internal governance. External governance includes domestic and international regulations, share pricing, takeovers and mergers, credit ratings, accounts auditing, business analyst reports, suppliers, customers, creditors, institutional shareholders or shareholders of publicly listed companies and other affected parties. And internal stakeholders are board of directors, management, employees and shareholders (not publicly listed companies).<sup>103</sup> This distinction is important because the access to information, property rights, power of intervention, inclusion in decision making process, and operational issues of corporations differ between various groups.

Broadly the one could label Anglo-US model of governance as external since much of the emphasis to achieve good governance via external stakeholders, whilst the German-Japanese model focus upon the internal stakeholders.<sup>104</sup> But the crucial commonality in the external versus internal stakeholders debate (including convergence),<sup>105</sup> is that there is no substitute for the board of directors’ role, in

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<sup>100</sup> Corbett A. and Bottomley, S. (2004) ‘Regulating Corporate Governance’, in Parker C., Scott C., Lacey, and Braithwaite, J., *Regulating Law*, Melbourne, OUP, pp. 64-81.

<sup>101</sup> Bolman, L. and Terrence Deal (2003) *Reframing Organizations; Artistry, Choice, and Leadership*, San Francisco, Jossey-Bass, pp. 20-40.

<sup>102</sup> Report of the HIH Commission (Owen Report), (2003)

<<http://hihroyalcommission.gov.au/finalreport/index.htm>> xxxiii

<sup>103</sup> See Shleifer A and Vishny R (1996) ‘A Survey of Corporate Governance’, *NBER Working papers No. 5554*, April 1996, Zingales, L (1997) ‘Corporate Governance’, *NBER Working papers No. 6309*, Dec 1997, and Cochran P. and Wartick, S. (1988) *Corporate Governance; A Review of the Literature*, New Jersey, Financial Executive Research Foundation.

<sup>104</sup> See Charkham, J. (1995) *Keeping with good Company; A Study of Corporate Governance in Five Countries*, Oxford, OUP.

<sup>105</sup> See Milhaupt, C. ed. (2003) *Global Markets, Domestic Institutions; Corporate Law and Governance in a New Era of Cross-border Deals*, New York, CUP.

particular supervision over management and answerability (in variable degrees and depending on context) towards various stakeholders.<sup>106</sup>

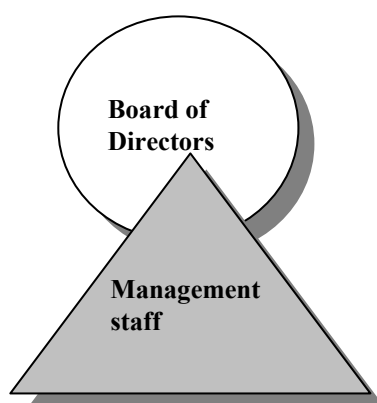
Henry Bosch (2001) argues in Australia,

An even greater change has taken place in the way companies are controlled. Before the 1990 the words “corporate governance” were rarely heard and little thought was given to ways in which directors could discharge their duties better. Since then something of a revolution has begun throughout the developed world and Australia has, in some respects, taken a leading part in it. At the heart of the changes, directors have come to take their role more seriously and to accept boards employ management, and may be held accountable for their actions. This has led to a more conscious defining roles; and to a greater care by boards in performing their own functions, and in seeing to it that management is managing properly.<sup>107</sup>

This was also echoed by Justice Owen stating, “[f]or me, the key to good corporate governance lies in substance, not form. It is about the way the directors of a company create and develop a model to fit the circumstances of the company and then test it periodically for its practical effectiveness.”<sup>108</sup> Therefore directors are in fact corporate governors.

Section 9 of *Corporations Act 2001* (Cth.) stipulates that the roles of directors and managers seem to ‘blur’, ‘director’ and ‘officer’ appear to be interchangeable (to a certain extent), in part, because executive directors manage the corporation, as well as be a member of the board of directors. Austin (2005) et al. note that, “[C]orporations Act contemplates that management, in the absence of contrary provision in the company’s constitution, will be vested in a board of directors consisting of natural persons.”<sup>109</sup> But it is important to note not all directors are involved with managing the corporation (see diagram below).

#### Board and Managers



<sup>106</sup> Du Plessis, J., McConville, J., and Bagaric, M. (2005) *Principles of Contemporary Corporate Governance*, Melbourne, Cambridge University Press, pp. 14-52.

<sup>107</sup> Bosch, H. (2001) 'Introduction' in *Collapse Incorporated: Tales, Safeguards & Responsibilities of Corporate Australia*, CCH, Sydney, Op. Cit., p. 3.

<sup>108</sup> Report of the HIH Commission (Owen Report), (2003) <<http://hihroyalcommission.gov.au/finalreport/index.htm>> para 6.6

<sup>109</sup> Austin B., Harold, F. and Ramsay, I (2005) *Company Directors; Principles of Law and Corporate Governance*, Sydney, Butterworths, Op. Cit., p. 59

Source: Adapted from Tricker, R. (1994)

Therefore *Corporations Act 2001* (Cth.) states that the board of directors' role is to govern and manage the affairs (both internal and external) of a corporation.

Boards today are confronted with ever increasing responsibilities and pressures from technological changes, competition from across the globe, to an extent the boards are struggling to keep up with the rapid changing in the business environment.<sup>110</sup> Within the board there are issues arising from composition and structure, meetings and scrutiny over the CEO and CFO. These issues are not merely structural or procedural. Logically the 'formula' for an effective board hinges upon relationship between its members.<sup>111</sup>

From a business perspective according to Kiel and Nicholson (2003) the major roles of boards are:<sup>112</sup>

- Strategy formulation and approval
- CEO/CFO selection, monitoring, evaluation, mentoring, remuneration and removal
- Monitoring of organisational performance
- Overview of risk management policies and practices
- Overview of compliance policies and practices
- Network on behalf of organisation
- Communicate with stakeholders
- Exercising control of the organisation in times of crisis

Each of these roles calls for care and diligence to be employed at all times, this suggest board member would have to constantly interact and consult with individuals and groups both inside and outside of the corporation, so as to execute their duties effectively.

Under *Corporations Act 2001* (Cth.) the duties of a director stimulated in sections 180-184, and 588G, underscore that directors should at all times be 'acting in the interest of the company as a whole'. So what is in the interest of the company? The company defined under section 124 is a separate entity and the internal management is regulated by the company's constitution under section 134, and if there is no restrictions barring the company from signing contracts and be tortious liable for acts and omission, as well as be liable for criminal acts, thus the role of a director under law is to manage and be accountable to all stakeholders for the actions or inactions of a company. Therefore the interest of the company is all concerns that could affect the company's past, present and future. All concerns means customers, suppliers, creditors, auditors, regulators, shareholders, employees, and the community the

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<sup>110</sup> Carter C and Lorsch J (2004) *Back to the Drawing Board; Designing Corporate Boards for a Complex World*, Boston, HBS, pp. 15-40.

<sup>111</sup> Frances, I (1997) *Future Direction; The Power of the Competitive Board*, London, FT Pitman Publishing, pp. 163-179.

<sup>112</sup> Kiel G. and Nicholson (2003) *Board that Work; A New Guide for Directors*, Sydney, McGraw-hill, p. 104

company affects indirectly like the environment or social impacts. Clarke and Clegg (1998) argue that, “[t]he importance of developing good stakeholder relationships for successful enterprise in the information age is becoming increasingly apparent.”<sup>113</sup> This is reiterated in Recommendation 10.1 of the Australian Stock Exchange, Principles of Good Governance and Best Practice Recommendations in 2003.<sup>114</sup>

Back to the question previously asked, ‘whose interest has priority?’ Clarke and Clegg (1998) also concur, “[o]nce it has been established who key stakeholders are, and what it is they value in their relationship with a business, there remains the tricky job of assessing whether, over time, relationships are improving as planned.”<sup>115</sup>

If we look at insolvency provisions under *Corporations Act 2001* (Cth.), the priority is as follows: secured creditors, unsecured creditors, tax, employees and contributors (shareholders). According to Farrar (2001) in Australia directors ranked shareholders interests first, the company as a whole second, customers third.<sup>116</sup> However these two positions tend to be rigid and not taking into account the dynamic nature of the business environment these companies operate. Ranking should therefore depend on the context by considering the potential impact of each stakeholder on the company at a given time and situation, on condition that the foreseeable outcome is in the interest of the long run sustainability and profitability of the company. Another proviso should be taken on board is that decisions made should not make any particular group of stakeholder worst off.

Arguably, convergence of both business and legal perspectives with respects to effective corporate governance is to have an effective board, and an effective board is to manage the relationships and interests of various stakeholders. Then would do we treat the issue of accountability? Can the board be accountable to every stakeholder, given the complexity and sometimes-ambiguous nature of a corporation? If they are, are we simply looking for people to blame when things go wrong? If they are not, then who is in charge? Does accountability insinuate looking someone or body to blame if things go wrong. But the debate has only thus far only begun to deal with a complex question. More important if various stakeholders all have an interest in a corporation’s performance governance should thus be every stakeholder’s business. The board could act as a co-ordinating body to address stakeholders’ interest.

## **Conclusions:**

This paper has thus far only ‘scratched the surface’ of a multi-dimensional and constantly evolving issue of corporate regulation and governance. Whilst Australia’s experience with regulation has shown an ever mounting number of regulation for businesses to comply, problems prior to regulation has not seemed to abate, except for the fact that regulators are responding faster by prosecuting or litigating against corporations and directors for their part in corporate failures, mischief and wrongdoings. The climate of tougher enforcements suggests that corporate

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<sup>113</sup> Clarke, T and Clegg, S (1998) *Changing Paradigms; The Transformation of Management Knowledge for the 21<sup>st</sup> Century*, London, Harper Collins, Op. Cit., p. 367.

<sup>114</sup> <<http://www.shareholder.com/visitors/dynamicdoc/document.cfm?documentid=364&companyid=A SX>>

<sup>115</sup> Id., Op. Cit., pp. 335

<sup>116</sup> Farrar, J (2001) *Corporate Governance in Australia and New Zealand*, Melbourne, OUP, p. 35

wrongdoings are not tolerable given the willingness of regulators to act upon any signs of mischief. But what is accomplished is more prosecutions and litigation, not necessarily achieving greater deterrence or rectifying the root causes at all.

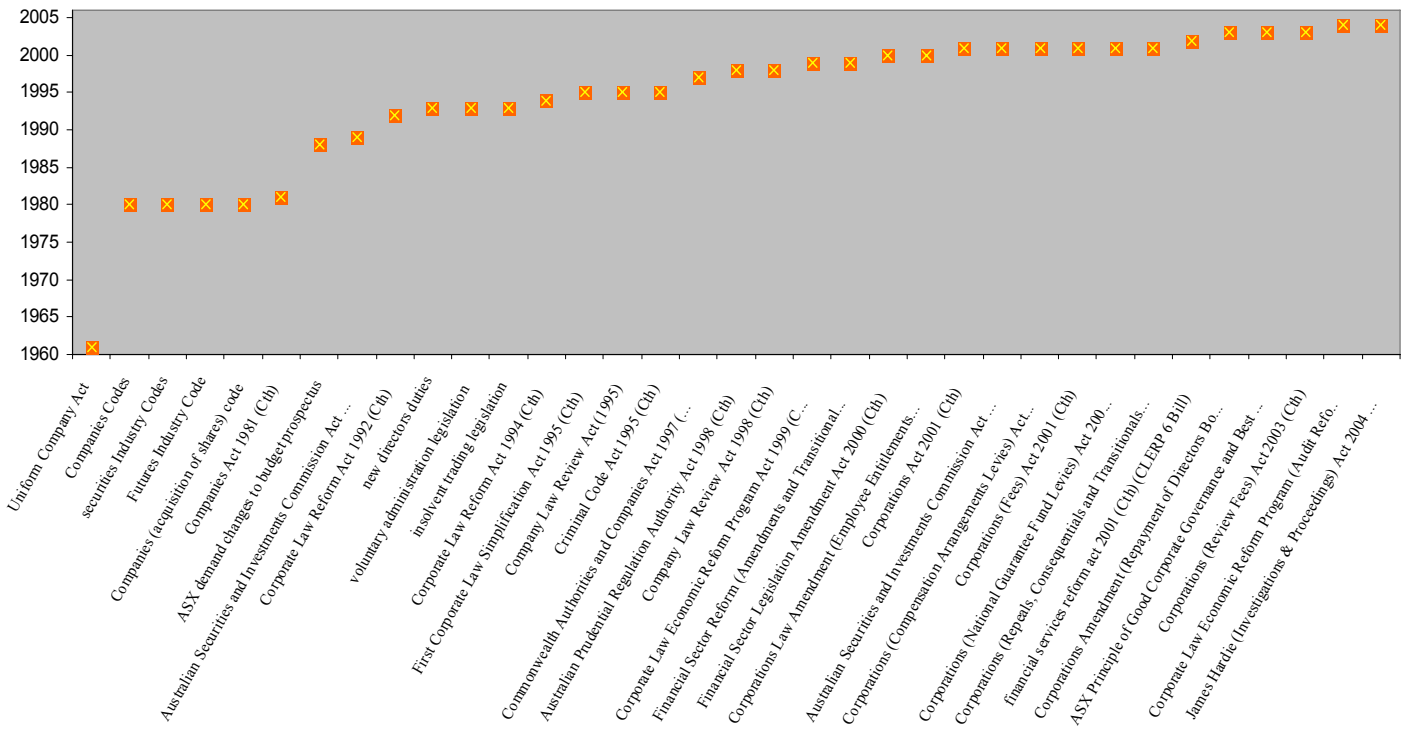
On the one hand, regulatory innovations might assist in alleviating shortfalls in traditional 'command and control' type regulations and improve compliance, nevertheless, there are still weaknesses to this approach, which suggest regulatory reach might be limited despite the regulators' will. On the other hand, self regulation in conjunction with 'tit-for tat' enforcement is still a viable regulatory tool.

Corporate governance is another important part of regulating corporate behaviour. Setting aside the ongoing debate about what is corporate governance, and what does governance accomplish, there has been greater emphasis on developing a system of checks and balances to control the organisation and its management, as well as a system of accountability to the corporation's stakeholders. Clearly there should be substance in governance rather than merely instituting mechanisms or 'tick list'. At the heart of governance is the board of directors. If the effectiveness of governance is linked to the performance of the board then what the board does becomes a key factor.

With modern business environment growing and innovating at a rapid pace and competition is global, boards have to respond to an ever more complex and competitive environment with multiple stakeholders. Neglecting or mishandling any group of stakeholder could be determinant to the company's sustainability and profitability. However having effective corporate governance might not be adequate to 'tame' or prevent certain groups of stakeholder from taking advantage or harming the corporation's interest, this is where regulation is crucial to either punish or restrict such behaviour. Therefore, regulation and governance should work hand in hand. And since the success of regulation is measured by its ability to modify or curb behaviour, and effective governance is about accountability towards various stakeholders, combined good governance and responsive regulation could mean cooperation between all stakeholders. Cooperation requires constant interaction, communication and negotiation. But what if the stakeholders cannot agree to a course of action? Besides, cooperation does not prevent the vested interest of a certain group of stakeholders from capturing or dominating the agendas in governance. Nevertheless, this paper suggests that managing relationships between stakeholders of a corporation with the board acting as a coordinating and governing body and the regulators as 'governors of last resort', is the key to moderating corporate collapses. The relationship managing role of the board calls for board members to be better trained, qualified and perhaps professionalised.

# Diagram One

## Corporate Governance Legislation/Regulations/Codes



**Diagram Two**  
**Corporate Governance**

