CORPORATE GOVERNANCE IN AUSTRALIA: OWNERSHIP PERSPECTIVE

*Shreya Srivastava**

INTRODUCTION

Corporate governance in Australia has come to light, especially in wake of the increased globalization of business and corporate collapses in the recent past. The reasons behind those collapses are many and include fraud and dishonesty, stock option manipulation, poor market knowledge, incompetence and poor decision making, insolvent trading, money laundering, accounting failures, breaches of directors' duties, excessive pay to executives, extravagance, the arrogance of management teams, and the directors' exaggeration about performance and failure to ascertain facts.[1] Thus, in order to increase investor confidence and generally improve the corporate regime in Australia, more focus has been put on the system of corporate governance in the continent. In Australia, different ownership structures have prevailed at different points of time. These can broadly be classified as:

- Insider control by close-knit business groups, including non-institutional blockholders
- Institutional shareholders

These have in turn had an impact on how the corporations are governed. The author has tried to analyse these different categories and their significance upon the corporate governance structure of Australia.

INSIDER CONTROL

Individual shareholders

Separation between ownership and control has been a relatively recent characteristic of firms in Australia Australian companies in the first half of the twentieth century were best described as 'family capitalism' with important director and managerial positions held by a close-knit business group. There is little evidence of hierarchies of salaried managers outside the banks, pastoral companies or mining houses. Indeed, a study of the largest 102 companies in Australia in the indicated the founding families

* Teaching and Research Associate, Gujarat National Law University

[1] John Zadkovich, *Mandatory Requirements, Voluntary Rules and Please Explain: A Corporate Governance Quagmire,* 12 Deakin L. Rev. 23 2007, available at www.heinonline.org, last visited 8th July, 2016.

were in a position to control the majority of those companies through their board positions and shareholdings. Only one third of domestic companies could be identified as management controlled.[2] Further, a 1998 study shows that 86% of medium-sized companies and 84% of small companies in the sample had a non-institutional investor with at least a 10% shareholding. This was most commonly a family shareholder.[3]

Blockholders

The same study as quoted above shows that 46% of large companies have a non-institutional investor with at least a 10% shareholding. This was most commonly a non-institutional corporate shareholder. The blockholders have the ability to intervene in the affairs of management. The difference in the attitude of blockholders is visible from the following examples; where one non-institutional corporate shareholder has a strategic blockholding in another company - such as where it is a major supplier, competitor or customer - industrial strategy considerations will tend to prevail over the desire to maximise financial returns on equity. A blockholder that is also a creditor of the company may be more interested in securing the prompt repayment of loans plus interest than the maximisation of shareholder returns. Moreover, in some cases prestige and family heritage considerations may be important determinants of blockholder behaviour.

Large shareholders can exert governance through two main mechanisms. The first is direct intervention within a firm, otherwise known as "voice." Examples include suggesting a strategic change via a public shareholder proposal or via a private letter to management or voting against directors. Although most of the early research on blockholder governance has focused on voice, a recent literature has analyzed a second governance mechanism—trading a firm's shares, otherwise known as "exit," following the "Wall Street Rule," taking the "Wall Street Walk," or "voting with your feet."[4] If the manager destroys value, blockholders can sell their shares pushing down the stock price and thus hurting the manager ex post. Ex ante, the threat of exit induces the manager to maximize value.[5]

[2] Grant Fleming, *Corporate Governance in Australia,* Agenda, Volume 10, 2003
[3] *Ibid*
[4] Alex Edmans, *Blockholders and Corporate Governance,* working paper series, available at www.ssrn.com, last visited 8th July, 2016.
[5] *Ibid.*

Blockholders may also have the opposite affect instead of resolving a problem. The threat of intervention may erode managerial initiative, and their mere presence may lower liquidity. Second, instead of maximizing firm value, blockholders may extract private benefits. There may also be conflict of interest between the blockholders and small shareholders.

This concentrated ownership structure has several implications. For instance, it can have consequences on remuneration of management. The managers may not end up paying themselves excessive regulation, as opposed to diffused ownership, as here the management and share owning is intricately related. The type of ownership also affects the type of remuneration received by managers. An authoritative study found that when a company has a dominant shareholder, bonuses and long term incentives adopted as part of the remuneration plan ensure that CEO's remuneration primarily reflects the performance of the company. This is not true for management controlled companies.[6] Companies having concentrated ownership also warrant broader freedom to contract than their counterparts. This principle has been recognized in Australia's Companies and Securities Law Review Committee Report of 1989, with respect to director's duties. It was suggested that nominee director should not be held responsible for breach of his duty if- all shareholders had given their consent to the particular exercise of power or performance of duty in that way; or the company is being managed in accordance with an agreement to which all shareholders are parties which authorize the director to take into account the interests of one or more of the shareholders in the particular exercise of power or performance of duty.[7]

Conflicts between managers and shareholders have been in the forefront in the Australian corporate landscape. However, some of these conflicts have been inter-investor conflicts as well, where majority shareholders have hampered the interests of the minority. This happens because sometimes managers cause companies which they control to invest in public companies which they also manage. They then engage in wealth transfers from minority shareholders in public companies to those companies which the managers control. [8]

Institutional investors

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[6] Ramsay et al, *Ownership Concentration, Institutional Investment , and Corporate Governance: An Empiirical Investigation of 100 Australian Companies,* available at www.ssrn.com, last visited 8th July, 2016.

[7] *Ibid.*

[8] *Ibid.,* as per the data collected by the Australian Securities Commission.

An institution investor can be defined as 'institutions which have as their primary role the professional investment and management of any fund established for the purpose of pooling monies paid by individual investors and invested in financial and non-financial assets.' The importance of institutional investors in Australia can be seen from the fact that the life insurance and superannuation bodies together with other financial institutions particularly the investment companies, own in excess of 33 per cent of the listed equity in Australian corporations.[9] By 2009, the figure had increased to 64%[10]. In Australia, the two major categories of institutional investors are investment managers (including insurance companies) and superannuation funds.

The impact of institutional investors on the corporate governance codes can be seen a s follows:

- That these investors have not demonstrated willingness to monitor adequately the management of the companies in which they invest.
- That these investors have interests that do not necessarily coincide with the interests of the company, thereby acting for their benefit and harming the interest of less influential shareholders.
- Have a short term focus that leads companies in which they invest to neglect lng term planning and business development.

In Australia, superannuation funds and investment managers have become more diligent in exercising ownership rights over the past decade. Greater institutional investor involvement on corporate governance has been spearheaded by superannuation funds. A decade ago, there were no expectations on investment managers to focus on corporate governance. Since then, however, superannuation funds have increasingly pressed their asset managers to vote and engage investee companies more actively.[11] One superannuation fund stated that it was willing to pay a higher management fee to enable fund managers to devote greater resources to corporate governance activities.[12]

At the same time, however, many superannuation funds appear to incentivize their asset managers to deliver short-term performance. According to a veteran investor relations executive, fund managers

[9] Lynden Griggs, *Institutional Investors and Corporate Governance,* available at http://www.austlii.edu.au/au/journals/JCULRev/1996/4.pdf, last visited 8th July, 2016.
[10] The Role of Institutional Investor in Promoting Good Corporate Governance, available at http://www.oecd.org/daf/ca/49081553.pdf, last visited 8th July, 2016.
[11] *Ibid.*
[12] *Ibid.*

in Australia rarely ask questions on long-term sustainability and corporate governance matters because their superannuation clients focus mostly on their near-term performance.[13]

[13] *Ibid.*