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A profile of the non-executive directors of Australia's largest public companies

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Abstract

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Keywords

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A profile of the non-executive directors of Australia's largest companies

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1. Introduction

In the wake of high profile business collapses such as Enron, WorldCom, HIH Insurance, and OneTel, and the increase in shareholder activism, public attention has become more focussed on corporate governance (Petra, 2005; Peaker, 2003; Roberts et al., 2005). A common feature of these corporate scandals has been an inadequate system of corporate governance (O'Regan et al., 2005). Defined as the “system by which companies are directed and controlled” (ASX, 2003, p. 3; Long et al., 2005, p. 667), corporate governance is concerned with the “duties and responsibilities of a company’s board of directors in managing the company” (Pass, 2004, p. 52).

Conflicts of interest between company directors and executives have prompted both legislative and non-legislative reform aimed at safeguarding the interests of corporate stakeholders and strengthening the independence of company boards through the appointment of non-executive directors. Described as the “mainstay of good governance” (Editorial, 2003, p. 287), non-executive directors are considered to be a guarantee of the integrity and accountability of company boards. Although efforts to define the role of a non-executive director are said to have “taxed the nation’s finest intellects” (Ham, 2002), non-executive directors typically participate in long-term decision making, contribute external business expertise, identify potential business opportunities, and monitor the actions of company executives (Pass, 2004; Long et al., 2005; Higgs, 2003).

Much of the academic literature concerning corporate governance and board composition in Australia and elsewhere has sought to establish causal relationships between board structure and firm performance or sought to apply a theoretical explanation for the behaviour of corporate boards. Kiel and Nicholson (2003), for example, examined the top 348 companies in the Australian Stock Exchange (ASX), describing the board composition, examining the correlates of board composition, and

attempting to link board demographics with corporate performance. Sharma (2004) studied the relationship between board independence and fraud across a sample of 62 Australian listed companies. He found that the presence of independent directors on company boards, and the absence of duality (board of director chairman not also being the CEO) significantly reduced the likelihood of fraud (Sharma, 2004). In the Malaysian context, Abdullah (2006) used regression analysis to predict, *inter alia*, the relationship between board independence and financial distress using a sample of companies listed on the Bursa Malaysia, finding no statistically significant relationships between these variables.

Long et al. (2005) compared the role of non-executive directors between listed and unlisted UK companies. Based on a series of semi-structured interviews which covered issues relating to strategy involvement, financial monitoring, and overall board contribution, they found that non-executive directors on listed boards are inhibited by high levels of visibility, shareholder perception, information asymmetry, and the impact of corporate governance regulation (Long et al., 2005). Brennan and McDermott (2004) assessed the extent of independence of boards of companies listed on the Irish stock exchange, profiling 80 company's boards and their adherence to the independence requirements set out in the Higgs Report.

Interestingly, Hooghiemstra and van Manen (2004) proposed an "independence paradox" concerning the role of non-executive directors. They conducted telephone interviews and mail questionnaires to survey the opinions of Dutch non-executive directors regarding their roles and limitations. They found that, although non-executive directors are expected to operate independently from management, in practice, they are unable to do so because they rely on this same

group to provide them with the information necessary for decision making, thus leading to an independence paradox (Hooghiemstra & van Manen, 2004, p. 322).

In an examination of the characteristics of non-executive directors in the UK, Pass (2004) conducted an empirical study of 50 listed companies. Gathering data on non-executive directors' characteristics such as age, gender, length of service, remuneration, and other directorships, Pass's (2004) study presented a comprehensive profile of non-executive directors within large UK companies and considered the consistency of this profile with the requirements and recommendations contained in legislative reforms. The value of studies such as that conducted by Pass (2004) was noted by Pettigrew (1992, p. 178) who argued that:

...the study of boards and their directors has not been helped by over-ambitious attempts to link independent variables such as board composition to outcome variables such as board and firm performance. The task perhaps is a simpler one, to...provide some basic descriptive findings about boards and their directors.

Following the lead of Pass's (2004) study, and keeping in mind the comments of Pettigrew (1992), this research provides a descriptive profile of the non-executive directors of Australia's largest public companies. In the next section, the Australian corporate governance framework is reviewed. This is followed by details of the sample of companies examined and a description of the characteristics of the non-executive directors of these companies. Finally conclusions are presented, along with research limitations and suggestions for future research.

2. Background: Corporate governance in Australia

Corporate governance policy reform in Australia has primarily been a response to both local and international corporate collapses, which were largely due to

fraudulent behaviour and practices of key executives and inadequate corporate governance systems. Even though the Australian corporate failures “lacked the global impact of American failures like Enron and WorldCom” (Robins, 2006, p. 34), Australian organisations such as HIH Insurance, and OneTel brought home the reality of the larger, and more publicised, collapses of US organisations. The US response was principally legislative, for example the Sarbanes-Oxley Act of 2002. In Australia the response has been a mix of legislative and non-legislative initiatives which have included the development of the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act, known as “CLERP 9”, the adoption of the International Financial Reporting Standards, and the establishment of a Corporate Governance Council by the ASX (Robins, 2006).

Work began on CLERP 9 in September 2002, with one of the key aims being to restore public confidence in corporate Australia by strengthening the disclosure, financial reporting, and governance framework within which Australian businesses operate. Also at this time, the HIH Royal Commission, led by Justice Neville Owen, was underway to inquire into the circumstances surrounding the failure of the HIH Insurance Group. The Royal Commission has had an important influence on corporate governance in Australia with many definitions, models, and principles considered by Justice Owen during his investigation. In sections 6.1 and 6.2 of the HIH Final Report, Justice Owen noted the importance of corporate governance structures that would not prejudice the interests of creditors, employees, and shareholders, and that would ensure that these stakeholders have confidence in the management of the business (HIH Final Report, 2003). The background, skills, and expertise of board members were considered relevant to the development of good corporate governance practices and Justice Owen stressed the importance of the

presence of independent non-executive directors on company boards (HIH Final Report, 2003).

Just prior to the handing down of Justice Owen's HIH Final Report in April 2003, the ASX's Corporate Governance Council released its ten Principles of Good Corporate Governance in March (see Figure 1). These ten principles, and associated recommendations and guidelines, were intended to optimise "corporate performance and accountability in the interests of shareholders and the broader community" (ASX, 2003, p. 5).¹ Recognising that not all companies have the same reporting and disclosure requirements, and, consistent with the recommendations of Justice Owen (HIH Final Report, 2003), the ASX Principles were not made compulsory, however if a listed entity elected not to follow the recommendations, justification must be provided.

Take in Figure 1

As shown in Figure 1, the second principle refers to the structure of the board of directors. It is recommended that boards of listed organisations have a majority of non executive independent directors so that the board is able to appropriately discharge its responsibilities and duties. The purpose of non-executive director independence, both actual and perceived, is to provide key stakeholders such as shareholders and regulators with confidence that the director is sufficiently removed from the management of the organisation and "free of any business or other relationship that could materially interfere with the exercise of their unfettered and independent judgement" (ASX, 2003, p. 19). Reiter and Rosenberg (2003, p. 1) supported this argument by explaining that the true independent director is one who is "unconstrained by potential conflicts of interest will bring the sort of rigour and

¹ The ASX Corporate Governance Principles have been updated and were to be effective from 1 July 2007, however the date for their adoption has been postponed until 1 January 2008 (ASX, 2007).

critical analysis required to limit recurrences of the debacles we have seen, and restore investor confidence”.

Leblanc and Gillies (2003) suggested that an effective board is composed of directors who are independent and competent and behave in manner that supports these characteristics. Competence has been measured by reference to such factors as years of experience, qualifications, and breadth of experience (O’Higgins, 2002; Pass, 2004). However ascertaining whether or not a director is truly independent is more subjective and it may be difficult to determine the level of independence of particular directors (Leblanc & Gillies, 2003). The ASX recommendations enable a non-executive director to be classified as independent provided he or she is not a substantial shareholder of the company, has not been employed by the company in an executive capacity during the last three years, has not been a material professional advisor of the company during the last three years, has no material contractual relationship with the company (ASX, 2003).² However, while a director may meet the ASX definition of an independent director, social relationships, friendships and other forms of conflicts can compromise independence (Leblanc & Gillies, 2003). Young (2003, p. 2) defines this ASX-type definition of independence as “resume independence”.

To examine the profile of non-executive directors serving on the boards of Australian listed companies, a sample was selected from the ASX 50 listing. Details of the sample and the data gathered are provided in the following section.

² The ASX Principles (2003) state that an independent director is a non-executive director if he or she is not a member of management. The data for this research were collected on the basis of this definition, hence (if not made explicit in the annual report) where an independent director was not part of the management team, they were considered a non-executive director, and where non-executive directors were considered to be independent from management.

3. Empirical tests

3.1 Sample selection

A sample of 42 companies was selected from the ASX 50, which comprises the 50 largest stocks by market capitalisation in Australia (ASX, 2006). A list of the companies selected for the analysis is presented in Appendix 1. Eight companies were eliminated from the sample because information concerning the non-executive directors was absent or the company structure was not typical of a reporting entity. For example, Macquarie Airports which consists of three entities, a company incorporated in Bermuda, and two trust vehicles (Macquarie Airports, 2006). The 42 companies that comprised the sample group for this study were drawn from 9 industry sectors, as summarised in Table 1.

Take in Table 1

The 2006 annual report for each company of the sample was obtained and, consistent with Pass (2004), the following information gathered:

- Non-executive directors as a percentage of total board of directors
- Age of each of the non-executive directors, where available
- Gender of each of the non-executive directors
- Average time served by the non-executive directors on the company board
- Remuneration of each non-executive director
- Number of other non-executive directorships held

The results from this analysis are presented in the following section.

4. Results

4.1 Non-executive directors as a percentage of total

As noted, 42 companies were selected for the analysis. Across that sample there were 288 non-executive directors from a total of 354 board members. Therefore, in total, 81 percent of company board members were independent non-executive directors. The ASX requirement that the majority of board members be independent from management was met by all companies sampled. The companies with the lowest percentage of non-executive directors were Macquarie Bank (64 percent) and Westfield (62 percent), however these boards still maintained a majority of non-executive directors.

In comparison with the UK, it appears that Australian boards contain proportionally more non-executive directors. The majority of companies studied by Pass (2004) had non-executive directors comprising between 50 and 60 percent of the total board. It is also interesting to note the results of Kiel and Nicholson's (2003) examination of Australian corporate boards in 1996. Although their research involved a sample of 348 companies and is therefore not comparable to the current study, Kiel and Nicholson (2003) reported that the average proportion of non-executive directors on Australian company boards in 1996 was 69 percent.

4.2 Age and gender of non-executive directors

The average age of non-executive directors on Australian company boards ranged from 32 to 74, with the average age being 60 years. This result is consistent with Pass (2004) who reported the average age of non-executive directors on the boards of the 50 largest UK companies to be 59 years. Interestingly, the average age of male non-executive directors (61 years) was significantly higher than that of female non-executive directors (53 years).

There were significantly fewer female non-executive directors compared to males, with just 17 percent of company boards including one or more female non-executive directors. This compares to Pass' (2004) study which showed women represented 11 percent of the total number of non-executive directors examined. Both these and Pass's (2004) results appear to be an improvement on the situation described by Li and Wearing (2004), who reported that only 6 percent of non-executive directors in the top 350 UK listed companies were female and suggested that women face a "second glass ceiling" even after reaching board level (Li & Wearing, 2004, p. 355). Indeed, there were only two female Chairmen serving on Australian company boards during 2006.

4.3 Time served by non-executive directors

According to ASX Principle 2, to be considered independent from management, a director must "not have served on the board for a period which could or could reasonably be perceived to materially interfere with the director's ability to act in the best interests of the company" (ASX, 2003, p. 20). Therefore, it was important to collect data on the length of time served by non-executive directors on company boards. As shown in Table 2, the length of service ranged from less than one year to 23 years, with the average time served by non-executive directors on a particular company board being 6 years.

Take in Table 2

This result is consistent with Pass (2004) who found that the average length of service by non-executive directors was 5.6 years. However, the substantial length of time served by some non-executive directors, particularly those spending 10 or more years with the same company, could reasonably be perceived to interfere with the

independence of these board members from the company and thus conflict with ASX Principle 2.

4.4 Remuneration of non-executive directors

The ASX Principles provide that non-executive directors may receive remuneration but that it must be disclosed clearly and adequately distinguished from the remuneration applied to company executives. In almost all cases this Principle was adhered to by the companies sampled. However, it was the independence principle that became questionable upon reviewing the salary packages of non-executive directors. The average remuneration of non-executive director chairman of company boards in 2006 was \$456,946, while the average salary of all other non-executive directors in that year was \$149,662. While this remuneration pales in comparison to the salaries and share options packages received by executives of these major companies, it would be difficult to justify, particularly to a layman, the independence of non-executive directors from a company that is paying them salary in excess of \$149,000.

4.5 Other non-executive directorships

There has been global concern over the incidence of multiple directorships (Pass, 2004; Kiel & Nicholson, 2006). Although there may be some benefits of multiple directorships, such as bringing to company boards access to key resources, the Australian Shareholders Association has argued that any director who serves of more than five boards is not acting in the best interests of company shareholders (Kiel & Nicholson, 2006). The non-executive directors examined in this sample held an average of three other directorships, with the largest number of other directorships held being nine (see Table 3).

Take in Table 3

Many of these multiple directorships are held with other companies within the ASX 50. For example, Ms Elizabeth Alexander serves on the boards of Boral Ltd and CSL Ltd, and Dr Nora Scheinkestel serves on the boards of AMP Ltd, Orica Ltd and Newcrest Mining Ltd. Mr David Gonski, a non-executive director of Westfield Holdings Ltd, is also the Chairman of Coca-Cola Amatil and a director of ANZ Ltd, while Mr Don Argus serves on the boards of BHP Billiton Ltd and Brambles Industries Ltd. These overlapping relationships of directors across companies, referred to as interlocking directorships in the literature, enable board's to remain strategically aware of other company's actions and may facilitate the development of strong lobbying positions among major corporations (Murray, 2001).

5. Summary and conclusion

This study has indicated that Australia's largest companies are adopting ASX Principles of Good Corporate Governance. One of the key issues in Australian corporate governance reform has been the appointment of non-executive directors to company boards (ASX, 2003; Robins, 2006). In this analysis of 42 companies, of the 354 board members reviewed, 81 percent were non-executive directors. However, despite the appointment of non-executive directors to corporate boards, concerns as to the actual and perceived independence of these directors persist. While actual independence may be difficult to ascertain without being privy to the nuances of boardroom friendships, social relationships, and other forms of potential conflict, the perception of independence may be significantly compromised by the levels of remuneration received by non-executive directors. In the companies' sampled, the average level of remuneration of non-executive chairmen was \$456,946 and, for non-executive directors, average remuneration was in excess of \$149,000. It would be

difficult to explain to key stakeholders at an annual general meeting that a non-executive director of a company can act independently while at the same time receiving such substantial compensation. The ASX Principles address this issue by simply stating that the level of remuneration must be “sufficient and reasonable” (ASX, 2003, p. 51). The subjectivity of these terms inhibits their usefulness as a source of valuable guidance. A related issue was identified by Hooghiemstra and van Manen (2004) as the independence paradox which arises due to non-executive directors, in the course of fulfilling their responsibilities, relying heavily on the information provided by the same executives from whom they are to said to be independent.

The primary limitation of this study is the size bias resulting from the review of Australia’s largest companies. The research could be extended to include a random sample of companies outside the top 50 and the examination could be conducted over a period of time to obtain a broader perspective of corporate governance practices in Australia. Future research could also incorporate theoretical perspectives such as network theory used by Murray (2001) to explain interlocking directorships across company boards.

It is argued that the presence of competent non-executive directors on the boards of companies is a significant benefit to the majority of stakeholders of organisations, particularly shareholders and regulators (Pass, 2004; Kiel & Nicholson, 2003). Non-executive directors can contribute significantly to organisations through setting organisational strategy, monitoring the performance of and reporting from executive management, and contributing to the development or removal of executive management. However, is the benefit to key stakeholders the result of directors’ independence, their competence or a mixture of both? The lack of prescriptive

legislation in Australia, the fact that the current ASX guidelines are based on a “comply or explain” philosophy (Higgs, 2003), and the absence of specific guidance on the role of non-executive directors in the ASX guidelines means that concern over the independence of non-executive directors is likely to continue.

Appendix 1: Companies selected for analysis from the ASX 50

Symbol	Company	Sector
AWC	Alumina Limited	Materials
AMC	Amcor Limited	Materials
AMP	AMP Limited	Financials
ALL	Aristocrat Leisure Limited	Consumer Discretionary
ANZ	Australia And New Zealand Banking Group Limited	Financials
AGL	Australian Gas Light Company (The)	Utilities
BHP	BHP Billiton Limited	Materials
BSL	Bluescope Steel Limited	Materials
BLD	Boral Limited	Materials
BIL	Brambles Industries Limited	Industrials
CCL	Coca-Cola Amatil Limited	Consumer Staples
CML	Coles Myer Limited	Consumer Staples
CBA	Commonwealth Bank Of Australia	Financials
CSL	CSL Limited	Health Care
FXJ	Fairfax (John) Holdings Limited	Consumer Discretionary
FGL	Foster's Group Limited	Consumer Staples
IAG	Insurance Australia Group Limited	Financials
JHX	James Hardie Industries N.V.	Materials
LLC	Lend Lease Corporation Limited	Financials
MBL	Macquarie Bank Limited	Financials
NAB	National Australia Bank Limited	Financials
NCM	Newcrest Mining Limited	Materials
ORI	Orica Limited	Materials
ORG	Origin Energy Limited	Energy
PMN	Promina Group Limited	Financials
QAN	Qantas Airways Limited	Industrials
QBE	Qbe Insurance Group Limited	Financials
RIN	Rinker Group Limited	Materials
RIO	Rio Tinto Limited	Materials
STO	Santos Limited	Energy
SGB	St George Bank Limited	Financials
SGP	Stockland	Financials
SUN	Suncorp-Metway Limited.	Financials
TAH	Tabcorp Holdings Limited	Consumer Discretionary
TLS	Telstra Corporation Limited.	Telecommunications Services
TCL	Transurban Group	Industrials
WES	Wesfarmers Limited	Industrials
WDC	Westfield Group	Financials
WBC	Westpac Banking Corporation	Financials
WPL	Woodside Petroleum Limited	Energy
WOW	Woolworths Limited	Consumer Staples

Source: Standard & Poor's - Indices S&P/ASX 50 (available at:
http://www2.standardandpoors.com/portal/site/sp/en/au/page.topic/indices_asx50/)

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Figures and tables

Figure 1: ASX Principles of Good Corporate Governance

<p>A company should:</p> <ol style="list-style-type: none"> 1. Lay solid foundations for management and oversight Recognise and publish the respective roles and responsibilities of board and management. 2. Structure the board to add value Have a board of an effective composition, size and commitment to adequately discharge its responsibilities and duties. 3. Promote ethical and responsible decision-making Actively promote ethical and responsible decision-making. 4. Safeguard integrity in financial reporting Have a structure to independently verify and safeguard the integrity of the company's financial reporting. 5. Make timely and balanced disclosure Promote timely and balanced disclosure of all material matters concerning the company. 6. Respect the rights of shareholders Respect the rights of shareholders and facilitate the effective exercise of those rights. 7. Recognise and manage risk Establish a sound system of risk oversight and management and internal control. 8. Encourage enhanced performance Fairly review and actively encourage enhanced board and management effectiveness. 9. Remunerate fairly and responsibly Ensure that the level and composition of remuneration is sufficient and reasonable and that its relationship to corporate and individual performance is defined. 10. Recognise the legitimate interests of stakeholders Recognise legal and other obligations to all legitimate stakeholders.
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Source: ASX, 2006



