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Keywords
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Profiling non-executive directors in Australia

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Classification code: M40 – Accounting and Auditing, General

Key words: corporate governance, non-executive directors, independence

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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 and 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):

> …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 Australian Stock Exchange (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. Concurrently, the ASX's Corporate Governance Council established ten Principles of Good Corporate Governance, which were released in March 2003 (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). Recognising that not all companies have the same reporting and disclosure requirements, 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 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 and 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). 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 and 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 is provided in the following section.

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 2004 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 and gender of non-executive directors
- Average length of service of non-executive directors

- Remuneration of non-executive directors
- Ownership of shares by non-executive directors
- Professional background of non-executive directors
- Number of other non-executive directorships

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

4. Results

A total of 301 non-executive directors were employed by the sample companies during 2004. As Table 2 shows, in 35 companies (83 percent of the sample), non-executive directors comprised 80 percent or more of total board membership.

Take in Table 2

These results are consistent with the ASX Principles of Good Corporate Governance, which recommend that a majority of the board should be independent (ASX). The results also show an improvement in the independence of Australian company boards when compared to Kiel and Nicholson's (2003) study, which reported that in the top 348 companies included in their sample, the mean proportion of non-executive directors on company boards was 69 percent. This is likely to be a consequence of the issue of the ASX Principles in March 2003.[2] It appears that Australian boards are more independent than those in the UK, with the majority of Pass's (2004) companies having non-executive directors comprising between 50 and 60 percent of the total board.

[2] Kiel and Nicholson's (2003) study was first presented at the 5th International Conference on Corporate Governance and Direction in October 2002, meaning that the data they reported on was likely to be at least a year old by the time the ASX Principles were published.

In terms of average age of Australian non-executive directors, the majority of non-executive directors were aged between 60 and 69, which is consistent with the results of Pass (2004) in the UK context (see Table 3).

Take in Table 3

Take in Table 4

As shown in Table 4, in terms of gender 35 of the Australian companies examined (83 percent) had one or more female non-executive directors on the board. As a proportion of male and female non-executive directors, females comprised 16 percent. This compares to Pass's (2004) study which showed that 58 percent of UK companies had one or more female board members, and 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), which 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 and Wearing, 2004, p.355).

Table 5 reports the average length of service of non-executive directors. The average length of service ranged from 1 year to 21 years.

Take in Table 5

This information is relevant to assessing the independence of directors. According to ASX Principle 2, an independent 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). The median length of time served is consistent with Pass (2004), however the substantial length of time served by some non-executive directors could reasonably be perceived to interfere with the independence of these board members and thus conflict with the ASX Principles.

Table 6 provides details of the remuneration of the non-executive directors of the sampled companies. The majority of companies sampled (67%) provided their non-executive directors with average remuneration package in excess of A$140,000. In accordance with the ASX Principles, the disclosure of non-executive directors' remuneration was clear and adequately distinguished from the remuneration structure applied to company executives.

Take in Table 6

Table 7 shows the ownership of ordinary shares by the non-executive directors. According to the ASX Principles, non-executive directors are permitted to receive remuneration in the form of equity but should not receive share options. Many of the companies sampled included shares in the remuneration packages offered to non-executive directors.

Take in Table 7

Table 8 indicates the general background of the 302 non-executive directors of the survey companies. The majority of non-executive directors (95%) are also current executives in other organisations and, as shown in Table 8, hold other directorships, both executive and non-executive.

Take in Table 8

Finally, as indicated in Table 9, the majority of non-executive directors in the companies studied hold between one and four other directorships. Many of these directorships are held with other companies within the ASX 50. For example, Ms Elizabeth Alexander serves on the boards of Amcor Ltd, Boral Ltd, and CSL Ltd, all of which are ASX 50 listed companies, and Mr Don Argus serves on the boards of BHP Billiton Ltd and Brambles Industries Ltd, also on the ASX 50.

Take in Table 9

5. Summary and conclusion

This study has indicated that Australia's largest listed companies are beginning to adopt the ASX Principles of Good Corporate Governance. One of the key issues in Australian corporate governance reform has been the appointment of independent non-executive directors to company boards (ASX, 2003; Robins, 2006). In this analysis, the data shows that for 83% of the sample the ratio of independent directors to executive (non-independent) directors is 4:1, indicating that this principle has indeed been embraced by Australian companies.

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' sample, the average level of remuneration was in excess of $140,000. 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 independent 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.

There is little doubt that the presence of competent independent directors on the boards of companies is a significant benefit to the majority of stakeholders of organisations, particularly shareholders and regulators. The independent 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 independent 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
PBL	Publishing & Broadcasting Limited	Consumer Discretionary
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
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

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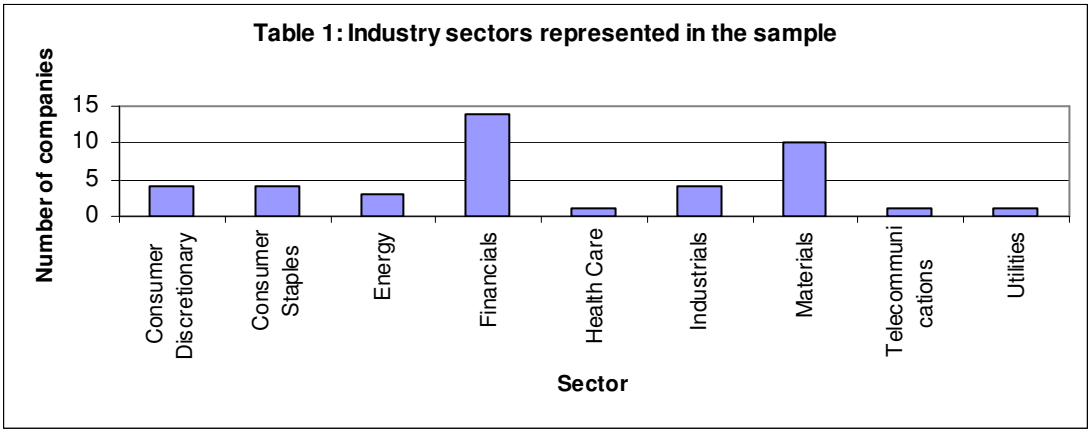
Figures and tables

Figure 1: ASX Principles of Good Corporate Governance

A company should:

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.

Source: ASX, 2003



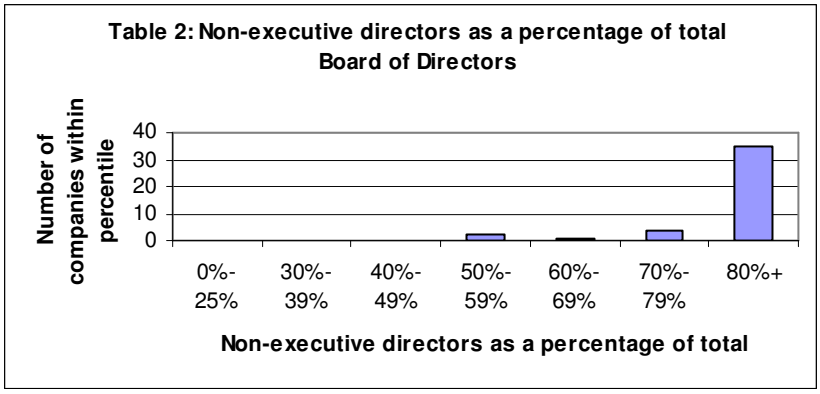


Table 2: Non-executive directors as a percentage of total Board of Directors
Number of companies within percentile
40
30
20
10
0
0%-25%
30%-39%
40%-49%
50%-59%
60%-69%
70%-79%
80%+
Non-executive directors as a percentage of total

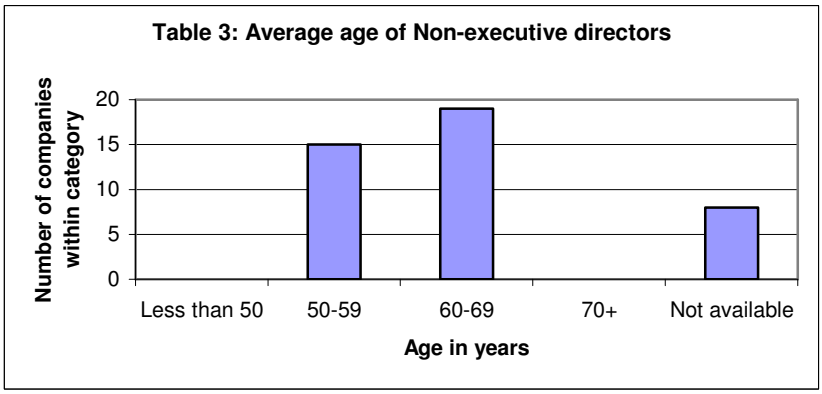


Table 3: Average age of Non-executive directors
Number of companies within category
20
15
10
5
0
Less than 50
50-59
60-69
70+
Not available
Age in years

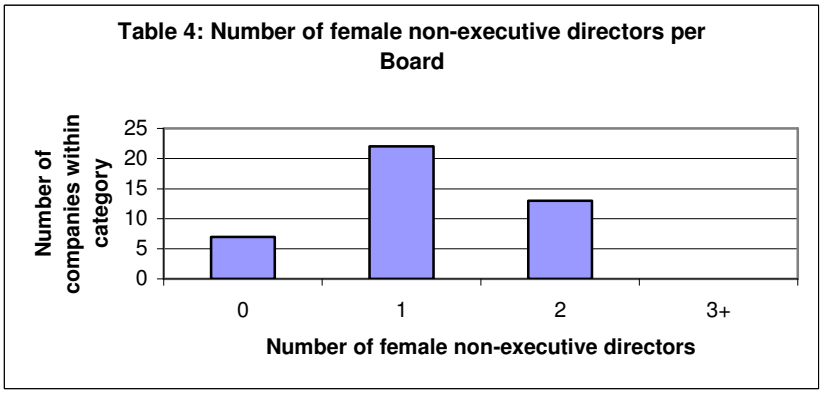


Table 4: Number of female non-executive directors per Board
Number of companies within category
25
20
15
10
5
0
0
1
2
3+
Number of female non-executive directors

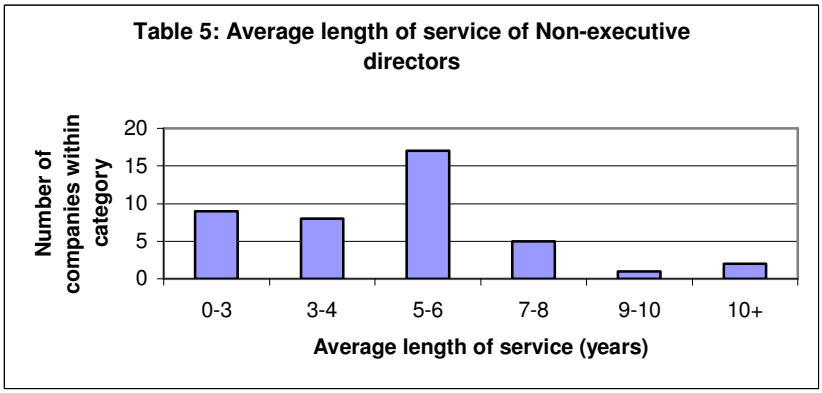


Table 5: Average length of service of Non-executive directors
Number of companies within category
20
15
10
5
0
0-3
3-4
5-6
7-8
9-10
10+
Average length of service (years)

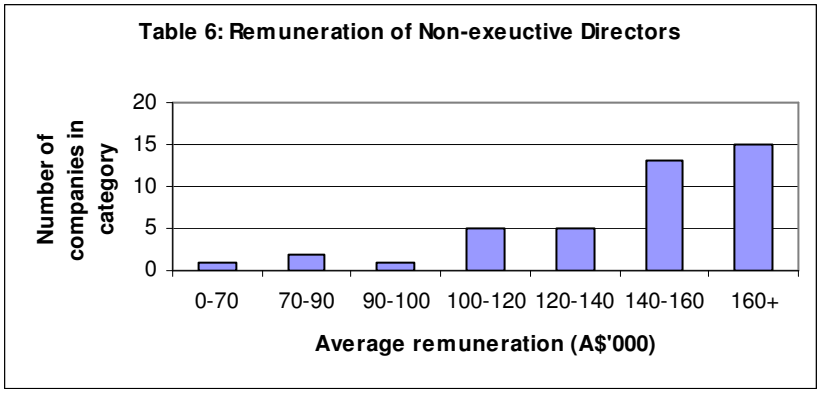


Table 6: Remuneration of Non-exeuctive Directors
Number of companies in category
20
15
10
5
0
0-70
70-90
90-100
100-120
120-140
140-160
160+
Average remuneration (A$'000)

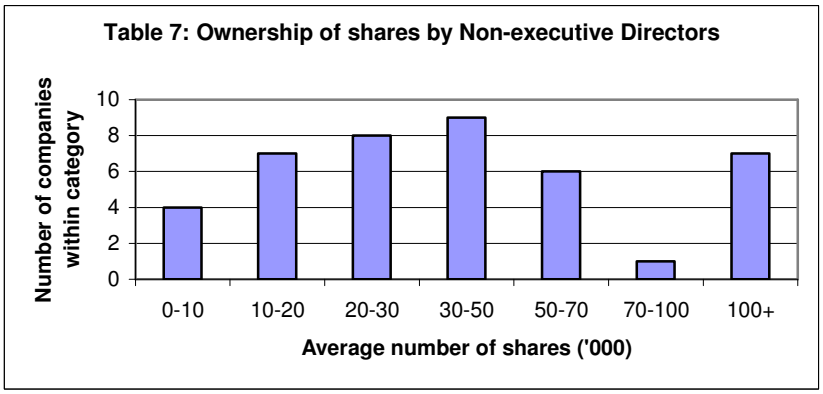


Table 7: Ownership of shares by Non-executive Directors
Number of companies within category
10
8
6
4
2
0
0-10
10-20
20-30
30-50
50-70
70-100
100+
Average number of shares ('000)

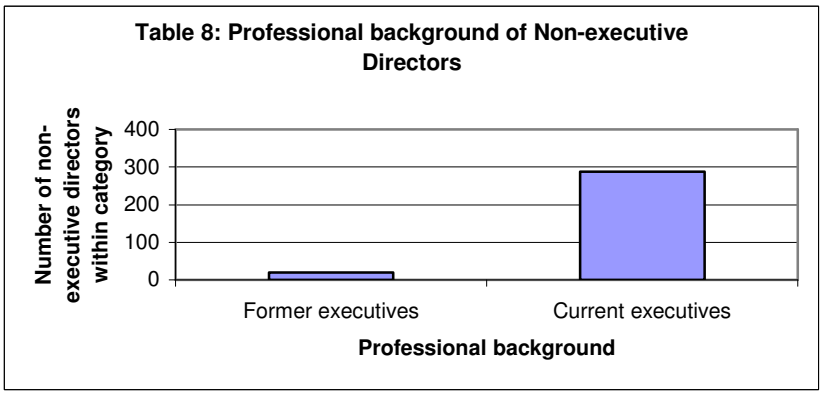


Table 8: Professional background of Non-executive Directors
Number of non-executive directors within category
400
300
200
100
0
Former executives
Current executives
Professional background

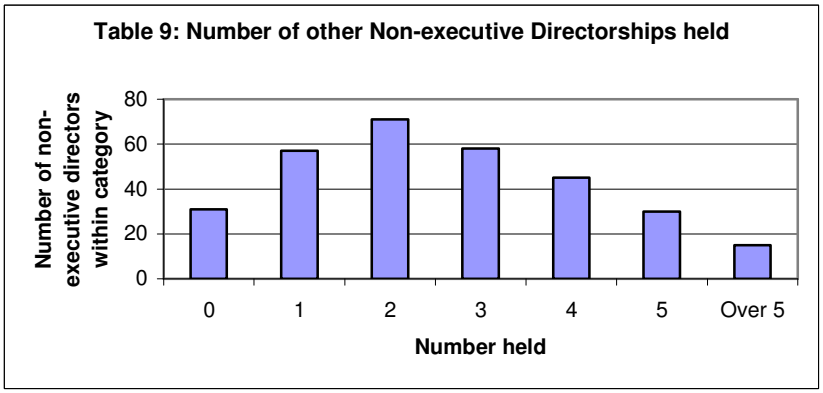


Table 9: Number of other Non-executive Directorships held
Number of non-executive directors within category
80
60
40
20
0
0
1
2
3
4
5
Over 5
Number held