A survey of ethical and value practices of the top 200 ASX listed companies

conducted by

Centre for Research into Ethics and Decision-making in Organisations

commissioned by

The Australian Council of Superannuation Investors Inc (ACSI)

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CREDO is the Centre for Research into Ethics and Decision-making in Organisations at the Australian Catholic University. The Centre offers consultancy, research and educational programs to organisations in the public, private and not-for-profit sectors.

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Executive Summary

This report of research findings on corporate governance practices from an ethical perspective is presented in two parts: 1), a review of current literature; and 2), a survey of the chairs of the top 200 listed companies in Australia. It was commissioned by the Australian Council of Super Investors (ACSI) and conducted by Professor Jack Flanagan of CREDO, the Centre for Research into Ethics and Decision Making in Organisations, at the Australian Catholic University.

The research has indicated that corporate governance is seen now as important to corporate boards and executives, that monitoring of governance may affect director and CEO behaviour, and that the attributes of “good” governance may improve company performance.

Corporate governance researchers state regularly that they actually know very little about the internal operations of boards, how difficult it is to gain an understanding of boardroom dynamics, and that despite the importance of share prices, it is unlikely that directors rely on this as their sole information variable. This area appears to be critical for an evaluation of company performance, yet remains difficult to access. The current research project, in attempting to open up some dimensions of these internal operations, confirms this difficulty, but casts some light on governance practices.

Findings from the literature review
Our research commenced with a literature review of journal articles and internet sites, of companies, major associations and institutes, Australian and overseas.

Our findings were:
1. Mutual funds that invest in companies with independent directors on boards, the existence of audit and compensation committees and the existence of good
governance characteristics, have achieved superior returns over three and five year holding periods

2. A majority of Australian chief financial officers believe that the new corporate governance rules (ASX principles and CLERP initiatives) would not prevent a repeat of large corporate collapses

3. Firms with stronger shareholder rights had, on average, higher firm values and higher sales growth

4. The promotion of a culture of ethical behaviour at the boardroom that was promulgated throughout the organisation, and that “walking the talk”, were important to the long-term performance of a company

5. The remedies prescribed for improving corporate governance have all been structural, whereas the key to governance is social. There is little evidence that increasing the proportion of outside directors has improved company performance

6. Towards the end of their careers, the interests of CEOs and shareholders tend to diverge, as CEOs tend to put their own financial futures first

7. Institutional investors have, in the past, been reluctant to vote their shareholdings, giving their proxies to the chair

8. Analysts and institutional investors, in monitoring the activities of companies, appear to constrain some excessive behaviour

9. There is no strong link between pay and performance at the executive level

10. Strong governance structures have an inverse relationship with the explanatory power of accounting profits

Findings from our survey

Our questionnaire had seven topics or themes of questions and was sent to the chairs of the top 200 listed companies. The response rate - effectively 16% - though small as a sample size, is sufficient for us to make some initial observations.

Our findings will contribute to a general framework of ‘work-in-progress’ and guidelines within which ACSI might continue to develop its understanding of corporate ethical practice.
Our findings are as follows:

1. Boards are taking ethics seriously, 80% responding that ethics were discussed in the last year.

2. The ASX guidelines on corporate governance were overwhelmingly seen as a good way to address governance issues, being flexible and not prescriptive.

3. Many boards have yet to bring stakeholder issues firmly into focus. Issues, such as conflict of interest and environmental risk, which could adversely affect the company’s ongoing success, are still not core issues. The only stakeholders whose views were actively considered were shareholders or institutional investors, with directors acting as proxies for other stakeholder concerns.

4. Most chairs thought that risk management was a function that could safely be left to a committee. This could indicate a potential weakness, as boards must ultimately be responsible for risk issues and directors must be aware of all significant risk issues facing the company.

5. The vast majority of companies had a mission or values statement that had been reviewed recently.

6. Only 30 per cent of companies required directors to sign on to the company’s mission and values statements yet 73 per cent thought they were valid guidelines for decision-making. This is problematic. If you cannot get directors to sign on to the mission statement, of what real value is it?

7. Where directors needed guidance on the mission statement, the chair was the source of guidance. This is consistent with keeping issues within the board where possible and letting them outside only where absolutely necessary.

8. Of note is the degree to which appraisal of managers and employees in many companies was linked to the company’s code of conduct, and compliance with the code being monitored and enforced. The major problem with this approach is that mission and values statements and codes of conduct become yet another control mechanism, leading to an organisation structure where compliance with rules is seen as more important than doing the right thing for customers, employees, suppliers and the community. In only a few cases were company performance
indicators tracked against the codes of conduct, and these indicators in the
majority of respondent companies were not collected or reported. It is in this area
that codes of conduct can be most fruitfully used to improve organisational
effectiveness, yet, based on the survey results alone it appears that data is rarely
collected.

9. The assumption that directors are ethical enough when they achieve board
membership is of particular concern given the significance of recent corporate
failures. It is too easy to state that all directors are expected to be ethical, yet
without an exploration of what ethics means to each director it is not possible to
state that the ethical values held by directors are congruent with societal norms.

10. The majority of chairs emphasised that ethics were at the core of all decision-
 making.
   a. Some even stressed that the behaviour of all directors and staff should
      reflect the ethics of the organisation.
   b. Others indicated a separation of ethics from other attributes of decision-
      making by suggesting that ethical input would be sought if needed.

11. Chairs were concerned that directors be:
    a. Independent (although what this is, was never spelled out), and
    b. Skilful and knowledgeable about the business.

12. In relation to board meetings, chairs expressed the need for:
   a. Open debate, with directors free to express their views;
   b. A strong ethical framework to guide decisions;
   c. Directors being mindful of their responsibilities, especially to
      shareholders; and
   d. The existence of clearly articulated mission, values and strategy.

13. With regard to the board receiving information in time to make decisions
consistent with the company’s mission, some talked about structural issues
(regular timetable, information packs, time to absorb information,), while others
emphasised behavioural issues (dialogue with directors, CEO and management,
and evaluation of board and board member performance).
14. Some chairs were keen to solicit directors’ views on sensitive issues anonymously, but most preferred to talk in private first and then discuss in open board meeting what was said in private.

   a. A majority of chairs emphasised the need for consensus views.
   b. Few wanted contentious issues to be decided on a show of hands.
   c. The view that a director should leave rather than breach board solidarity seemed very strong. Vigorous discussion was encouraged, but consensus was the goal of the discussion.

15. Few initiatives with regard to the ethical culture were being considered in most companies. Where there were any, they focussed on better communications, being more open and accountable, and improving management ethical education.

   In summary, our findings suggest that ethics is firmly on the agenda of most companies, and that the right words are being circulated to soothe those who might be sceptical about directors’ and executives’ integrity.

   However, the survey revealed several contradictions in the ways that ethics, mission statements and codes of conduct were being used. There was an absence of clear evidence from which to verify that any company complied with its code of conduct. There also appeared to be reluctance at board level to issue majority decisions, with consensus reigning supreme. The desire by the chairman to achieve consensus on decisions was likely to cramp the style of any director who felt that decision-making was not being made in line with the principles enshrined in the company’s mission statement and code of conduct.

**Reflections**

Further dialogue between ACSI and company boards can be constructed along lines established in the survey. What defines an ethical company, an ethical culture, a set of consistent and sustainable ethical practices is part of this ‘work-in-progress’. In the belief that this can be opened out by the principles of effective decision-making - be open, attentive, intelligent, reasonable and responsible – there is considerable work to be done. The norm ‘be open’ is a significant start.
Such would be, in our view, reflected in directors or chairmen being more open in their communications with interested parties about the way they make decisions and the mechanism they have in place to guide their decision-making. This study has tried to contribute to the debate by asking company chairs to comment on these aspects of corporate governance.

The world of corporate stakeholders is changing for corporate executives and boards. Until recently, the major demand from the market, communicated via fund managers seeking to generate competitive returns by investing in the corporate sector, was for increasing earnings per share. This focused corporate management firmly on reporting increasing profits for the next reporting period to add upward pressure to share prices.

With the increasing size of superannuation funds, trustees are combining their new found influence with the social responsibility that flows from their fiduciary obligations to protect the interests of their members. As member investments take up to 25 years or more to come to maturity, trustees by necessity must take a long-term perspective to their investment portfolios. To do this they will require more frequent information from their corporate investees than is provided by annual and half-year reports. They need to continually monitor the riskiness of their investments, and time is the most expensive commodity in the investment world. Trustees need to be convinced by corporate boards and executives that an investment in their company has long-term prospects that benefit shareholders, employees, customers, suppliers and the community. This requires a greater dialogue between the two sectors to enable both parties to discover the needs of the other, establish coalitions of trust and respect, and respond positively and beneficially to the different needs and pressures facing them.

A major issue for trustees placing significant amounts of funds in any one company is the risk inherent in that investment. Boards need to convince trustees that they have developed sound risk management policies, that they know the significant risk factors facing the company, and have strategies in place to deal with them effectively. Such risk management factors will minimise risk for any specific company, increase the stability of returns, and generally strengthen its share price.
We had hoped that our survey might encourage chairmen and women to be more forthcoming in their questioning, and more open to being questioned. In our view effective governance is a function of the trust in which the board is held by those outside the company. Is it a valid goal to get to know the chairs of major companies a little better if chairs are not prepared to be more open and more transparent? If chairs avoid being better known and understood, we should ask why?

The 84% of companies that did not reply to our survey could indicate a serious problem of lack of openness and transparency in the corporate sector. Company managements receive many requests for research surveys to be completed, but we suspect that corporate boards receive very few direct requests. The present survey was undertaken in response to some directors asking ACSI to get to know them better. We think the poor response rate is an indicator of a lack of serious intent on behalf of the boardrooms of Australia, for ACSI to get to know them better. We think the call was genuine but did not represent the majority view of company boards where secrecy and the privacy decision-making still dominate board communications with the stakeholders they purport to represent.

If trust can be built to increase the transparency between boards and ACSI, then a conduit opens that can be used by ACSI to ask chairs directly about such things as governance best practices, and those areas of social performance and ethical practices where some additional indicators would assist their members.
Introduction

At an ACSI conference in 2003, a prominent Australian board director challenged ACSI, in relation to ethics and governance, to ‘get to know us better’, beyond a mere box-ticking exercise. ACSI, keen to take up the challenge, approached CREDO to discuss how it might do this.

Together, we agreed to attempt to establish a baseline, framework and set of initial understandings from which future dialogue between ACSI, their members and boards might be held. After searching the literature on governance issues and practices from an ethical perspective, we developed a set of relevant questions for a survey of company chairs. Our questionnaire was first tested with several chairs and directors before being sent to the Chairs of the top 200 listed companies in early 2004.

Design

In the early stages of our review of the literature, two findings in particular emerged to influence our approach to the research we undertook. These were:

1. the social nature of the board is an area largely ignored or overlooked, but nevertheless has significant impact on corporate performance.
2. there is no general consensus on what governance means. Each theory, form or model influences what a researcher would identify as significant or problematic.

In relation to the first finding, we attempted to open up the social dimension in our survey. And, in relation to the second, we became more aware of the value and place of the model of governance we were using. Constructed on a foundation of questioning (see Appendix A), it reveals a set of company ‘products’ relevant to decision-making and governance. This set of products has influenced the type and range of questions we asked in our survey.

We are also aware of an assumption we hold. It is that ethics, as understood and practiced by boards and senior managers, primarily and significantly influences and
shapes corporate practice and performance. Thus, in our view, to know the ethics of a company we must first start with the Board, and to approach the Board, we first approach the Chair.

In our survey of Chairs, the questions we asked required a mixture of tick and comment for response. We organised our questions under seven themes or topics, as follows:

1. **The scope of governance issues addressed by boards and the policies in place that could be covered by the term governance:** This included the use of committees, how recently issues were discussed, policies, ASX guidelines, the type of forum for discussion of issues and input from outsiders

2. **The focus of mission and values in board discussions:** This topic addressed such matters as the existence of statements of mission and values, their role, how used, when last reviewed and methods for their interpretation

3. **The codes of conduct put in place and their link to the company’s mission and values:** Here we addressed focus, linkage to mission, implementation and monitoring, linkage to performance and performance indicators, training in ethics and the impact of codes

4. **How boards manage risk and reputation:** Here we sought to identify types of risk

5. **How the board communicates codes of ethics and conduct:** In this topic, we attempt to assess the impact of ASX guidelines on disclosure, and understand approaches to stakeholder communication

6. **How ethical issues impact the effectiveness of the board:** We explore the timeliness of information, social factors of the board, the role of ethics in deliberation, and the place of individual opinion and consensus, and planning for this year

7. **Final issues on stakeholders:** covering employees and suppliers.

From our first mail out of the questionnaire we received 22 completed questionnaires and eight letters declining to participate. A second mail out generated a further ten completed survey questionnaires and a further six letters declining to participate. We thus generated
46 responses, of which 32 were completed questionnaires. Of the 200 listed companies several had common chairs, thus reducing the number to 195. Thus, our effective response rate with the 32 questionnaires was 16.4%.
Preliminary Considerations and
Methodological Challenges

Much research has been conducted into corporate governance, and much more will be done, but at the end of the day researchers themselves say that they do not know how directors make decisions – what factors they take into account, the pressures on them, and the values and ethical principles that guide their deliberations.

The majority of the research conducted to date regards the boardroom as a black box. So the problem then is how do we get inside the board room – how do we get to know the directors better? This presented us with immediate methodological difficulties. How do we get to know directors better unless they agree to let us in? As we cannot attend board meetings how are we to get a feel for board processes and the ethical input to their deliberations? Our view was that we initially needed to get directors to answer a series of questions. However, we first had some questions of our own: who to direct questions to, and how should we put the questions to them? We firstly decided that the questions should be directed at the chairperson, as this was a critical figure in any company board.

Secondly, how should we question them? Should we interview or develop some form of questionnaire? Interviews would be more insightful but also very time consuming. A questionnaire was easier to administer, so we decided to use a questionnaire, but allow for the chairpersons to answer the questions in a more dynamic way than simply ticking the appropriate boxes. As chairpersons are busy people we needed a questionnaire that was fairly easy to work through. This would require some box ticking as an easy way into the questions. So we were already in a dilemma. We wanted to go beyond ticking boxes but here we were suggesting that some box ticking was inevitable.

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1 This section is based on a paper “A dynamic model of governance: the link between corporate governance and corporate practice?” presented by Professor Flanagan at the ACSI Annual Conference, Melbourne, June 2004
Meaning of the word ‘governance’

It is clear that there is no definitive definition of governance that suits all parties. The issue is not, of course, “governance” per se. The real issue is who controls the activities of the company and for whose benefit is control exercised? Control is difficult to observe because of a lack of transparency in board decision-making, leading to a perceived lack of accountability of boards and executives for their actions. As Senator Paul Sarbanes put it when talking about Enron:

“The collapse of the Enron Corporation brought to the surface grave defects in our accounting, auditing and corporate governance practices. They were not random. They were not just the work of the proverbial "few bad actors." On the contrary, they were systemic and structural deficiencies. They undermined the integrity of our markets, caused massive losses to individual investors, contributed to weakening the economy and resulted in the collapse of investor confidence.” (Sarbanes, 2003)

How can investors, regulators and lenders “see” what is happening in the decision-making process of those companies in which significant amounts of scarce capital have been invested? The term “corporate governance” came to prominence in the early 1990s through the activities of groups such as the Cadbury Committee in the UK (1992), and was seen by directors themselves as an effective method of recapturing the trust of fund suppliers apparently lost in the 1980s.

The Latin etymology of “governance” can be found in the term “gubernator” which refers to the direction-giving for a ship. An alternative etymology is from old French word “gouvernance” meaning to control, or in a state of being governed (Farrar, 2001, p.3). Governance can also refer to a “system of management” (Macquarie Dictionary, 1987) or “the controlling, directing, and regulating of influence, and a mode of living or behaviour.” (Oxford English Dictionary, 1933).

We can thus immediately see two distinct aspects of the word governance. Firstly, it can refer to the system by which the activities of the company are controlled by those given that responsibility, and thus gives focus to identifying the elements of a corporate governance system, and then testing the effectiveness of that system to changes in the internal and external environment. Secondly, it can refer to the behaviour of
guiding a company by controlling, directing and regulating the influence of those who work in the company, in a manner that is consistent with other modes of living. This gives rise to questions about the motivations, skills, character and ethics of the people charged with this duty – namely the board of directors and senior executive – and the culture that develops within the organisation as a result.

Figure 2 provides one way of mapping the way in which researchers have tried to observe governance as practised in companies. Firstly there is the impact of corporate governance practices on markets, and vice versa, via share price movements. Secondly there is the impact of stakeholders – significant shareholders, institutional shareholders, regulators, chief executive officers (CEOs), directors and others – on corporate governance practices. There are generally two models of influence on governance practices: what we have called the realist-pessimist models, the finance and political models, and what we have called ideal - hopeful models, the stakeholder and stewardship models.
Of, the realist – pessimist models, the finance model relies on the functioning of highly liquid capital markets to discipline managerial behaviour through the selling and buying of shares. Applying this model, directors and managers will adopt governance attributes that keep investors investing in their shares (Hawley and Williams, 1996). The political model focuses on the power distribution between managers and investors. It encompasses situations where shareholders, or their representatives (fund managers, directors) seek to influence company policy by negotiating voting support rather than by buying and selling their shareholdings (Pound, 1992, p. 83). The two models form a systems view of corporate governance as they focus on the corporate governance system in place, and test the elements of a corporate governance system as indicators of director behaviour. A corporate governance system is seen as a control mechanism put in place to discipline managers to act in the interests of shareholders and not expropriate shareholder wealth for their personal consumption. These control mechanism can be external (monitoring by shareholders and creditors, regulatory and legal system, the market for corporate managers) or internal (management compensation plans, monitoring by directors, the internal management market) (Bushman and Smith, 2001, p. 238). This view of the workings of organisations is so widely held, that most research undertaken assumes that this is a reasonable explanation of the relationship between managers and shareholders.

Of the ideal – hopeful models, the stakeholder model sees management maximising the wealth of shareholders while meeting the conflicting needs of all stakeholders. Secondly, the stewardship model views directors and managers as responsible stewards who should be relied upon to run the firm unfettered in the interests of all stakeholders. Using these models, altruism and ethical behaviour are regarded as an alternative determinant of management behaviour. It is hard to believe that no directors have ethical principles and that self-interest is the only motivating force. Directors are likely to reflect the ethical views of the community and it is unthinkable that they leave their personal values and ethical approaches out of decision-making with regard to boardroom decisions. However, directors may have several conceptions of ethical practices and may distinguish personal ethical values (based on a notion of justice) from corporate ethical values (based on a notion of maximising returns). The
ideal – hopeful models comprise a behavioural view of corporate governance, and their testing requires making an attempt to observe the behaviours of directors in companies as they attempt to control the activities of managers and employees – a difficult exercise to carry out.

It is likely that most directors are conflicted by the tussle between the self-interest urge and their ethical principles and sense of justice. The purely self-interest view of director decision-making and the purely ethical view of decision-making are unlikely in themselves to explain all director behaviour. We know that directors can exercise significant power to benefit themselves at the expense of company shareholders apparently without being monitored by shareholders or other outside groups (Turnbull, 2000), so it is important to understand how directors cope with this struggle.

Directors, stock exchanges, and governments as well as the majority of researchers appear to have adopted the systems definition of governance. According to the much referenced Cadbury Committee in the UK, corporate governance is the "system by which companies are directed and controlled." (emphasis added). According to the Cadbury Committee, managers needed to "be free to drive their companies forward, but exercise that freedom within a framework of effective accountability." (emphasis added). According to the committee, companies needed to implement a system of checks and balances for effective resolution of conflicts and control over the exercise of managerial power (Charkham, 1995, pp 2-5).

A definition of governance based on a “system of accountability” can be seen firstly, as more understandable to directors and their advisors, as they would be familiar with systems of accountability imposed by the Corporations Act as reflected in disclosed financial statements. Secondly, a systems definition was simpler to implement, as the “remedy” appeared more concrete than trying to grapple with a definition based on directors’ motivations, skills and ethics.

By focusing on a systems definition of governance, directors and others adopted the idea (common today) that there are explicit objective principles of governance available which if implemented will ensure that boards will not only be seen to be fully accountable for their actions, but will actually act in such a manner.
The term “corporate governance” seems to have a life of its own as it develops to fill the transparency-accountability void. The definition of governance adopted in practice, the systems definition, provides a two-dimensional model of governance, as it assumes that the system reflects the actions of directors and the values that drive those actions, whereas we do not know this just from the existence of an apparently working system.

The lack of a precise definition of corporate governance has not impeded the rapid development in corporate governance research. There is an increasing number of research studies that employ a contractual concept of governance, in which observable elements of governance, such as the number of independent directors, plays a role in the contractual relationships between managers, shareholders and other stakeholders. As well, a minor industry has grown via the construction of corporate governance indices to “measure” good governance. These take essentially the same measures used by the researchers applying the contractual concept of governance, give each a score and then sum them to arrive at an overall score for “good” governance.

**Approach to the survey**

The view taken in this project is that good corporate governance has its origins in the ethical practices of its board and senior management. Such ethical practices are a function of the adoption of good governance principles that are operationalised via business codes to which directors say they will adhere. How these codes are implemented and monitored indicate the sorts of values that drive decision-making in the organisations.

Business codes generally have two components. Firstly, a statement of values, that may be enshrined in a mission statement, which sets out the organisation’s core values. Secondly, a code of conduct, that is a compliance-oriented document setting out specific behavioural standards for board members and executives in applying those values. The existence of a code of conduct represents formal ethical compliance, but it is programmes for its implementation that lead to effective ethical compliance. The code
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should provide a light to guide senior management with regard to what is the right thing to do in all circumstances.

The model that informed the structure of the questionnaire goes more broadly than codes (see appendix A). Based on a structure of questioning (Lonergan, 1957), it gives rise to several “products” that can be used to assess the ethical basis of decision-making in an organisation. These products include questioning itself, the governance system that protects such questioning, the nature and extent of research undertaken by or on behalf of the board to collect relevant data, the communication between directors, and with other significant stakeholders, understanding of the risks faced by the company, the existence of value and mission statements to guide decision-making, and codes of conduct used to implement these statements.

The questionnaire completed by the chairs of the responding companies tests the existence, extent and effect of these ‘products’ as used in companies.

Pilot study

A pilot study was conducted with four ex-chairmen to test the relevance, scope and understandability of the questions developed. Incorporating feedback from this pilot study the questionnaire was then sent to the chairpersons of the ASX / S&P 200 companies.

The questions asked in the survey focused on the chairperson’s views on seven areas:

1. the scope of governance issues addressed by boards, and the policies in place that could be covered by the term governance;
2. the focus on mission, and values in the board deliberations;
3. the codes of conduct put in place and their link to the company’s mission and values;
4. how boards manage risk and reputation;
5. how the board communicates codes of ethics and conduct;
6. how ethical issues impact the effectiveness of the board.
7. how key stakeholders are considered
Some of the questions provided for chairs to respond by making a selection from a list of options. All the questions provided for written response by the chairs. A final section allowing for the chairs to make any further comments was also provided.

We expected the answers to some of the questions set to be useful in identifying critical questions that could be developed and used by ACSI in a subsequent stage when communicating with the companies in which its members had investments. ACSI will have a better base of information upon which it will explore such things as governance best practices, and those areas of social performance and ethical practices where some indicators would be useful to it.
Findings

Our findings are in two parts. The first contains a summary of the major findings which we reached in our review of the literature. The second part reports the findings of our survey of the Chairs of the top 200 listed companies in Australia.

Part 1 Literature Review

We detailed our findings from a review of the literature in a separate report\(^2\). The following summarises the principal findings that emerged and which we reported at the 2004 ACSI conference:

- Mutual funds that invest in companies with independent directors on boards, the existence of audit and compensation committees and the existence of good governance characteristics, have benefited from superior returns over three and five year holding periods. (Lipper, 2004).
- A majority (51%) of Australian chief financial officers (CFO) believed that the new corporate governance rules (ASX principles and CLERP initiatives) would not prevent a repeat of large corporate collapses. (Deloitte Survey of CFO and Corporate Governance, 2003).
- In a study that compiled a governance index as a proxy for shareholder rights from 24 governance rules for 1500 US companies in the 1990s demonstrated that firms with stronger shareholder rights had, on average, higher firm values and higher sales growth (Gompers, Ishi and Metrick, 2003).
- There was little evidence that increasing the proportion of outside directors improved company performance (Bhagat and Black, 1998 and 2002, Vafeas and Theodorou, 1998).

\(^2\) "A dynamic model of governance: the link between corporate governance and corporate practice?" presented by Professor Flanagan at the ACSI Annual Conference, Melbourne, June 2004
Towards the end of their corporate careers the interests of CEOs and shareholders tend to diverge as CEOs put their own financial futures ahead of the shareholders (Garvey and Swan, 1994, Gibbons and Murphy, 1992).

Institutional investors in the past have been reluctant to vote their shareholdings (Black and Coffee, 1994). This situation is undergoing rapid change and they are becoming more active on corporate governance issues, as the recent events at the National Australia Bank amply testify (Carleton, Nelson and Weisbach, 1998).

Analysts and institutional investors spend considerable time monitoring the activities of companies and do appear to constrain some excessive behaviour (Moyer, Chatfield and Sisneros, 1989).

There appears to be no strong link between pay and performance at the executive level (Jensen and Murphy, 1990, Lewellen, Loderer and Martin, 1987, Gregg, Machin and Syzmansky, 1993, BT Governance Advisory Service, 2003).

Governance structures may compensate for the low explanatory power of accounting numbers, as researchers have found that strong governance structures have an inverse relationship with the explanatory power of accounting profits (Bushman, Chen, Engel and Smith, 2003).

These findings highlight that corporate governance is seen now as important to corporate executives and boards, that monitoring of governance may affect director and CEO behaviour, and that the attributes of “good” governance may improve company performance.

Corporate governance researchers state regularly that they actually know very little about the internal operations of boards, how difficult it is to gain an understanding of boardroom dynamics, and that despite the importance of share prices, it is unlikely that directors rely on this as their sole information variable (Bushman and Smith, 2001, p. 289, AMP Capital Investors, 2004).

In the wake of National Australia Bank boardroom conflicts in 2004, monitoring by analysts and institutional investors appears to offer promise in getting managers to adhere to good corporate governance practices, especially where legislation puts an onus
on groups such as institutional investors to carry out some monitoring\(^3\). Active monitoring assumes that there is something tangible to monitor, yet corporate governance is still too nebulous a concept to be easily observed by outsiders.

Sonnenfeld points out that many failed companies carried all the external hallmarks of good governance, with independent directors with large personal stakes in the shares of the company, demonstrating a range of skills, with audit and compensation committees, and codes of ethics. He points out that the remedies prescribed for improving corporate governance have all been *structural*, whereas the key to governance is *social*. Boards of directors have to develop a “virtuous cycle of respect for each other, trust and candour.” (Sonnenfeld, 2003). A recent report from the Australian Institute of Company Directors in conjunction with the Group of 100 stated that what brings companies down is not tangible and measurable, but dysfunction in the social system that a board of directors becomes (Cairnes, 2003).

Lastly interviews with American CEOs and directors indicated that boardroom ethics was a sensitive issue. Respondents indicated that the promotion of a culture of ethical behaviour at the boardroom level that was promulgated throughout the organisation, and that “walking the talk”, was important to the long-term performance of a company (Ashly, Atwood, and Niesdorf, 2004).

In summary, good businesses are run by good business people. The questions then are: how can we know if directors are doing the right thing, bringing integrity and honesty into their business decision-making? One approach is to get directors or chairmen to be more open in their communications with interested parties about the way they make decisions and the mechanism in place to guide their decision-making. In this project we have taken up this challenge.

\(^3\) For example, in the United Kingdom, where a 2000 amendment to the 1995 Pensions Act, requires trustees of pension funds to state their policy on ethical investment in their Statement of Investment Principles, including their policy directing the exercise of voting rights attaching to investments.
Part 2  The Survey

Surveys were sent to the chair or company secretary of all of the top 200 listed companies. Some of the contact names for the top 200 listed companies were common. This was especially the case with listed trusts (such as the Macquarie Bank, Deutsche Bank and Westfield listed trusts), where eight companies had just three chairs. This cut the possible number of responses down to 195.

Response rate

The response to the initial mail out was a return of 22 completed survey questionnaires and eight letters declining to participate. The second mail out generated a further ten completed survey questionnaires and a further six letters declining to participate. We thus generated 46 responses, of which 32 were completed questionnaires. This represented a total response rate of 23.6 percent, and a useable response rate of 16.4 percent. The 16.4 per cent useable response rate, whilst on the surface appeared to be disappointing, we suggest is a good response from a group that has been very difficult to access in the past.

Of the respondents who replied but declined to complete the survey, five stated that it was company policy not to respond to questionnaires, two simply stated that they would not participate, and three stated that they would not complete the survey but referred us to their annual reports and web sites for information relevant to the survey.

If the investment community is to get to know company boards better, a company policy not to respond to questionnaires presumes that outsiders will get to know the particular boards better only if and when the board decides that such a move is called for. While the economy is buoyant and share prices remain at record levels, company chairs may be able to ignore relevant stakeholders. However, as the problems at the National Australia Bank, with its losses on unregulated derivative trades, and at James Hardie Industries NV, over movements that quarantined the company’s obligations to sufferers from asbestos-related diseases, indicate, particular stakeholders may act in response to
the ethical climate of a company in ways that hurt it economically (such as lower share prices and lower custom\textsuperscript{4}).

A company policy not to respond to research advances, presumably on the basis that it diverts staff from more important tasks, undermines the mutuality of information flows. There is always some research that companies will happily engage in if it shows them in a favourable light. A blanket policy not to respond to research requests reflects a long held notion of never divulging information that need not be divulged, even for research activities from which they could personally benefit. This notion will be increasingly difficult to maintain with increasing demands for accountability and transparency in decision-making.

The low response rate could also reflect a lack of interest in governance and ethical issues generally by many company chairs, and thus a lack of interest in what such a survey might tell them. We must contrast this with the chairs who did respond, and who appeared genuinely concerned with ethical issues.

**Differences between early and late responders and large and small companies**

With categorical data, we cannot comment on much more than the frequencies of each item to which the chairs responded. We did however apply a test to ascertain whether answers differed significantly between companies responding by the due date, and those responding after the due date. 22 companies submitted their surveys before the due date, and ten after a second round of letters. There were no significant differences between the answers from the two groups.

We also tested to see whether answers were significantly different for large and small companies\textsuperscript{5}. Our surrogate for size was revenue generated. The average revenue for a respondent was $2688 million. The smallest company generated revenues of less than $100 million per annum, and the largest generated revenues in excess of $10,000 million. Of the sample of 32 usable companies, 17 had revenues of less than $1 billion (small companies), and 15 had revenues over $1 billion (large companies). We tested

\textsuperscript{4} For example, James Hardie Industries NV suffered a 30\% decline in share price from October 2003 to August 2004, and profit for the first half-year to September 2004 fell by nine per cent (Parker, J., James Hardie cuts full year outlook, *Australian Financial Review*, Monday 22 November 2004)

\textsuperscript{5} the non-parametric test, chi-squared was used for this purpose, with a 95 per cent level of significance.
responses for significant differences between the responses of companies with revenues larger or smaller than $1 billion.

Five of the possible 80 responses to the questions set, generated significant differences. With so few answers generating a significant difference we can say that the two populations were essentially the same. In the following analysis of the results we have indicated which questions generated statistically significantly different responses from large and small listed companies.

**Board size**

The smallest number of directors on a respondent board was five, and the largest, eleven, with a mean of seven directors. All boards had at least one executive member (usually the CEO), whereas some respondents had four. Boards with two or more executive directors tended to be larger boards.
Questions addressed by the survey

Topic 1. The scope of governance issues addressed by boards, and the policies in place that could be covered by the term governance.

The aim of the six questions in this section of the questionnaire was to develop a picture of the fora in which governance issues were addressed, the kind of issues addressed, and the stakeholder interests considered. The six questions in this section are analysed individually and then a conclusion is drawn on the basis of the responses.

1.1. Does the board deal with certain issues by committee first?

The answer in all cases to the question, does the board deal with certain issues in committee first, was yes. However, the committees most used by respondent companies varied as some had separate committees for each function, whereas others combined functions in just two or three committees.

<table>
<thead>
<tr>
<th>Function</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Audit</td>
<td>97</td>
<td>3</td>
</tr>
<tr>
<td>Board and Senior management remuneration</td>
<td>97</td>
<td>3</td>
</tr>
<tr>
<td>Board nominations</td>
<td>87</td>
<td>13</td>
</tr>
<tr>
<td>Risk Management</td>
<td>84</td>
<td>16</td>
</tr>
<tr>
<td>Taxation</td>
<td>52</td>
<td>48</td>
</tr>
<tr>
<td>Occupational Health &amp; Safety</td>
<td>52</td>
<td>48</td>
</tr>
<tr>
<td>Significant aspects of Governance</td>
<td>38</td>
<td>62</td>
</tr>
<tr>
<td>Social responsibility /sustainability</td>
<td>18</td>
<td>82</td>
</tr>
</tbody>
</table>

The audit committee and the board and senior management remuneration committee were most common in respondent companies, followed by board nominations, risk management and taxation. The issue that was least often dealt with by committee
was social responsibility and sustainability (18 per cent) followed by significant aspects of governance (38 per cent). With both issues this could indicate a general lack of focus on these issues or a need to discuss them at a full board meeting. We suspect that governance is generally addressed at full board meetings. We also suspect that social responsibility and sustainability are not yet sufficiently captured by board of directors radar. Further investigations could be instructive here.

In some companies risk was managed by the audit committee, in others it was a function split over several committees. Other committees that some respondent companies used included human resources, environment, financing and investing, credit, and compliance committees.

1.2. Has the board discussed the following issues during the last 12 months?
It was obvious that the topics suggested were all generally discussed in the last 12 months by most boards.

<table>
<thead>
<tr>
<th>Issues</th>
<th>Yes %</th>
<th>No %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Board governance generally</td>
<td>100</td>
<td>0</td>
</tr>
<tr>
<td>Risk management</td>
<td>100</td>
<td>0</td>
</tr>
<tr>
<td>Director remuneration</td>
<td>97</td>
<td>3</td>
</tr>
<tr>
<td>Director independence</td>
<td>94</td>
<td>6</td>
</tr>
<tr>
<td>Conflict of interest</td>
<td>94</td>
<td>6</td>
</tr>
<tr>
<td>Confidentiality of information</td>
<td>80</td>
<td>20</td>
</tr>
<tr>
<td>Ethical practices</td>
<td>80</td>
<td>20</td>
</tr>
<tr>
<td>Environmental risk</td>
<td>77</td>
<td>23</td>
</tr>
<tr>
<td>Options based compensation</td>
<td>64</td>
<td>36</td>
</tr>
</tbody>
</table>

Interestingly, the least discussed item was options-based remuneration, which is surprising considering the publicity this topic has received and the disclosure requirement for directors remuneration detailed in Australian Accounting Standard AASB 1046
Different wording, such as executive and director remuneration may have elicited a greater positive response rate. Of major interest is that ethical practices were discussed by 80 per cent of the boards indicating that ethical issues are certainly now on the agendas of many boards.

Comments made by respondents give some indication about the focus of boards in relation to these issues. Some talked about their company’s code of conduct (10 per cent of respondents) or the need to follow ASX guidelines (7 per cent). Other issues that were raised included succession planning, continuous disclosure, strategy and planning, supply chain management, corporate social responsibility, capital management and auditor independence.

Of great interest were comments such as “conflict of interest is not currently an issue...” and “environmental risk is not a major issue for the company at this time, as the nature of our activities is not likely to create sudden or immediate impairment to the environment.” Both statements indicate a limited view being taken of these issues. Conflict of interest, by its nature, must be an ongoing issue for directors of any company. All companies affect the environment is some way, but without directly addressing the question how, directors may tend to have a poor understanding of their company’s impact on the environment, either directly, or indirectly.

1.3 Does the company have specific policies (or written guidelines) in the following areas?

Nearly all companies are developing policies on the main governance topics as indicated in the table on the next page. Areas where they are being addressed by respondents include: roles and responsibilities of the board and management, recognising and managing risk, and promoting ethical and responsible decision making. Topics such as the size and composition of the board, and respecting the rights of shareholders, did not receive universal support, which is surprising, as one would expect that companies by now would have developed policies covering both.

Six companies referred us to their web sites for evidences of what they were doing with these governance topics. Additional topics proffered by respondents included
occupational health and safety issues, financial reporting structures to safeguard the integrity of financial reporting, and trading in securities by directors (six per cent).

<table>
<thead>
<tr>
<th>Topic</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Roles and responsibilities of Board and management</td>
<td>100</td>
<td>0</td>
</tr>
<tr>
<td>Recognising and managing risk</td>
<td>97</td>
<td>3</td>
</tr>
<tr>
<td>Promoting ethical and responsible decision making</td>
<td>93</td>
<td>7</td>
</tr>
<tr>
<td>Reviewing and enhancing Board effectiveness</td>
<td>90</td>
<td>10</td>
</tr>
<tr>
<td>Ensuring that executive and Board remuneration is fair</td>
<td>90</td>
<td>10</td>
</tr>
<tr>
<td>Recognising the legitimate interests of other stakeholders such as occupational health and safety of employees, environmental and pollution control, equal opportunity and consumer protection.</td>
<td>90</td>
<td>10</td>
</tr>
<tr>
<td>Size and composition of Board</td>
<td>87</td>
<td>13</td>
</tr>
<tr>
<td>Respecting rights of shareholders</td>
<td>87</td>
<td>13</td>
</tr>
</tbody>
</table>

1.4. Do you believe that the Australian Stock Exchange (ASX) guidelines on corporate governance is a good way to address corporate governance issues?

The overwhelming answer to this question was yes (97 per cent), but this section also pulled in a large number of qualifications. There were concerns expressed by some chairs that the guidelines could lead to a box ticking mentality (10 per cent). As this has been the case often in other areas, such as financial reporting, such misgivings are natural. Some saw flexibility in the guidelines as advantageous, others stated that the guidelines were a good start and less prescriptive that the US Sarbanes-Oxley requirements. In contrast, some chairs saw the lack of prescription in the guidelines as
being an impediment, with the level of “detail not necessarily helpful” and some seeing a need for the ASX to provide more prescriptive rules “once and for all”.

Some saw the ASX rules as rules for the “big end of town”, and of limited use for small, fast growing companies, where there were limited resources to comply with the guidelines. Others understood the distinction between rules about systems and rules about behaviour, commenting on the paper trail not leading to significant cultural change.

Only one respondent stated that the ASX guidelines provided the minimum baseline for governance activities, but for the others compliance with the guidelines was seen as the ultimate goal. This indicates a weakness in the promulgation of such guidelines. Instead of acting as the minimum requirement for compliance, the guidelines act as the goal to be achieved, thus diminishing the intent of such guidelines.

1.5. In what forum or committee are the following corporate governance issues addressed?

The responses to this question indicate that boards take a major responsibility when dealing with corporate governance issues at board level, as would be expected.

<table>
<thead>
<tr>
<th>Activities</th>
<th>Board only %</th>
<th>Committee only %</th>
<th>Board and committee %</th>
<th>Other %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Establishing Board practices</td>
<td>81</td>
<td>6</td>
<td>13</td>
<td>0</td>
</tr>
<tr>
<td>Establishing Board structures</td>
<td>71</td>
<td>6</td>
<td>23</td>
<td>0</td>
</tr>
<tr>
<td>Reviewing Board structures and practices</td>
<td>69</td>
<td>9</td>
<td>19</td>
<td>3</td>
</tr>
<tr>
<td>Conflict of interest</td>
<td>69</td>
<td>9</td>
<td>19</td>
<td>3</td>
</tr>
<tr>
<td>Trading in company shares</td>
<td>61</td>
<td>13</td>
<td>19</td>
<td>7</td>
</tr>
<tr>
<td>Risk management</td>
<td>19</td>
<td>39</td>
<td>42</td>
<td>0</td>
</tr>
</tbody>
</table>

However, risk management is left, in most cases, to a committee only or the board and committee working in conjunction. Risk management is increasingly a major board function, so leaving it in the hands of a committee in 39 per cent of cases could indicate
a need for special attention to risk issues, a lack of expertise of board members to deal with risk issues, or a poor understanding about how risk factors can affect the company. The latter two scenarios are not comforting when board responsibility is factored in, although the ASX Guidelines specifically allow for committee responsibility for risk management\(^6\). The responses to risk management may indicate that some chairs do not yet see risk management as the major corporate governance issue that it appears to becoming, even after the warnings generated for boards such as those that surfaced in 2004 at National Australia Bank over derivative losses and at James Hardie Industries under-funding for asbestos-related injury claims.

On the other hand, 40 per cent of respondents were keen to indicate by additional comment that all corporate governance issues were always a matter for full board approval.

**1.6. Are the views of any outsiders sought on governance issues?**

The response to this question indicates that, in the main, the only stakeholders whose interests are considered are major shareholders and institutional shareholders.

<table>
<thead>
<tr>
<th>Outsiders</th>
<th>Yes %</th>
<th>No %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate governance advisors</td>
<td>59</td>
<td>41</td>
</tr>
<tr>
<td>Major shareholders</td>
<td>50</td>
<td>50</td>
</tr>
<tr>
<td>Major institutional investor representatives</td>
<td>44</td>
<td>56</td>
</tr>
<tr>
<td>Fund managers</td>
<td>29</td>
<td>71</td>
</tr>
<tr>
<td>Broking firms</td>
<td>25</td>
<td>75</td>
</tr>
<tr>
<td>Community representatives</td>
<td>16</td>
<td>84</td>
</tr>
<tr>
<td>Major lenders</td>
<td>9</td>
<td>91</td>
</tr>
<tr>
<td>Supplier representatives</td>
<td>6</td>
<td>94</td>
</tr>
<tr>
<td>Major customers</td>
<td>6</td>
<td>94</td>
</tr>
</tbody>
</table>

\(^6\) ASX Corporate Governance Council, Principles of Good Corporate Governance and Best Practice Recommendations, Principle 7, pp. 43-45
The prominence of corporate governance advisors (59 per cent) providing board
with input, gives one indication that boards currently feel that they are in need of
guidance on governance issues. What is significant is that with all companies feeling
their way on governance, it is difficult to see just what sort of advice such advisors can
provide, other than telling a board what other boards are doing.

Stakeholders, other than shareholders, who boards should consider, are rarely
sought out for input. It is heartening to know that six per cent of respondents do seek
input from customers and suppliers, and sixteen per cent seek input from community
representatives, but boards are barely scratching the surface in this area of governance
responsibility. It is hard to see how a company could meet the requirements of ASX
Principle 10\(^7\), if it gathered no data from suppliers, customers, or the community.

If the focus is on shareholders and institutional investors, with other stakeholders
being relegated to minor roles, then governance may still be being interpreted by boards
as a mechanism for protection of asset values and share prices. If this is the case, then the
full range of possible benefits to all stakeholders is unlikely to form part of the evaluation
when decisions are being made. This suggests that other forms of evaluation need to be
used by directors that address the issue of the benefit being generated and where all
stakeholders fit into the decision-making process.

Respondent comments indicated that the only other outsiders from whom
comments were sought were the regulatory bodies\(^8\) and company auditors. Comments to
this question showed that a large minority (23 per cent) of respondents did not seek the
views of any stakeholders. Most preferred to rely on the board members themselves being
across stakeholder issues from their own reading, contacts, membership of other bodies,
and rely on the directors’ own principles and ethics to provide guidance. How a director
was expected to know what the interest of any stakeholder was, other than by deduction
was not stated by any respondent. Some chairs said that views expressed to the board in

\(^7\) ASX Corporate Governance Council, Principles of Good Corporate Governance and Best Practice
Recommendations, Principle 10 deals with recognising the legitimate interests of stakeholders adopting the
view that value is created by better management of natural, human, social and other forms of capital.

\(^8\) Specifically, the Australian Stock Exchange, the Australian Securities & Investments Commission, and
the Australian Prudential Regulatory Authority.
writing by any stakeholder were considered by the board, and others said that comments
made by stakeholders in the press, or in publicity material was reviewed.

Comments such as:

*Company F* - “Board members are expected to keep themselves informed of governance issues
and developments through many means, such as membership of directors’ bodies, reading
reports from law firms, accounting bodies, business schools and attending forums”, and

*Company V* - “I think that directors’ own principles and ethics are the best moderator of
governance issues”.

indicate that an unstructured rather than a systematic approach to soliciting the views of
outsiders is adopted, with it being left to a director’s personal contacts as a source of
stakeholder concerns which greatly reduces the scope for effective stakeholder input.

**Conclusion to topic 1**

Boards in general appear to be taking ethics seriously with 80 per cent responding
that ethical practices were discussed in the last year. The ASX guidelines on corporate
governance were overwhelmingly seen as a good way to address governance issues,
being flexible and not prescriptive. A small number of respondents understood the
difference between rules about systems of governance and rules about management
behaviour. However, many respondent boards seemed complacent, or even ignorant,
about stakeholder issues, such as conflict of interest or environmental risk, that could
adversely affect the company’s ongoing success. The only stakeholders whose views
were actively considered were shareholders or institutions, and many said that they relied
on directors being up to date on stakeholder issues, which is a strange basis on which to
consider stakeholder concerns. This could result only in a skewed view of the direction
and significance of stakeholder concerns.

The responses of chairs to these questions could be interpreted as strategies for
avoiding conflict between the company and certain stakeholder groups. There appear to
be, in most companies, no mechanism for dealing with the social dimension of
organisational activities. Yet these very activities have the potential to disrupt the smooth
running of a company in significant ways, as the 2003 / 2004 problems at National
Australia Bank and James Hardie NV have shown. Board members need to collect data and be open to questioning from these groups, develop effective conflict management skills, and become more adept at dealing with social – and environmental – issues.

Most chairs thought that risk management was a function that could safely be left to a committee. This could represent a weakness, as boards must ultimately be responsible for risk issues and such a responsibility requires that all directors understand all the risk issues faced by a company.
Topic 2. The focus on mission, and values in the board deliberations

There were five questions in this section. They dealt with the existence and location of mission and values statements, the issues covered by them, when they were reviewed and where a director would go in interpreting these statements.

2.1. Does your company have formal mission and/or value statements?

Only one respondent had no mission statement or statement of values. That respondent said that the company had a formal corporate strategy instead. Most respondents included a copy of their mission or values statement. In many cases these could be seen on the company web site. In one instance, the company did not have a mission statement but individual divisions did.

<table>
<thead>
<tr>
<th>Statement</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mission</td>
<td>14</td>
</tr>
<tr>
<td>Values</td>
<td>21</td>
</tr>
<tr>
<td>Both mission and values</td>
<td>62</td>
</tr>
<tr>
<td>Neither</td>
<td>3</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
</tr>
</tbody>
</table>

The terms “mission” and “values” were not always used by companies. Some had a statement of purpose or a commitment to excellence. Others referred us to their code of conduct or a code of ethics where the mission was spelled out. In only two responses was an indication given that the terms mission and values meant something fundamental, with a response indicating that these statements were intrinsic to their activities. The following comment is indicative of a company in which mission, vision, and values are not only critical but life-supporting:

*Company Z* - “The mission and values are incorporated in the company’s DNA and define what we stand for, where we are heading, and how we are going to do
it, where we are heading, and how we are going to do it. They define our vision, our mission, our values, our strategy, and our key objectives.”

2.2. With regard to your mission and or values statement, which of the following statements applies to your company?

If the mission and values are at the core of a company’s activities, it would seem appropriate to get all directors to sign on to them. That only 30 per cent of companies required directors to do this could be seen as somewhat alarming. This may be just an oversight, but it is more likely that the board do not see the mission and values as having significant meaning for them and their organisations.

73 per cent of respondents believed that the mission or values statement was a valid guideline for decision-making, yet only 57 per cent of respondents actually stated that they used it in decision-making, as can be seen in the results below.

<table>
<thead>
<tr>
<th>Question</th>
<th>Yes %</th>
<th>No %</th>
</tr>
</thead>
<tbody>
<tr>
<td>It is located on the Company website</td>
<td>77</td>
<td>23</td>
</tr>
<tr>
<td>It is perceived as a valid guideline for decision-making in the absence of policy or precedent</td>
<td>73</td>
<td>27</td>
</tr>
<tr>
<td>All employees have a copy</td>
<td>63</td>
<td>37</td>
</tr>
<tr>
<td>It is posted at all Company sites</td>
<td>60</td>
<td>40</td>
</tr>
<tr>
<td>It is used in Board decision making</td>
<td>57</td>
<td>43</td>
</tr>
<tr>
<td>All Directors and executives are asked to sign on to the Company’s Mission and/or Values Statement</td>
<td>30</td>
<td>70</td>
</tr>
</tbody>
</table>

In many cases the mission and or values statement was posted on the company web site (77 per cent), but fewer than 60 per cent of companies provided the statement to all employees or posted them at company sites, although two respondents stated that the mission and values statement was on the company’s intranet site.

2.3. What aspects do the company’s mission statement and or values statement
cover?

This question tried to elicit an indication of what focus the company took in relation to its mission. CREDO is of the view that generally the broader the group of stakeholder interests considered, the more ethical the decision-making is likely to be.

The major focus of respondent companies was on employees and customers (over 80 per cent of respondents), with suppliers being engaged by only 48 per cent of respondents. The behaviour of the company itself was seen as a major aspect, followed by values that should inform decisions and rules of conduct for employees.

<table>
<thead>
<tr>
<th>Topic</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employees</td>
<td>84</td>
<td>16</td>
</tr>
<tr>
<td>Customers</td>
<td>81</td>
<td>19</td>
</tr>
<tr>
<td>Behaviour of the company</td>
<td>81</td>
<td>19</td>
</tr>
<tr>
<td>Values that should inform all decisions</td>
<td>71</td>
<td>29</td>
</tr>
<tr>
<td>Rules of conduct for all employees</td>
<td>68</td>
<td>32</td>
</tr>
<tr>
<td>Treatment of shareholders</td>
<td>58</td>
<td>42</td>
</tr>
<tr>
<td>Suppliers</td>
<td>48</td>
<td>52</td>
</tr>
</tbody>
</table>

A significant difference was observed between large and small listed companies in relation to customers being addressed in a company’s mission and values statements with large companies being more likely to incorporate customer issues in their mission or values statements.

Several respondents focused on the availability of the mission and values statement on the company web site. A small number of respondents (ten percent) stated that the mission and values statements were integral to the company’s strategy or its commitments, what the company stood for, or stated that they featured on all internal communications indicating the pervasiveness of the role played by these statements. In these cases of commitment, the respondents stated that directors and employees were expected to exhibit behaviour that reflected these statements in their daily activities. Several respondents indicated that these statements were incorporated in the company’s
This question may have misled respondents, as we were surprised that only one respondent mentioned profits or finance among the values held dear by the firm. Many respondents have taken this to be assumed as profits were not identified specifically in the question, but it could also indicate a disjunction between values and value in the minds of company chairs, with value (as in asset value) being seen as an objective characteristic, and values (as in ethical values) being seen as a behavioural characteristic. Yet companies need to value profit and cash flow as aspects of sustainability. Only one respondent mentioned this:

“The company’s mission and values statement covers all aspects of the company. It covers the financial, social and environmental responsibilities and impact on the company’s operations.”

### 2.4. What year was the mission and or value statement last reviewed?

In 32 per cent of cases, the mission and values statement was reviewed in the current year and 63 per cent had been reviewed within the last three years. The large number of cases where no response was given might reflect the location of this question (at the bottom of a page), or a lack of knowledge on the part of the respondent regarding the year of review. In one case the respondent stated that the mission and governance statements were reviewed annually.

<table>
<thead>
<tr>
<th>Year</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>32</td>
</tr>
<tr>
<td>2003</td>
<td>19</td>
</tr>
<tr>
<td>2002</td>
<td>12</td>
</tr>
<tr>
<td>2001</td>
<td>6</td>
</tr>
<tr>
<td>1998</td>
<td>3</td>
</tr>
<tr>
<td>Missing</td>
<td>28</td>
</tr>
</tbody>
</table>

### 2.5. Where does a director go if they need guidance in interpreting the mission and
or values statement?

The major sources of interpretation for directors of the mission and values statements is the chairman (82 per cent) followed by the CEO (64 per cent), and then the company secretary (48 per cent). The human resources department was generally not seen as a major source of guidance (17 per cent), but independent legal advice was considered as an option by 37 per cent of respondents.

<table>
<thead>
<tr>
<th>Source of Interpretation</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chairman of the board</td>
<td>82</td>
<td>18</td>
</tr>
<tr>
<td>CEO</td>
<td>64</td>
<td>36</td>
</tr>
<tr>
<td>Company Secretary</td>
<td>48</td>
<td>52</td>
</tr>
<tr>
<td>Independent legal advisor</td>
<td>37</td>
<td>63</td>
</tr>
<tr>
<td>Human Resources Department</td>
<td>17</td>
<td>83</td>
</tr>
</tbody>
</table>

There was a significant difference in the response of large and small companies to directors using the human resources division of a company for guidance in interpreting the mission or values statement. In small companies the directors were more likely to consult with the human resources department.

Comments received indicated that directors would be expected to consult with senior executives on this issue. In two cases only was the comment made that it was up to the director where he or she got their guidance from. In one case, directors needed to notify the chairman if they were seeking independent legal advice, and in another the respondent stated that this was unlikely to arise as board discussion was the best forum for such guidance.

The following comment is instructive:

“Directors are encouraged to access the CEO or any member of the senior management at any time to request relevant information. Where directors perceive an irregularity in a company-related matter, they are entitled to seek independent legal advice at the company’s expense. Directors must ensure that the costs are reasonable and must inform the chairman before the advice is sought. The advice must be made available to all directors”
It would appear that chairs are keen to keep guidance on mission and values in house. Outside legal advice is to be sought only on an irregularity, and with approval. It is perfectly understandable that chairs would be keen to keep any issue with regard to the application of mission and values in house, following the principle that family squabbles should be settled behind closed doors. Unfortunately, it could also reflect a control mentality that appears pervasive in board culture, with a desire to minimise or eliminate shocks and surprises.

**Conclusion to topic 2**

The vast majority of companies had a mission or values statement or a statement that performed the same function that had been reviewed recently. Only 30 per cent of companies required directors to sign on to the company’s mission and values statements yet 73 per cent thought they were valid guidelines for decision-making. This appears to be problematic. If you cannot get directors to sign on to the mission statement, of what real value is it? Where directors needed guidance on the mission statement, the chair was the main source of guidance. This is consistent with keeping issues within the board where possible and letting them outside only where absolutely necessary. Most mission and values statements focused on the behaviour of the company and its employees and customers.
Topic 3. The codes of conduct put in place and their link to the company’s mission and values.

The eight questions in this section dealt with a company’s code of conduct. The questions addressed the areas covered by the code, the link with the mission statement, how effectively the code is implemented, whether performance indicators track the code, and to who they are communicated, the training received by directors and managers, and the effect of the code on corporate practice.

3.1. In what areas have corporate codes of conduct been established?

From the responses it can be seen that for a clear majority of respondents (80 per cent or more) most of the issues listed are the subject of a corporate code of conduct.

<table>
<thead>
<tr>
<th>Topic</th>
<th>Yes %</th>
<th>No %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share trading by executives</td>
<td>97</td>
<td>3</td>
</tr>
<tr>
<td>Confidentiality of information</td>
<td>93</td>
<td>7</td>
</tr>
<tr>
<td>Ethical behaviour of all corporate officers and employees</td>
<td>93</td>
<td>7</td>
</tr>
<tr>
<td>Insider trading</td>
<td>93</td>
<td>7</td>
</tr>
<tr>
<td>Discrimination</td>
<td>90</td>
<td>10</td>
</tr>
<tr>
<td>Corruption/fraud/bribery</td>
<td>87</td>
<td>13</td>
</tr>
<tr>
<td>Occupational health and safety</td>
<td>83</td>
<td>17</td>
</tr>
<tr>
<td>Data security</td>
<td>70</td>
<td>30</td>
</tr>
<tr>
<td>Environmental safety</td>
<td>63</td>
<td>37</td>
</tr>
</tbody>
</table>

Only in the areas of environmental safety (63 per cent) and data security (70 per cent) did the response rate decline. Yet these latter two topics can have a huge effect on corporate sustainability. For example where data is stolen and sold, or taken by key staff when they move to a rival company.

Other issues covered by some companies’ codes of conduct included: crisis management, privacy, continuous disclosure, accounting, human resources policies, trade
practices, treasury, dealing in company shares, disclosure issues, email and internet usage, gifts, conflict of interest, whistleblowing, and communicating with the media. Two respondents stated that their codes of conduct were still under construction.

3.2. What is the link between the mission and values statement of the company and its code of conduct?

Of the respondents, 64 per cent separated their mission and values statements and codes of conduct. In only 14 per cent of responses were the two documents integrated. In only 21 per cent of responses was feedback on the understandability of the statements and code sought.

These responses indicate a piecemeal approach to mission, values and codes being undertaken in most companies, although several respondents did indicate that the separate statements supported each other. If a piecemeal approach is taken it is unlikely that such statements will have a significant effect on the actions of employees, executives or board members. Only an integrated, consistent effort in communication and education linked with some feedback mechanism is likely to generate a culture in which these statements are taken seriously.

<table>
<thead>
<tr>
<th>Statement and Code</th>
<th>Yes %</th>
</tr>
</thead>
<tbody>
<tr>
<td>The statement and code are dealt with separately</td>
<td>64</td>
</tr>
<tr>
<td>Compliance with the code is monitored and enforced</td>
<td>54</td>
</tr>
<tr>
<td>Feedback on the understandability of the statement and code is sought</td>
<td>21</td>
</tr>
<tr>
<td>Regularly</td>
<td></td>
</tr>
<tr>
<td>The statement and code are incorporated together</td>
<td>14</td>
</tr>
</tbody>
</table>

Compliance with the code was monitored and enforced in 54 per cent of responses, indicating that a control mentality was developing in relation to the codes, with them being used to control management and employee behaviour rather than to get management to modify its behaviour for the benefit of all involved.

Comments received emphasised the fact the mission and values statement and codes of conduct were obviously connected, but that connection was nowhere made
explicit. In one case only, was it evident that values were incorporated into a code of conduct in a coherent framework:

“Our values are incorporated into our code of conduct and everything is linked via our governance and corporate responsibility frameworks. We conduct social and environmental audits and seek external comments.”

3.3. What mechanisms are in place to ensure that corporate codes of conduct are effectively implemented?

The major mechanism in place to ensure that codes of conduct are implemented are appraisals linked to the code of conduct (55 per cent of respondents) followed by employee appraisal linked to the code and training (48 per cent). Despite the suggested need for whistleblower protection, only 36 per cent of respondents had developed a whistleblower mechanism.

<table>
<thead>
<tr>
<th>Mechanisms</th>
<th>Yes %</th>
<th>No %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management appraisal linked to Code of Conduct</td>
<td>55</td>
<td>45</td>
</tr>
<tr>
<td>Employee appraisal linked to Code of Conduct</td>
<td>48</td>
<td>52</td>
</tr>
<tr>
<td>Training of officers of the company</td>
<td>48</td>
<td>52</td>
</tr>
<tr>
<td>Whistleblower hotline</td>
<td>36</td>
<td>64</td>
</tr>
<tr>
<td>Management appraisal linked to monitoring of the Code of Conduct for direct staff</td>
<td>21</td>
<td>79</td>
</tr>
<tr>
<td>Regular bulletins</td>
<td>17</td>
<td>83</td>
</tr>
<tr>
<td>Personnel trained in ethics give to guidance to staff</td>
<td>14</td>
<td>86</td>
</tr>
<tr>
<td>Help Desk</td>
<td>3</td>
<td>97</td>
</tr>
</tbody>
</table>

The use of appraisal systems to ensure codes are implemented adds another layer of external control to staff activities, whereas the goal of such mechanisms should be to help managers become better informed and more self-reliant. Several respondents stressed that compliance with codes was being institutionalised in compliance management systems (10 per cent of respondents).
There were significant differences in the responses from large companies and small in relation to employee appraisal\(^9\) and management appraisal\(^{10}\) where large companies were more likely to link appraisal to the code of conduct.

In some companies giving staff a copy of the code was seen as sufficient. At others there were no formal codes in place (ten percent). One company had an integrity officer whose job was to provide, education, advice and counselling to management and staff on integrity issues, see fair play occurred when integrity breaches were discovered, and to ensure complainants were not victimised.

Contrast the following comment:

“Compliance with the Code is incorporated into the compliance management systems. Compliance reports are developed within business units and then collated before being passed up through senior management and to the Audit committee. Managers are required to certify that they and their teams have acted in line with the code. Exemptions to compliance with the code are included in reports to the audit committee. Whistle blowing mechanisms are implemented through the protected disclosure policy that applies to the company's subsidiaries.”

with:

“The Code of Conduct and the various compliance, responsibility, and good governance policies and practices are part of a fabric of all of the company's communications. Formal staff publications exist in each area as well as access via the internet and intranet.”

The first comment sees the code as a systemic, compliance issue. The second comment sees the code as an essential behavioural aspect of the company’s activities.

3.4. Are performance indicators used to track performance either directly or indirectly against the codes of conduct?

\(^9\) p-value 0.014  
\(^{10}\) p-value 0.017
In 48 per cent of respondent companies, performance was not tracked against the code of conduct. 14 per cent tracked it directly and 34 per cent tracked it indirectly.

<table>
<thead>
<tr>
<th></th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Directly</td>
<td>14</td>
</tr>
<tr>
<td>Indirectly</td>
<td>34</td>
</tr>
<tr>
<td>Both</td>
<td>4</td>
</tr>
<tr>
<td>Not tracked</td>
<td>48</td>
</tr>
</tbody>
</table>

The major aspects of the code that were tracked against performance were safety and environmental factors. In some companies managers were expected to behave in a manner that reflected the code, and contravention of the code brought on disciplinary action that could lead to dismissal. In some companies material violations of the code were reported to the audit committee. In others, certificates of compliance were expected to be endorsed by responsible management.

3.5. To whom are the indicators communicated?

It was not the practice in most respondent companies to report indicators to the board, a board committee, the HR department or employees.

<table>
<thead>
<tr>
<th>Parties</th>
<th>Yes %</th>
<th>No %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Board</td>
<td>32</td>
<td>68</td>
</tr>
<tr>
<td>Board committee</td>
<td>26</td>
<td>74</td>
</tr>
<tr>
<td>Human Resource Department</td>
<td>26</td>
<td>74</td>
</tr>
<tr>
<td>Employees</td>
<td>26</td>
<td>74</td>
</tr>
<tr>
<td>Legal Department</td>
<td>6</td>
<td>94</td>
</tr>
</tbody>
</table>

Where companies reported to a committee, it was usually to the audit or compliance committee, which again indicates that this is seen as a quasi-legal compliance issue. This is probably only natural, as senior staff are familiar with such models and it is
more convenient to put code compliance into the same basket. In some companies there was direct reporting on a monthly basis to the board, especially on safety issues. In only one instance were performance indicators tracked against the code of conduct and reported to a social responsibility committee, despite eighteen per cent of respondent companies stating that they had committees of the board dealing with social responsibility.

3.6. Are directors provided with any training in ethics?

72 per cent of respondent chairs stated that directors are assumed to have the necessary ethical background.

<table>
<thead>
<tr>
<th></th>
<th>Yes %</th>
<th>No %</th>
</tr>
</thead>
<tbody>
<tr>
<td>It is assumed that Directors have the necessary ethical background</td>
<td>72</td>
<td>28</td>
</tr>
<tr>
<td>Informal—ethical issues are regularly raised in meetings</td>
<td>50</td>
<td>50</td>
</tr>
<tr>
<td>Ethics training provided if requested</td>
<td>36</td>
<td>64</td>
</tr>
<tr>
<td>During orientation only</td>
<td>18</td>
<td>82</td>
</tr>
</tbody>
</table>

The following comment is instructive:

“The ethical background of directors is a fundamental criterion for appointment. (There is) no indication to date that training or other formal processes are necessary. This should not be interpreted as complacency. Board culture is such that any issue would be quickly flushed out.”

Assumptions and reality often collide. Where does a chairman discover whether the values of any one director are congruent with the organisation as a whole? Too many episodes in which directors turned out not to have acted ethically abound in the annuls of corporate failures both in Australia and overseas. In no other domain would assumed competency be a major criterion for employment. We wonder whether this could result partly from the widely-held view that directorships of leading companies are a closed
network of mates? Building on an assumed ethical background for directors is the belief that directors get informal training in ethics when the issues are raised in board meetings – generally not the best place to learn values but to apply values learned beforehand.

The comments provided by chairs all support the notion that directors must have a strong ethical background before being appointed. We wonder, however, how a chairman or chairwomen is to assure themselves that a director is ethical? On the basis of a chat or a quick check with colleagues who have worked with the person being sought for a board appointment?

Certainly getting a new director to subscribe to the values and codes of conduct of the organisation is a start, but it hardly constitutes evidence that a person is of high ethical character. What is never discussed is what ethics mean to each director and whether the views held by directors are congruent with each other. There tends to be an assumption held that it is self-evident fact, yet there is no evidence to support the assumption.

3.7. What form of ethics training is provided for directors and senior management?

What is obvious from the responses is that little if any training is given to most directors. In only 25 per cent of respondent companies did directors receive training in understanding the company’s code of conduct.

Managers fare a little better, but there is no overwhelming movement on behalf of respondent companies to train managers in the code of conduct and ethical decision-making, despite several companies having put in place management appraisal linked to compliance with their code of conduct. Where are managers supposed to learn about their code of conduct, its application and its link to ethical decision-making?

<table>
<thead>
<tr>
<th></th>
<th>Directors</th>
<th>Managers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes %</td>
<td>No %</td>
<td>Yes %</td>
</tr>
</tbody>
</table>
A significant difference was observed in response to the question about managers integrating the Code of Conduct (ethics) into their personal values. Larger companies appear to do this better than small companies.

What is heartening to see is that some companies do take seriously the training of directors in the related aspects of codes of conduct, ethics and decision-making. However the incidence of this is extremely low. Also the question must be asked: if it is good enough for some companies to engage in it, why do they all not do so?

Statements were given by some chairs that directors and managers are aware and have agreed to the code of conduct, and that seems to be sufficient to indicate to the chairs that it is understood and respected by the directors. A common response was that the board routinely examines the ethical dimensions of matters under discussion.

Those few companies that appear to understand the significance of ethics training, provide formal training in ethical decision-making usually across the entire company from the boardroom down.

Comments include:

“No formal training in ethics is carried out on a holistic level. Ethical issues are discussed at Board meetings and senior management team meetings in an open and candid manner and further information - guidance is sought as required on
particular issues.”

and

“The company's values guide the decision-making process across the company, from directors to front line. Staff throughout the company participate in the breakout program which further explores the company's values and their use in ethical decision-making.”

3.8. Can you think of any examples where your code of conduct has influenced or changed corporate practice? Provide brief details below.

Only 15 per cent of respondents answered in the affirmative, and provided examples. The examples cited included trading in the company’s shares, safety measures, contractor relationships and false signing of code of conduct compliance certificates that led to a manager’s dismissal.

The dearth of examples provided could indicate a poor fit between the code of conduct and organisational practice. If this was the case, there would be few if any examples. A notable comment was:

“A middle manager was recently dismissed for signing a false certificate of compliance. This sent a powerful message through the organisation as the manager was a strong performer in terms of business results. Last year was the first year that formal sign off required. The code is now a common topic of conversation among managers.”

No wonder. If code compliance becomes a key control mechanism, it’s bound to become a topic of conversation and concern.

Conclusion to topic 3

The most outstanding aspect of the responses to this section was the degree to which appraisal of managers and employees was linked to the company’s code of conduct, and that compliance with the code was monitored and enforced. If the mission and values are turned into a code of conduct and then used as a control mechanism, the
result will be a highly cynical management and workforce structure where compliance with rules is more important than doing the right thing for customers, employees, suppliers and the community. The focus will be inwards and protective of self, not outwards and caring for others.

In only a few cases were performance indicators tracked against the code of conduct, and these indicators in the majority of respondent companies were not collected or reported.

The assumption that directors are ethical when they achieve board membership flies in the face of evidence from corporate failures that indicated that directors’ ethics were a problematic issue. It is laudable of company documents to state that all directors are expected to be ethical, but without an exploration of what ethics means to each director or how their ethical principles translate into decisions made, it is not possible to state that the ethical values held by directors are congruent with societal norms or the values that the company espouses.

There was just one question in this section.

4.1. Please identify the three most important areas (1 being the most important) where the board has discussed issues affecting risk and reputation in the last year.

<table>
<thead>
<tr>
<th>Area</th>
<th>Rank</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Workplace safety</td>
<td></td>
<td>10</td>
<td>4</td>
<td>0</td>
<td>14</td>
</tr>
<tr>
<td>Accounting disclosures</td>
<td></td>
<td>6</td>
<td>6</td>
<td>2</td>
<td>14</td>
</tr>
<tr>
<td>Technology</td>
<td></td>
<td>3</td>
<td>0</td>
<td>2</td>
<td>5</td>
</tr>
<tr>
<td>Conflict of interest</td>
<td></td>
<td>2</td>
<td>3</td>
<td>0</td>
<td>5</td>
</tr>
<tr>
<td>Security of information</td>
<td></td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Currency</td>
<td></td>
<td>1</td>
<td>2</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>Cash flow</td>
<td></td>
<td>1</td>
<td>2</td>
<td>0</td>
<td>5</td>
</tr>
<tr>
<td>Outsourcing</td>
<td></td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Discrimination</td>
<td></td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Fraud</td>
<td></td>
<td>0</td>
<td>0</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Interest rates</td>
<td></td>
<td>0</td>
<td>1</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Downsizing</td>
<td></td>
<td>0</td>
<td>1</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Executive/Director remuneration</td>
<td></td>
<td>0</td>
<td>1</td>
<td>5</td>
<td>6</td>
</tr>
<tr>
<td>Executive/Director options</td>
<td></td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Entertainment</td>
<td></td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Product safety</td>
<td></td>
<td>0</td>
<td>2</td>
<td>2</td>
<td>4</td>
</tr>
<tr>
<td>Legal</td>
<td></td>
<td>0</td>
<td>2</td>
<td>2</td>
<td>4</td>
</tr>
<tr>
<td>Environmental</td>
<td></td>
<td>0</td>
<td>1</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>Sexual harassment</td>
<td></td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Human Resources</td>
<td></td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>1</td>
</tr>
</tbody>
</table>
The maximum number of responses that any single area of importance could receive was 32. From the responses given, the number one priority risk factors are workplace safety (31 per cent) followed by accounting disclosures (19 per cent), technology (9 per cent) and conflict of interest (6 per cent). In terms of a 1, 2, or 3 ranking, workplace safety (44 per cent) and accounting disclosures (44 per cent) pull in the most rankings, followed by executive remuneration (19 per cent), technology (16 per cent), cash flow (16 per cent) and conflict of interest (16 per cent), then currency, product safety, legal and environmental issues (all 12 per cent).

Considering the rising incidence of fraud in the workplace\textsuperscript{11}, the low ranking of fraud is concerning. Also the low rankings of discrimination, downsizing and sexual harassment provide some indication that some key stakeholder issues are relegated to second tier concerns to be addressed only when some adverse event happens. This may constitute a gap in the risk management policies and systems within a company.

Other risk factors ranked by respondents included growth, credit risk, transactional risk, commodity trading, exploration, and reputation risk. One respondent declined to answer this question.

The growing significance of reputation risk is indicated by the following comment:

\textit{"Reputation risk issues are comprehensively discussed including the board's strategy off site. Many issues have been raised in this context including: OHS (workplace); security of information; supply chain risks; discrimination; mis-selling."}

Reputation always includes a wide group of stakeholder concerns as the issues mentioned above indicate.

\textsuperscript{11} see KPMG Fraud Survey 2004, KPMG, Sydney office that indicates a significant underlying level of fraud, and many organisations, even those that have experienced serious loss, are yet to adopt even the most fundamental fraud prevention measures. pp. 5-6)
Topic 5. How the board communicates codes of ethics and conduct.

The two questions in this section concern board communication with various stakeholders and the impact of the ASX corporate governance guidelines on corporate governance and codes.

1. What has been the impact of the ASX guidelines on the disclosure of your current corporate governance guidelines and codes of conduct?

<table>
<thead>
<tr>
<th></th>
<th>Governance Guidelines</th>
<th>Code of Conduct</th>
<th>Code of Business Conduct</th>
</tr>
</thead>
<tbody>
<tr>
<td>Meet ASX requirements and disclose on external website</td>
<td>93%</td>
<td>83%</td>
<td>67%</td>
</tr>
<tr>
<td>Need to develop guideline or code committee charters and disclose them</td>
<td>17%</td>
<td>3%</td>
<td>10%</td>
</tr>
<tr>
<td>Meet ASX requirements but published internally only</td>
<td>3%</td>
<td>7%</td>
<td>10%</td>
</tr>
<tr>
<td>Meet ASX requirements and disclose but not on website</td>
<td>0%</td>
<td>3%</td>
<td>0%</td>
</tr>
<tr>
<td>Need to update and disclose to meet ASX guidelines</td>
<td>0%</td>
<td>3%</td>
<td>3%</td>
</tr>
</tbody>
</table>

Most of the respondent companies stated that they were complying with the ASX guidelines and disclosing the information on their web sites. A significant proportion (up to 17 per cent) still had not fully developed their governance guidelines or a code of conduct.

Some respondents stated that the ASX guidelines had not changed governance policy, but more information was being published on their web sites. Many respondents had moved to change their governance policies before the ASX guidelines had been
released. Several respondents stated that they now reported against the ASX Best Practice recommendations.

5.2. **How do you as the chair communicate with internal and external stakeholders?**

The use of meetings was essentially limited to communication with senior management. Employees, trade unions, suppliers, banks, and the community were relegated to a newsletter or email communication, or were excluded from communication altogether.

<table>
<thead>
<tr>
<th></th>
<th>Briefings/Meetings</th>
<th>Newsletters/Email</th>
<th>No direct Communication</th>
</tr>
</thead>
<tbody>
<tr>
<td>Senior Management</td>
<td>77</td>
<td>23</td>
<td>23</td>
</tr>
<tr>
<td>Both meetings and newsletters</td>
<td>20</td>
<td>17</td>
<td>23</td>
</tr>
<tr>
<td>Employees, trade unions, suppliers, banks, community</td>
<td>3</td>
<td>47</td>
<td>40</td>
</tr>
<tr>
<td>Brokers</td>
<td>0</td>
<td>13</td>
<td>14</td>
</tr>
<tr>
<td><strong>totals</strong></td>
<td><strong>100</strong></td>
<td><strong>100</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

Several respondents pointed out that meetings with brokers, employees, and unions was the responsibility of the CEO and the management team. One chair did say that he tried to have more communication with brokers, employees, regulators, and analysts.

Responses indicate that outside communications is the domain of management, not the board. The board gets most of its information via senior management, and communicates mainly with them. This is quite understandable and expected, but unless an effort is made to communicate with other stakeholders their concerns will essentially remain out of sight. The following comment was encouraging:
“I endeavour as often as time permits to have direct 2-way communication with employees, investors, regulators and analysts. I expect the CEO to have more frequent communication. I reply personally to all shareholder correspondence to the chairman, but with such a large number of shareholders (900,000) it is difficult, outside the AGM, to communicate other than by way of newsletter.”
Topic 6. How ethical issues impact the effectiveness of the board.

There were six questions in this section. The questions required written responses. Only 23 of the 32 respondent chairs completed this section of the questionnaire. Those who did were generous and candid with their comments on a range of questions that addressed board effectiveness. The remaining chairs left these sections blank.

6.1. How do you satisfy yourself that the Board receives all the information needed, in a timely manner, for full deliberation of decisions to be taken by the Board, to be confident that decisions made are consistent with the Company’s mission and values promoted?

This question was interpreted differently by different chairpersons. To some it was an issue of having a regular timetable and members receiving a comprehensive information pack prior to each meeting, usually containing operating and financial information, on a monthly, but sometimes more regular basis (weekly in one case), but with enough time to absorb the data given.

To others the question was about the dialogue with other directors over sensitive issues prior to board meetings. Some chairs mentioned the importance of a culture of openness and transparency, and an evaluation of the mission against behaviour. We can thus see that viewing governance as essentially systemic or essentially behavioural will influence what is seen as “information”.

To some chairs this question was seen as a need to be in regular dialogue with the CEO and senior management. This was the view expressed most often (48 per cent of respondents). The relationship with management was often seen as critical with the necessity for an open and constructive management of the relationship essential.

To others, the question was about evaluating the quality of information received by the board or it was about the annual review of board performance. In one instance the chairman stated that his own assessment was the major criterion against which the quality of board papers, discussion and director involvement was judged. Relevant quotes include:
“A corporate timetable of key events is prepared for the year and distributed to directors. Thus the board is aware of when key information is required. The chairman works closely with senior management to understand significant matters of interest and that those matters are adequately addressed in board papers. The board is composed of experienced, astute active members who meet monthly and are aware of business and industry issues and they seek assurances and evidence from management that issues are being addressed and are on the agenda for consideration.”

“The timetable for distribution of papers is followed. Clear expectations are communicated of papers and information. There is a charter setting out board and management responsibilities. There is regular evaluation of papers and evaluation of board and committee functions.”

“By direct questioning of all board members and other senior executives at board meetings and otherwise as considered necessary. “

To some chairs, information is a physical attribute of activities (issue papers, financial reports, information fed from senior management), whereas to others it is a function of questioning. We assert that it is only the latter that leads to understanding that can result in a considered decision.

6.2. A range of activities would appear to impact on the effectiveness of the Board, as a decision making entity (for example, leadership, breadth of understanding, team spirit, openness to debate, independence of judgment etc.)? Given your experience with the Board how do you regard these issues? Can you provide some insight into the functioning of the Board?

6.2.1 Issues affecting board effectiveness
Many respondents stated that the factors given were all important (40 per cent). Several stated that directors should:
• be independent (26 per cent)
• be experienced in management and as director
• have well-developed personal skills and expertise
• have deep knowledge and understanding of the business

and that critical issues for the board were:
• open debate with directors free to express their views (61 per cent)
• it should be kept small;
• cohesion and trust among board members and executive;
• effective mix of board members;
• clearly articulated mission, values and strategy
• mindful of responsibilities – mainly to shareholders
• a strong ethical framework
• a meeting structure that encourages debate

6.2.2 Insight to the functioning of the board

Just about every chair agreed that board members needed to be independent decision-makers with strong characters. It was important to have “robust debate” on issues that came before the board. The board needed to be open, respectful of each other, collegiate and trusting. Breadth of experience and a mix of skills were seen as important, as was teamwork. The fact that these factors were mentioned so often indicates that there exists a “cake mix” of appropriate board member characteristics, yet most of them are extremely vague. How can you tell an independent decision-maker? What is robust debate? What leads to board members trusting one another? Is it there common background? What we could observe is that, rather than they being different from each other, they are probably very similar, both in terms of social background and work experience.

Only one respondent talked about the need for integrity and an enquiring mind as a major characteristic for a director. An enquiring mind can be gleaned by the number of searching questions that a director asks at meetings.

Relevant comments from this section were:
“Key elements are:
1. to have directors who are independent of thought.
2. to have a clear and articulated mission, values and strategy to guide decision-making.
3. to have robust debate but also commitment to common action.
4. to build trust and respect between independent directors and between independent directors and CEO and executive team.
5. to have regular and open dialogue all the time and not just at board meetings.
6. to ensure the format of board meetings are structured to ensure that current issues are being debated and the company is focussed on moving forward.”

“These issues are important. Our board functions on collegiate lines with no topic taboo. Discussion is full and frank even at the risk of being tedious. This way we ensure that no matter is overlooked or lacks necessary attention. We believe it is better to spend too much time on a contentious issue than not enough.”

“These are regarded as important qualities as are business acumen, experience, enquiring minds and personal integrity.”

6.3. What is your personal view of the role that ethics should play in board deliberations?

The vast majority of chairs expressed the view that ethics were at the core or foundation of all decision-making (65 per cent of respondents). Such comments as ”they should be the first point of reference”, “they underpin the ethos of the company,” “ethics are a given in all board deliberations,” “ethical standards bind the fabric of the board,” and “each board member has a strong ethical base,” were common. A strong ethical background was indicated as a pre-requisite to appointment to the board.

Several chairs stated that ethics were vital to the appropriate functioning of the board, and that behaviour of directors and all company staff should reflect the ethics of the firm.
Having said this, some chairs then went on to say that the need for ethical advice would depend on the circumstances (such as an ethics committee in health industry), that the ethical basis of decisions was not generally addressed at board meetings, and that the published values statement was what was used to guide decision-making.

In one instance a chair stated that chairs needed to be wary of unethical directors who would find ways around rules, and another admitted that you could not regulate good behaviour, it had to come from within.

Comments included:

“The ethical basis of decision-making is not generally addressed in the course of the board process. Each of the board members, including executive directors, has a strong, individual ethical base, and the debate of board issues proceeds accordingly. Decisions are taken on the basis of what is the "right decision", as opposed to any option that might be legally available.”

“Ethical standards bind the fabric of a board. Trust and confidence in the integrity and honesty of members are essential just to function effectively. Any doubts should be raised first privately and then with the whole board or only with those not subject to the doubt. If one's personal values are likely to be affected by a board decision, they should be raised with the chair before deliberation. If this is not possible they must be raised at the meeting.”

“They are critical in business and good governance must be first and foremost principles-based. One cannot regulate good behaviour - it must come from within. Hence the board spends a lot of time on the values and behaviours that are acceptable and appropriate for the company and deliberating on the ethical aspects of our business and the impact we have on our stakeholders. Boards are the prime determinant of the corporate culture which is the backbone of corporate governance.”
6.4. How appropriate would you consider it, as chair, to solicit each board member’s (anonymous) opinion on sensitive issues (e.g., board or individual performance).

There seemed to be some division among the chairs on this issue. Several chairs stated that seeking anonymous opinions of board members on sensitive issues was a current practice, whereas just as many said that anonymous views were discouraged, and that views canvassed with individual directors were discussed in open board meetings. All said that individual directors met with the chair for performance reviews at least annually. The majority of chairs said that they discussed individual director performance with that director.

Comments made included:

“It is a practice currently undertaken with respect to board or individual performance. It also takes place on sensitive issues to be discussed at upcoming meetings.”

“I don't think it is appropriate to conduct anonymous surveys on a board with only six non-executive directors. However, one-to-one discussions and surveys are conducted annually on individual and board performance with the aggregated outcome shared with the full board.”

“It is important that the Chairman not create cliques or consensus panels within the board. However, it is important for a chair to obtain individual opinions - specialist expertise or sensitive issues including confidential / anonymous views on individual board member's performance.”

6.5. When dealing with contentious issues, how does the board reach a decision (consensus, formal vote, show of hands) and what role does ethics play in those deliberations?

The vast majority of respondents said their aim was to reach a consensus in reaching decisions. Rarely did chairs want contentious issues to go to a vote. One chair
said a decision would be deferred to the next meeting if there was no consensus. Some chairs said they had never had an issue come to a vote, others said it was very rare. One stated that a decision had gone to a vote only once in the last 20 years. Several times, chairs emphasised that a consensus decision was reached only after robust discussion and debate. Others said that contentious issues were discussed informally before the full board meeting and it was rare that directors were not in full agreement. One chair stated that he would be reluctant to move on a decision if there was strong opposition by even one director. In two instances only did chairs state that they would use a majority vote to arrive at a decision.

What came through from the chairs was how important board solidarity was. There could be plenty of vigorous discussion, but at the end of the day a consensus vote was needed. With limited time to make myriad decisions, the time for questioning at board meetings must be generally constrained. Ethics was mentioned as something that was always in the background, that it underpinned all decisions, and that it was in the minds of directors as they made decisions. Many respondents talked about consensus and ethics as if they were synonymous:

“In my time, constructive debate and proper "airing" of the issues has always resulted in unanimity of decision. The fact that a code of conduct and ethics policy now has a high profile within the company is always in the minds of directors as we discuss issues.”

“The Chair invites every director to provide his or her view and then a consensus is reached by a show of hands on any resolution required to be passed by a majority. It is essential that all directors act with integrity. Directors can ask for comments to be minuted and the board accepts that once a decision is passed there is solidarity on that decision outside the boardroom.”

“The board strives for consensus and in general terms would be reluctant to proceed with a contentious issue over a strong position by a director. Naturally ethics plays an important role in board deliberations. The company values guide
6.6. What new initiatives are you planning this coming year to build &/or maintain an ethical culture within the organisation?

35 per cent of chairs stated that there were no new initiatives in place to build or maintain the ethical culture. Others stated that they were holding more meetings outside formal boards, that they were revising the code of conduct, or seeking to improve communication with staff, others talked of the development of a more ethical culture where openness and accountability were the major criteria, others were improving the education of managers, and two were improving their whistleblowing policies.

Comments included the following:

“(Initiatives in) ongoing role modelling and leadership that displays the right behaviours from senior management, the board and CEO. Management initiatives will continue to seek to strengthen the compliance culture, review the code of conduct and to enhance effective communication to all stakeholders. Management will continue to be encouraged by the leaders and the board to bring out mistakes as they are made without fear, blame or criticism.”

“The board actively oversees the Code of Business Ethics compliance certification and support for whistleblowers, among other initiatives. The board has recently set example of its commitment to an open, ethical culture by voluntarily preparing comprehensive remuneration report and submitting it to shareholders for approval - and will continue to reinforce to management that sound ethics is an inviolate element of the company's culture.”

The distinctive nature of the cultures being developed by the two organisations, represented by the quotes made above, is stark. The first focuses on compliance and owning up to mistakes. The second talks about what the board will do to set an example of an open ethical culture.
Conclusion to topic 6

The majority of chairs emphasized that ethics was at the core of all decision-making. Some even stressed that the behaviour of all directors and staff should reflect the ethics of the organisation. Others indicated a separation of ethics from other attributes of decision-making by suggesting that ethical input would be sought if needed.

Chairs were concerned that directors be independent (although what this is, is never spelled out), skilful and knowledgeable about the business. In relation to the board, chairs expressed the need for: open debate with directors free to express their views; a strong ethical framework; directors who were mindful of responsibilities, especially to shareholders; and clearly articulated mission, values and strategy.

With regard to the board receiving information in time to make decisions consistent with the company’s mission, some chairs referred to structural issues (regular timetable, information packs, and time to absorb information), others referred to behavioural issues (dialogue with directors, CEO and management, evaluation of board and board member performance).

Some chairs seemed keen to solicit directors’ views on sensitive issues anonymously, but most preferred to talk in private first and then discuss in open board meeting what was said in private. A majority of chairs (85 percent) emphasised the need for consensus views. Few wanted contentious issues to be decided on a show of hands. The view that a director should leave rather than breach board solidarity seems very strong. Vigorous discussion was encouraged, but consensus was the goal of the discussion.

Few initiatives were being considered with regard to ethical culture in most companies. Where there were any, they were focussed on better communications, being more open and accountable, and improving management ethical education. No respondent talked about improving the ethical decision-making of the board through education in modes of questioning, or conflict management.
Topic 7. Final issues on key stakeholders

7.1. Where does an employee go if they need guidance in interpreting the mission or values statement?

As you would suspect most respondents stated that an employee should go to their supervisor (73 per cent), but a surprising 51 per cent would go to the CEO, and more than 50 per cent would go to the company secretary or human resources department.

<table>
<thead>
<tr>
<th>Issue</th>
<th>Yes %</th>
<th>No %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Follow a documented procedure through hierarchy of management until</td>
<td>23</td>
<td>77</td>
</tr>
<tr>
<td>the employee has received a satisfactory answer</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chairman of the Board</td>
<td>17</td>
<td>83</td>
</tr>
<tr>
<td>C.E.O.</td>
<td>52</td>
<td>48</td>
</tr>
<tr>
<td>Company Secretary</td>
<td>53</td>
<td>47</td>
</tr>
<tr>
<td>Human Resources Department</td>
<td>52</td>
<td>48</td>
</tr>
<tr>
<td>Their supervisor</td>
<td>73</td>
<td>27</td>
</tr>
</tbody>
</table>

Some respondents said that an employee would go in the first instance to a chief compliance officer, integrity officer, or the general counsel. One respondent said that employees tended to have more issues with the code of conduct that the mission and values statement. Others said that a whistleblower policy would deal with such issues.

7.2. When selecting key suppliers both in Australia and abroad the does the company take into account the following issues?

In all cases bar two, 50 per cent or more of respondents stated that these issues were not applicable when selecting suppliers. Only with occupational health and safety and environmental safety were the number of respondents with a policy or monitoring activity in the majority, and then only just. We surmise that the monitoring and policies in these two areas relate, in the main, to compliance with legal requirements.
What is clear, is that most of our respondents do not see issues that are commonly raised in relation to trans-national companies, as issues for local companies. Statements such as:

“Because of the nature of the company's industry and its key suppliers, none of the items listed in question 36 have particular relevance to us. However, if we became aware of particular issues in relation to key suppliers (such as corruption of child labour issues) these would be taken into account in concluding contracts with affected suppliers.”

“We make general enquiries about the reputation of our suppliers and do not deal with those with poor reputation on the issues raised in this question. No formal policy as yet. Currently under consideration.”
Yet many of a company’s suppliers will be international companies with activities located in third world countries. What was interesting was that in no instance were these issues reported to the board. We wonder whether this may be an example of benign neglect.

Several respondents stated that they would respond only if notified of particular issues with any suppliers. Others said that some of these issues were addressed when suppliers were first appointed, but not thereafter.

In only one instance did a respondent state that they had a sustainable supply chain policy, with all major suppliers being monitored for their sustainability principles:

“The company's formal "sustainable supply chain" policy is available on the company's web site under the social accountability section. All major suppliers are monitored and trusted for the sustainability principles and reports on supply chain performance and issues are provided to the board Social Responsibility Committee annually or more regularly if necessary. Further comments: The company's social charter combined with the Corporate governance statement sets out the governance and responsibility framework operating within the company. These are key priorities for the company as part of its commitment to deliver superior performance across all 3 pillars of sustainability -financial, social and environmental.”

Further comments

Only one chair provided any further comments. This chair stated that:

“I do not believe that ethics can be taught to mature individuals (most directors have had a life before their appointment). Personal standards are taught and learned from an early age - at home, at school, in church. By the time most people become directors their standards and values are formed. Due diligence on new directors is essential as is due diligence on our existing board if one is asked to join it. I believe that it is essential for a board to appoint both the CEO and CFO. If one leaves the appointment of the CFO solely to the CEO to whom he or she
reports and on whom he or she is dependent for continued employment, the prospect of unethical behaviour (even fraud) is increased.”
Conclusions from the survey

The response rate at 16.4 per cent was what we should have expected. It is difficult to break into the boardrooms of Australian companies. The survey responses are probably biased in favour of those companies that see ethics and good governance as important issues worthy of greater discussion and analysis.

From the respondents’ answers, the boards in our sample are taking ethics seriously with 80 per cent responding that ethical practices were discussed in the last year. The ASX guidelines on corporate governance were overwhelmingly seen as a good way to address governance issues, being flexible and not prescriptive. A small number of respondents differentiated rules about systems of governance and rules about director and executive behaviour. However, many respondent boards have yet to bring stakeholder issues firmly into focus. Issues such as conflict of interest and environmental risk, which could adversely affect the company’s ongoing success, are still not core issues. The only stakeholders whose views were actively considered were shareholders or institutions, with directors acting as proxies for other stakeholder concerns.

Most chairs thought that risk management was a function that could safely be left to a committee. This could represent a weakness as boards must ultimately be responsible for risk issues and, as such, risk management is a governance issue.

The vast majority of companies had a mission or values statement that had been reviewed recently. Only 30 per cent of companies required directors to sign on to the company’s mission and values statements yet 73 per cent thought they were valid guidelines for decision-making. This is problematic. If you cannot get directors to sign on to the mission statement, of what real value is it? Where directors needed guidance on the mission statement, the chair was the source of guidance. This is consistent with keeping issues within the board where possible and letting them outside only where absolutely necessary.

Of significance is the degree to which appraisal of managers and employees in many companies was linked to the company’s code of conduct, and compliance with the code being monitored and enforced. The major problem with this approach is that mission and values statements and codes of conduct become just another control mechanism.
In only a few cases were company performance indicators tracked against the codes of conduct, and these indicators in the majority of respondent companies were not collected or reported. It is in this area that codes of conduct can be most fruitfully used to improve organisational effectiveness, yet data is rarely collected.

The assumption that directors are ethical enough when they achieve board membership flies in the face of evidence from corporate failures that directors’ ethics are a problematic issue. It is too easy to state that all directors are expected to be ethical, but without an exploration of what ethics means to each director it is not possible to state that the ethical values held by directors are congruent with societal norms.

The majority of chairs emphasised that ethics were at the core of all decision-making. Some even stressed that the behaviour of all directors and staff should reflect the ethics of the organisation. Others indicated a separation of ethics from other attributes of decision-making by suggesting that ethical input would be sought if needed.

Chairs were concerned that directors be:

- independent (although what this is, is never spelled out), and
- skilful and knowledgeable about the business.

In relation to board meetings, chairs expressed the need for:

- open debate, with directors free to express their views;
- a strong ethical framework to guide decisions;
- directors being mindful of their responsibilities, especially to shareholders; and
- the existence of clearly articulated mission, values and strategy.

With regard to the board receiving information in time to make decisions consistent with the company’s mission, some chairs talked about structural issues (regular timetable, information packs, and time to absorb information), other chairs talked about behavioural issues (dialogue with directors, CEO and management, and evaluation of board and board member performance).

Some chairs seemed keen to solicit directors’ views on sensitive issues anonymously, but most preferred to talk in private first and then discuss in open board
meeting what was said in private. A majority of chairs emphasised the need for consensus views. Few wanted contentious issues to be decided on a show of hands. Board members seemed accepting of this view of the workings of boards. The view that a director should leave rather than breach board solidarity seems very strong. Vigorous discussion was encouraged, but consensus was the goal of the discussion.

Few initiatives were being considered with regard to ethical culture in most companies. Where there were any, they were focussed on better communications, being more open and accountable, improving management ethical education.

Ethics appear to be firmly on the agenda of most companies, and the right words are being circulated to soothe those who might be sceptical about directors’ and executives’ integrity. However, this survey revealed several contradictions in the ways that ethics, mission statements and codes of conduct were being used, a lack of evidence to verify that any company complied with its code of conduct, and a reluctance at board level to issue majority decisions, with consensus reigning supreme and likely to cramp the style of any director who feels that decision-making is not being made against agreed principles.

**Next step in engaging company directors in a culture of questioning and openness.**

We had hoped that our survey might encourage chairmen and women to be more forthcoming in their questioning, and more open to being questioned. In our view effective governance is a function of the trust in which the board is held by those outside the company. Is it a valid goal to get to know the chairs of major companies a little better if chairs are not prepared to be more open and more transparent? If chairs avoid being better known and understood we should ask why?

If trust can be built to increase the transparency between boards and ACSI, then a conduit opens that can be used by ACSI to ask chairs directly about such things as governance best practices, and those areas of social performance and ethical practices where some additional indicators would be appreciated.

Despite the respondents to our survey being open, and generous, in their answers, there is still a general lack of openness from too many corporations. The
notion of whose benefits, or the “good” (see appendix A) that gets considered by boards in their deliberations also needs be addressed.

Lastly, investors need to be able to ascertain the level of consistency in board decision-making. Feedback about the research data collected by boards about stakeholder interests and risks, as well as opportunities needs more systematic attention. It is possible that organisation costs will fall with better understanding of the risks involved, and the stakeholder interests that need to be met.
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Appendix A

The power of the question: a source of board control and accountability

Our approach takes us from the arena of hard data (number of independent directors, independent chair, audit committee chaired by independent director, & etc) to what is, for want of a better word, a more “squishy” approach that is still under construction. Our central proposition is that an alternative paradigm may be useful to try and get a handle on corporate governance. This paradigm focuses on a simple notion: the question. A key question for outsiders is who controls the questioning in the company? Our thesis is that the control of questioning in the organisation should reside at the board level, and provide the locus of control in the organisation. Questioning by and of board members is the source of openness and accountability by corporate management. Our underlying theoretical model is a questioning model developed using the work of Bernard Lonergan, elaborated in *Insight: A Study of Human Understanding* (1957), and John Finnis in *Natural Law and Natural Rights* (1980). Using their insights we have developed what we call a dynamic model of corporate governance (Figure 2).
Figure 2 The dynamic structure of corporate governance

Figure 2 requires directors to apply four thinking skills: be attentive, be intelligent, be reasonable, and be responsible. These four skills are operationalised by asking relevant questions.

At level 1, being attentive requires a director to do some research and ask questions such as who, what, when and where, to generate enough relevant data to move to the next level. At level 2, the director applies his or her intelligence to make sense of the data and find out what is going on. The result of this stage is the generation of one or more insights that links and explains the data. A move to level 3 is possible if by applying reason we can assent to our insight and confirm our understanding and judge it to be an indicator of the reality or truth of the situation or problem. If we cannot do this, we have not gathered enough data, the data is contradictory, or we do not properly understand it. When we move to the highest level 4, we take responsibility by acting on our understanding and backing our judgement. At this level we exercise a value judgement about the “good” generated by our action.

Of course in groups such as boards, each director will perform this task individually and then test their understanding and judgement against the understanding and judgement of fellow directors. At the board level the most effective choice is made by engaging in a dialectic where different conceptions of truth get debated with the object of achieving change in a manner that incorporates all points of view, and is assessed against the “good” that is generated all possible actions. Such choices are the product of individual and group learning and represents the output of a cumulative process that the organisation can draw on in future deliberations.

The choice taken should be assessed against the company’s values, vision and mission, it should be consistent with the organisation’s strategy and agreed policies, which in turn should be consistent with its values, vision and mission. The plan developed should flow from these values, strategies and polices, and lead to action on the ground that leads to outcomes valued by all the company’s stakeholders. Values statements and mission statements, strategies, polices, and plans, are all products of personal and group leadership by directors, and are critical to effective decision-making that takes into account all issues and stakeholders. The model takes into
account the stewardship and stakeholder views of governance, and puts openness and integrity at the core of decision-making.

The circle in the diagram indicates that this is a continuous, repeatable process that requires diligent attention by board members. Directors need always to be aware of sources of bias on the 'ground' in which they operate (institutional oversight, embedded bad practices, poor policy, etc) and in themselves (a narrow view, prejudice, closed mind, etc...). The overcoming of bias is a personal project and challenge requiring directors to be open, share information about themselves, seeking expert opinion when necessary, test their views openly and constantly ask questions.

The questioning system of enquiry is one we are all familiar with from the operation of Courts with cross-examination, the holding of public enquiries and Royal Commissions, Senate Estimates Committees, and the media questioning of people in powerful positions. A culture that allows people to ask all sorts of questions provides a good indicator of authenticity in the culture.

People naturally do not want to be held accountable if some of their decisions are suspect. If their decisions can be hidden behind a veil of silence or obfuscation, decisions will be made on the basis of values close to the hearts of those making them, but that the general community may think are unacceptable. However, if there is a culture of openness, and questions asked are answered honestly, then a culture of trust will be built, based purely on the way questions are addressed.

When we monitor a company from the outside, it is impossible to observe the character of the directors and their integrity in making decisions. Directors have all sorts of ways of putting up smokescreens to hide what they are doing and how they are doing it. In an early response to the questionnaire we sent out, one company secretary company stated that “the company” only replied to requests imposed under law, and so would not complete the survey questionnaire. Outsiders have great difficulty getting behind the corporate veil and are left to infer what is happening by going through their letter boxes and garbage bins.

Knowing one’s knowing requires one to be attentive to the stages of understanding given on the left side of our model in Figure 2. This process is part of our minding of ourselves. Personal integrity can be seen as a function of being attentive to the data, intelligent in understanding the data, being reasonable in judging the data and responsible in taking action based on the data. This is the basis of ethical action. It requires the director to be attentive, intelligent, rational and responsible in
each of their acts of attention, intelligence, rationality and responsibility. It is to know that they are a dynamically coordinated set of operations - inquiring, experiencing, understanding, formulating, judging, assenting, deciding and acting - which constitutes their mind. Acting on this knowledge is what Lonergan calls self-appropriation.

Now turning to the notion of “good”. We outline a threefold notion of good: particular good, good order and the human good. Particular good, in relation to a firm, can be seen through the eyes of its stakeholders as immediate goods or benefits: for example, owners: ROI; cash flow; margins; staff: a just wage, safe workplace; customers: quality product; suppliers: fair dealings.

Good order refers to those things which ensure that particular goods keep coming. It includes organizational sustainability and growth, work opportunities for employees and suppliers, and the reputation of the organization.

Human good, in our use of the term, refers to the set of ultimate reasons why we act. Our choosing is always to promote our self-fulfillment. Finnis developed this notion and proposed that a set of seven basic human goods will be found at the end of our self-examination as to why we act. He defined them as: life itself, knowledge, achievement, aesthetic experience, harmony with oneself, harmony with others and harmony with higher sources of meaning (spiritual harmony) (1980, pp. 86-89).

To demonstrate, think of a board determining how it gets the data to enable it to exercise more control over risk issues:

1. the board has need for more control over risk factors to reduce potential loss to all stakeholders.
2. the Chief information Officer (CIO) identifies opportunities for an on-line system of risk incident data collection.
3. the CIO tests the feasibility of the initiative as a means of meeting the board needs.
4. the range of options and positions that are suitable are identified.
5. a choice is made based on agreed values (for example: reliability, comprehension, accessibility and affordability), that are consistent with the mission and a commitment is made.
6. resources are deployed for establishing a new system configuration.
7. as part of the organisation’s capability building, the new system configuration is developed, installed and tested.
8. the product is delivered on the new platform.

Thus the board’s need for more control over risk factors (the particular good which the board achieves), involves a project in which the CIO relied on good order (on the ongoing trust in the staff to report critical incidents, and the system that the CIO recommends), and the human good of a quality outcome and skilled performance in meeting the needs of the board which have the ‘preservation of life itself’ underpinned both.

Our notion of ‘the good’ enlarges with our knowing. In seeking to give the board more control over risk management, we may not bring to mind ‘good order’ or the human good. But our knowledge of them will guide more mindful action in preserving or promoting conditions in which the particular good continues to be available. The CIO’s honest endeavours to meet board needs, for example, preserves trust.

Our view is that directors’ understanding of the ‘good’ shapes organisational choice and commitment. This is what is at stake, primarily, in what is entrusted to them by stakeholders and the community to do. The deeper their grasp of and commitment to the ‘good’, the more competent and ethical will be their decision-making. They can demonstrate their commitment to the “good” through the mission or values statement. Secondly they commit resources through strategy consistent with the good. Thirdly, they mediate ‘the good’ through their delegation to management to plan and build organisational capability and to deliver it by action on the ground.