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The Boardroom Report

Good governance pays off

> *"THE SURVIVORS FOLLOWED THE ASX* PRINCIPLES *ON COMMITTEES MORE CLOSELY THAN THOSE THAT DID NOT SURVIVE"*

A new study has found that initial public offering (IPO) companies that engage in good corporate governance practices at the committee level may increase their likelihood of survival.

The study by two University of Melbourne academics examined the popularity and development of board committees for 46 new listings on the Australian Security Exchange (ASX) from the time of their IPO in 2008 to the end of 2011, and measured this against whether they survived as companies.

The research followed the release of the ASX Corporate Governance Council's second edition of its *Principles and Recommendations* in August 2007, which recommended that boards of listed companies should establish nominations, audit and remuneration committees and suggested how these should be structured.

The *Principles*, which are built on a "comply or explain" model, also suggested that smaller boards should be responsible for the auditing, nomination and remuneration practices of the company if respective committees are not established.

The academics – Helen Wei Hu, a lecturer in the University of Melbourne's Faculty of Business and Economics, and Paul Ali, an associate Professor in its Faculty of Law – collected information on the IPOs at three different phases: at time of the IPO (from 2008 prospectuses); one year after the IPO (from 2009 annual reports); and from the 2011 annual reports of IPO companies that survived.

Out of the 46 companies that listed in 2008, 31 companies survived after four years, while 15 IPOs delisted for various reasons, including because they were taken over by another company or the scope of their business or their name changed.

The study found that surviving IPO companies had established more committees at the time of their IPO – particularly audit committees – than their non-surviving counterparts. Indeed, none of the non-surviving IPOs established a remuneration or nomination committee at this time and only two had established an audit committee.

A year into their IPOs, 13 out of the 31 surviving IPO companies had established an audit committee, with non-executive directors accounting for 77 per cent of their members. In contrast, only four of the 15 non-surviving IPO companies had established an audit committee and these were much smaller than those of the surviving companies.

Four years after listing, the study found that 14 companies (45 per cent) had an audit committee, seven had a remuneration committee and four had a nomination committee.

The results show that, generally, the IPO companies that survived followed the ASX *Principles* on committees more closely than those that did not survive. In particular, the study reveals that the establishment of board committees – especially, an audit committee – was more common in the surviving IPO companies.

It also found that the independence of audit committees, because of the presence of non-executive directors and independent directors, was higher in surviving than in non-surviving IPO companies.

The researchers believe the results of this study not only provide clear support for the recommendations for establishing board committees, but also have important practical implications for companies, regulators and policymakers.

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The Boardroom Report

Australian directors' identity crisis

A new King & Wood Mallesons report warns that Australian directors are increasingly facing an identity crisis.

Directions 2013, which polled more than 180 directors across a wide range of industries in November 2012, says part of this crisis has been spurred by ongoing difficult economic and business conditions domestically and internationally and pressure to re-orient towards the burgeoning Asian economies.

However, it adds: "The growing sense of identity crisis has been exacerbated by developments in Australia's legal and regulatory landscape. These developments have conditioned responses to various challenges, and opened a widening gap between, on the one hand, the traditional understanding of the role of directors as custodians of the strategic direction of companies and, on the other, directors' increasing risk and compliance-based responsibilities and functions.

"In this context, Australian directors are questioning the true nature and extent of their role in today's corporate environment, and whether the role of directors today still carries with it the potential for the level of creativity and entrepreneurship associated with the role in the past."

One cause of concern, according to the report, is a widening "expectation gap" – that is, the disconnect between how some sections of government, the courts and the public perceive the proper role of directors and how directors perceive their role.

"This is leading to a form of identity crisis for directors as they try to reconcile their view of what the role of a director is against the view held by other stakeholders," says the report.

"A key factor in the development of the expectation gap has been the increased focus placed by regulators, the public and the media in recent years on the directors' role in relation to the oversight and management of compliance and risk issues."

Directors polled indicated that rising compliance burdens and excessive red tape were leaving them with insufficient time to devote to providing companies with strategic direction and guidance. They also suggested that increased burdens were making their jobs less interesting and therefore less attractive.

The expectation gap was reflected in the top five issues of concern to directors:

- Increasing compliance burden (including risk of personal liability).
- Inability to devote sufficient time to providing strategic direction and guidance.
- Excessive bureaucracy and regulation.
- Time burden (number and length of meetings and volume of materials for review).
- Risk of damage to your reputation as a result of actions by or against your organisation.

Indeed, 17 per cent indicated they had refused, or resigned from, a directorship due to one or more of these concerns – up from 9.6 per cent of respondents in the previous year's survey.

The top three regulatory issues receiving director attention in 2012 were:

1. Changes to the work health and safety laws (up from the fourth-ranking issue in 2011). Almost 50 per cent of respondents included this issue as one of their top three issues, and it was also the issue most frequently cited as their most significant area of regulatory focus in 2012.
2. Directors' duties (including the implications of recent court decisions).
3. Ineffective regulation or excessive red tape.

Other regulatory issues that received substantial attention in 2012 were continuous disclosure regulations and practices, and the effect of political uncertainty at the federal level in Australia.

The survey's results show that the time directors dedicate to regulatory issues remains considerable. When it came to their top ranking issue, 39.7 per cent said they had spent more than 30 hours on this issue in the previous 12 months, 56.5 per cent had spent more than 20 hours and 80.5 per cent had spent more than 10 hours.

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It's not if but when a cyber security attack will happen

Businesses need to assume a cyber security breach will happen and prepare accordingly. And, the focus needs to shift from pure prevention to detection and response planning, the goal being to become resilient organisations that can bounce back quickly from attacks.

That is the advice from Tommy Viljoen, national security and resilience lead partner at Deloitte Australia, following the recent release of the *Deloitte TMT Global Security Study*, a survey of 121 global technology, media and telecommunications (TMT) companies.

It found that businesses are underestimating how well prepared they are to prevent cyber attacks, with 88 per cent of survey participants not seeing their company as vulnerable and over 60 per cent rating their ability to mitigate newly developed threats as "average" or "high".

The survey's report states that this widespread confidence may not be realistic. It notes that even the US Government's National Security Agency works under the assumption that it has been compromised and builds its systems on the assumption that adversaries will get in.

More than half (59 per cent) of the TMT organisations surveyed acknowledged that they experienced a security breach in the past year and of those incidents, seven per cent were considered high impact. Other organisations may have had their security breached without even realising it, the report notes.

It says: "The truth is every organisation is vulnerable; 100 per cent prevention does not exist. That's why a combination of detection and incident response, in addition to prevention, is becoming more important. In fact, TMT organisations today are increasingly focusing on cyber resilience, not just security."

Innovations in technology and how people use that technology were seen as the biggest security threat. More than three quarters of the respondents rated security breaches at third parties as one of their top three threats. As businesses become more reliant on third parties in their efforts to improve efficiencies (and as third parties develop their own downstream service networks and increasingly rely on the cloud), TMT organisations are concerned their data is, and will be, shared and exposed in ways they cannot control.

"In order to effectively counter cyber risks, companies need to move beyond pure contractual arrangements with their suppliers and other third parties, such as government, and be more willing to collaborate and co-operate to reduce the weaker links," says Deloitte technology risk leader, Dean Kingsley. "Only 30 per cent of the participants believe third parties are shouldering enough responsibility for cyber security."

He adds that the mobile and "bring your own device" (BYOD) trends continue to challenge security teams, with 74 per cent of survey participants ranking it as their second-biggest security risk. Despite this, only half indicated they have specific policies for mobile devices in place, and 10 per cent do not address BYOD risks at all.

In addition, 70 per cent of survey respondents also listed their employees' lack of security awareness as an "average" or "high" vulnerability.

According to the surveyed organisations, network-related protective technologies (such as firewalls and network zones) are by far the most effective methods. Security compliance tools are considered the least effective.

"Hacktivism" is referenced in the survey for the first time, with 63 per cent of participants rating it as a major concern. This combines social or political activism with hacking and seeking to block access to a company's online operations through a denial of service (DOS) attack.

"This vulnerability to hacktivism reflects that cyber attacks can now come from anywhere, and be prompted by perceived controversial business practices and decisions, often highlighted through social media," says Viljoen.

The survey found that one of the biggest obstacles to improving information security continues to be lack of budget, a barrier cited by 49 per cent of respondents. "This is an issue that organisations will need to address if they want to stay a step ahead of the threats," notes the report.

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Robert Fitzgerald to chair the ACNC advisory board

Robert Fitzgerald AM has been appointed the inaugural chairman of the Australian Charities and Not-for-profits Commission (ACNC) advisory board.

Fitzgerald is currently on leave from his role as a Commissioner with the Productivity Commission, having chaired its study into the contribution of the not-for-profit (NFP) sector.

He has a background in law and public policy and has made a large personal contribution to the charity and NFP sector through roles with Australian Council of Social Service (ACOSS) and St Vincent de Paul Society.

Presently a Commissioner on the Royal Commission into Institutional Responses to Child Sexual Abuse and a director of The Benevolent Society and Foyer Foundation, Fitzgerald was also a member of the Inquiry into the Definition of Charitable and Other Organisations in 2001.

Meanwhile, Fiona McLeay has been appointed as the ACNC advisory board's part-time deputy chairman, bringing a strong understanding of smaller charities and volunteer organisations through her work as executive director of the Public Interest Law Clearing House (PILCH) in Victoria, which provides specialist free legal services and training for NFPs. She is currently a director of the Human Rights Law Centre and Urban Seed, and a member of the Commonwealth Attorney-General's International Pro Bono Advisory Group.

Other directors appointed to the ACNC advisory board include:

- Gina Anderson, Philanthropy Fellow with the Centre for Social Impact and an experienced NFP director.
- Paul O'Callaghan, executive director of Catholic Social Services Australia and former executive director of the Australian Council for International Development.
- Professor Myles McGregor-Lowndes OAM, director of the Australian Centre for Philanthropy and Non-profit Studies at the Queensland University of Technology.
- Sheila McHale, CEO of Palmerston Association, a large Western Australian NFP drug and alcohol organisation.
- David Crosbie, CEO of the Community Council for Australia and a member of the NFP Sector Reform Council.
- Anthony Lang, a barrister specialising in NFP law and a board member of the Victorian Council of Social Service.

According to Minister for Social Inclusion Mark Butler, representatives from the governments of New South Wales, South Australia, Tasmania and Northern Territory will also form part of the ACNC advisory board in their capacity as ex-officio members.

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It's time for animal spirits to return to the boardroom

We could well be at a genuine and critical transition point for the world economy where the "animal spirits" were starting to return to financial markets and were now needed in the boardroom.

That was the view of ANZ's chief economist Warren Hogan at a recent Australian Institute of Company Directors lunch in Sydney.

Hogan said there had been a tremendous improvement in financial markets over the past six to nine months since the European Central Bank put policy mechanisms in place to bail out sovereign debt markets.

"Markets have since gone from strength to strength," he said. "My sense of it, having followed financial markets for a long time, is that there has been a real shift over the past two months – the first genuine secular improvement in risk appetite and confidence and if you will, the animal spirits are returning to financial markets. This is something that has been noticeably absent from the Western world since the start of the global financial crisis and the failure of Lehman Brothers. This dynamic is critical for us to take the next step in this recovery phase."

Hogan said markets were moving ahead of the economy, but for this to be sustained, we needed the improved sentiment and for the animal spirits "to jump into the boardroom" and for corporate investment to lead the way.

"We need the corporate sector to start to invest again because that lack of confidence as a general proposition has really held back the world for the past five years," he said.

He believed the US economy was generally on a reasonable footing, with its "big end of town" increasingly in great shape, but its small and medium-sized enterprises on their knees, affected by factors like a lack of confidence, the housing sector's problems, the "fiscal cliff" and shenanigans in Washington DC.

Hogan said the US was the engine of the world economy and if we could get it going, the global economic picture would change.

He did not expect the European Union to break up because there was too much political commitment towards keeping it together. And, while he worried about structural problems in the French economy, he believed the German economy was bouncing back.

He noted that China was able to control its destiny and had a successful self-funded development model. Its long-term ambition to modernise its economy, led by infrastructure spend, would be good for commodity prices. The threats, however, were inflation and that China might not succeed in broadening its economy.

Turning to Australia, Hogan suggested that investment in the mining sector would stop growing this year. "The big challenge for this economy is what we are going to do post that," he said.

An economy that had positive population growth, as Australia did, needed economic growth to keep unemployment steady, he said.

"We need metropolitan areas to see a pick up in terms of residential and non-residential construction. And, we need the top end of town to start investing."

Trying to drive growth in this economy via the consumer and consumer borrowings, as done in the past, would be a recipe for disaster, said Hogan.

"We must get business investment to lead the non-mining economy in this next phase for Australia."

Hogan expected the Australian dollar to remain high and a couple of rate cuts this year. However, he said fiscal policy was creating some uncertainty. "We are not going to get a budget surplus. But we need the Government to still be disciplined and keep the deficit at one per cent of GDP, not two or three per cent. If it starts throwing money into the economy, that would worry the Reserve Bank and investors."

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