BOARD COMPOSITION, STRUCTURE AND INDEPENDENCE IN AUSTRALIA'S LARGEST LISTED COMPANIES*

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[In recent years, a number of bodies have made recommendations of 'best practice' in corporate governance, particularly regarding the composition and structure of the board of directors. One of the main proponents of good corporate governance in Australia has been the Australian Investment Managers' Association ('AIMA'), which is the industry association representing Australia's major institutional investors. This article examines the rationale for the corporate governance recommendations made by AIMA and others. It also presents the results of a study of board composition and structure in Australia's 100 largest listed companies as at mid-1995. The study found that less than half of the sample companies conformed with two of the key recommendations of AIMA.]

CONTENTS

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I INTRODUCTION

Corporate governance was defined by Britain's Cadbury Committee as the system by which companies are directed and controlled.[1] One aspect of corporate governance so defined is the composition and structure of the board of directors. In this article the phrase 'board composition' means the make-up of the board in terms of executive and non-executive directors, independent and affiliated non-executive directors, and male and female directors. The phrase 'board structure' refers to the structural features of the board, such as the presence or absence of committees (eg audit and remuneration committees), and whether the roles of chairperson and chief executive officer ('CEO') are performed by one or two persons.

In recent years, a number of bodies including Britain's Cadbury Committee,[2] the American Law Institute,[3] the Bosch Committee[4] and the Australian Investment Managers' Association ('AIMA')[5] have made recommendations regarding best practice in the area of board composition and structure. Regarding board composition, all of these bodies have felt that best practice involves a certain proportion of 'independent' non-executive directors. As regards board structure, all of these bodies have recommended that boards should appoint an audit committee and a separation of the roles of chairperson and chief executive. Some have also recommended the appointment of remuneration and nomination committees. Of course, the Australian Stock Exchange ('ASX') decided, after some deliberation, not to take a prescriptive approach.[6] Listing Rule 4.10.3, which was introduced on 1 July 1996, requires each listed company to set out in its annual report '[a] statement of the main corporate governance practices that the entity had in place during the reporting period'.[7] An 'indicative list' of corporate governance matters is set out in Appendix 4A of the Listing Rules. Unlike overseas equivalents such as Britain's *Cadbury Code*, this list does not contain any recommended practices. It is merely a list of topics which companies might choose to discuss — for example, '[w]hether individual directors ... are executive or non-executive directors'.[8]

1 Committee on the Financial Aspects of Corporate Governance ('Cadbury Committee'), *Report* (1992) [2.5].

2 Ibid; Cadbury Committee, *Code of Best Practice* (1992) ('*Cadbury Code*').

3 American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations* (1994).

4 Working Party of the Australian Institute of Company Directors *et al* ('Bosch Committee'), *Corporate Practices and Conduct* (3rd ed, 1995).

5 AIMA, *Corporate Governance: A Guide for Investment Managers and A Statement of Recommended Corporate Practice* (1995) ('*AIMA Guidelines*').

6 Australian Stock Exchange, *Disclosure of Corporate Governance Practices by Listed Companies: ASX Discussion Paper* (1994).

7 ASX Listing Rule 4.10.3.

8 ASX Listing Rules, Appendix 4A: List of Corporate Governance Matters.

This article presents the results of an empirical study of board composition and structure in Australia's 100 largest listed companies in 1995. The study used the recommendations and definitions contained in AIMA's document as its benchmark.[9] The reason for using the AIMA document was twofold: (i) institutional shareholders have played an increasingly important role in corporate governance both in Australia and overseas in recent years;[10] and (ii) AIMA is the industry association representing the major investment managers operating in Australia.

The structure of the article is as follows. In Section II, there is a summary of the economic theory which indicates that there may be a link between, on the one hand, corporate governance rules and practices, and on the other hand, corporate performance. Section III comprises an overview of recent United States ('US') empirical research into the issue of whether corporate governance affects corporate performance. In brief, several US studies have produced indirect evidence of a positive relationship between the proportion of independent directors and shareholder wealth. However, three of the four latest US direct studies suggest that the proportion of independent directors is unrelated to corporate performance, whilst the fourth recent direct study indicates that board independence is *negatively* related to firm performance. Section IV of the article provides a possible explanation for the results of these US studies. Section V considers whether independent non-executive directors may be important for reasons other than corporate performance. The conclusion reached is that there is, indeed, an important role for independent non-executive directors distinct from the issue of firm performance. Section VI details the methodology used in, and the results of, the study. The study found that, as at mid-1995, less than half of the Top 100 listed Australian companies conformed with key AIMA recommendations on board composition and independence of the chairperson. It was possible during the course of the study to assemble data on multiple directorships. This data is presented in Section VI. Another limb of the study, reported in Section VII, found that there was a positive correlation between the proportion of independent non-executive directors and firm size (measured by market capitalisation) in the Top 100 companies as at mid-1995.

II Reduction of Agency Costs Through Monitoring

In most listed companies there is a division between the shareholders, the board and management, due to the size and scale of operation of such companies. Although there is usually some overlap between the constituents of each group, it is important to appreciate the division and why it exists.

9 *AIMA Guidelines*, above n 5.
10 G P Stapledon, *Institutional Shareholders and Corporate Governance* (1996).

> The corporate form of firm organization has obvious advantages for shareholders (suppliers of capital) and managers. Shareholders can participate in the gains from entrepreneurial ventures even though they lack management skills; managers can pursue profitable business opportunities even though they lack large personal wealth. Both parties benefit from this division of labor.[11]

However, as well as benefits from specialisation of function, there are also certain costs inherent in the corporate form of firm organisation.[12] The most significant of these are 'agency costs'[13] (so called because the body of shareholders and the directors/managers are, in a loose non-legal sense, in a principal–agent relationship). Agency costs arise because of a divergence between the interests of shareholders and managers.

> As residual claimants on the firm's income stream, shareholders want their agents — the firm's managers — to maximize wealth. Because managers cannot capture all of the gains if they are successful, and will not suffer all of the losses should the venture flop, they have less incentive to maximize wealth than if they themselves were the principals. Rather, managers have an incentive to consume excess leisure, perquisites and in general be less dedicated to the goal of wealth maximization than they would be if they were not simply agents.[14]

Agency costs comprise:

(i) the costs incurred by the shareholders in monitoring the managers in order to minimise the divergence between their interests;
(ii) 'bonding' costs incurred by the managers; and
(iii) the 'residual loss' resulting from the remaining divergence in shareholders' and managers' interests.[15]

Regarding (i) and (ii), there are in fact numerous legal rules, devices and market forces (eg the market for corporate control (takeovers), the capital and product markets, and the market for managerial talent) which serve to reduce the divergence between the interests of shareholders and managers.[16] Where a change in the use of such devices and rules brings about a net reduction in agency costs, corporate financial performance will, in theory, improve. It is significant in the present context that the use of independent non-executive directors to monitor the performance of the executive management is generally treated as an element of this tapestry of monitoring devices and rules. It appears that those who advocate an increase in the proportion of independent non-executive directors on company boards are implicitly, if not explicitly, suggest-

[11] Daniel Fischel, 'The Corporate Governance Movement' (1982) 35 *Vanderbilt Law Review* 1259, 1262.

[12] Ibid.

[13] Michael Jensen and William Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3 *Journal of Financial Economics* 305.

[14] Fischel, above n 11, 1262–3.

[15] Jensen and Meckling, above n 13.

[16] Henry Butler, 'The Contractual Theory of the Corporation' (1989) 11 *George Mason University Law Review* 99.

ing that such a development would bring about a net reduction in agency costs. But is it appropriate to cast non-executive directors into this monitoring role? While for many years there have been directors on the boards of Australian companies who have been part-time and without executive office, the Corporations Law refers only to directors: it does not differentiate between executive directors and non-executive directors. Thus, all directors have the same legal duties[17] and statutory responsibilities.[18] Nevertheless, the very existence of non-executive directors implies that their role is in some ways different from that of executive directors.

It is widely accepted that the boards of virtually all large Australian (and United Kingdom ('UK') and US) public companies do not manage their company's day-to-day business. This is a task performed by the executive management. The board's role has instead been referred to by the Cadbury Committee as one of 'direction and control of the company',[19] and by the Bosch Committee as 'oversee[ing] the management of the business.'[20] It is in the exercise of the oversight — or monitoring — function that a central difference between the roles of executive and non-executive directors becomes clear: executive directors 'are responsible (as managers) for activities which it is the duty of the board as a whole to monitor. ... This means that the nature of the monitoring role is *ipso facto* different for non-executive directors'.[21] This reasoning is usually taken one step further, because there is a distinction between those non-executive directors who are, and those who are not, independent of the executive management and free from any business or other relationship with the company that could compromise their autonomy. The former are known as independent non-executive directors, and the latter are known as affiliated non-executive directors. Clearly, of these two types of non-executive directors, independent non-executives are in a better position to monitor the executive management effectively.[22]

[17] Eg, all directors are under a fiduciary duty to act *bona fide* in the interests of the company. Note, however, that generally speaking, the standard of the directors' duties of care, skill and diligence under the general law, and of the overlapping officers' duties set out in s 232(4) of the Corporations Law, varies between executive and non-executive directors: see the wording of s 232(4) and *AWA Ltd v Daniels* (1992) 7 ACSR 759; *Biala Pty Ltd v Mallina Holdings Ltd* (1993) 11 ACSR 785; *Dempster v Mallina Holdings Ltd* (1994) 15 ACSR 1; cf *Daniels v Anderson* (1995) 16 ACSR 607.

[18] Eg, all directors are responsible for the preparation of the annual accounts: Corporations Law ss 292, 293, 295A, 295B.

[19] Cadbury Committee, *Cadbury Code*, above n 2, [1.4].

[20] Bosch Committee, above n 4, 7.

[21] Jonathan Charkham, 'Corporate Governance and the Market for Control of Companies' (Panel Paper No 25, Bank of England, 1989) 13.

[22] Nevertheless, as outlined below, even independent non-executive directors face several disincentives to detailed monitoring: see below Part IV.

III Does Corporate Governance Affect Corporate Performance?

A *United States Empirical Studies*

A number of empirical studies have been conducted in the US in recent years which examine whether there is any link between the presence of independent non-executive directors and corporate performance. The main studies are summarised below. It should be noted that in some of these studies the definition of an independent non-executive director embodied criteria slightly different from those used in the AIMA guidelines (which were used in the present authors' study described later in this article). This point, together with any structural and environmental differences between the US and Australia, should be borne in mind when considering the various studies below.[23]

1 *Direct Studies*

Some US studies have looked for direct evidence of a link between board composition and corporate performance. A study by Baysinger and Butler indicated that the proportion of independent non-executive directors in 1970 was positively correlated with return on equity (an accounting measure of performance) in 1980.[24] On the other hand, studies by Klein,[25] Bhagat and Black,[26] and Hermalin and Weisbach[27] have found that a high proportion of independent directors does not predict better future accounting performance. The studies of Klein,[28] and Bhagat and Black[29] also found that the proportion of independent non-executive directors had no consistent effect on market-adjusted share-price performance. Then there is the study of Agrawal and Knoeber, which showed that the greater the proportion of independent directors, the slower the company's growth.[30] Agrawal and Knoeber interpreted their results as evidence that board independence is *negatively* related to company performance. However, the results of the Agrawal and Knoeber study are also explicable on the basis that the high proportion of independent directors was a response to slower growth

23 Helen Bird, 'The Rise and Fall of the Independent Director' (1995) 5 *Australian Journal of Corporate Law* 235, 256–7.

24 Barry Baysinger and Henry Butler, 'Corporate Governance and the Board of Directors: Performance Effects of Changes in Board Composition' (1985) 1 *Journal of Law, Economics and Organization* 101.

25 April Klein, 'Firm Performance and Board Committee Structure' (Working Paper, Leonard N Stern School of Business, New York University, 1996).

26 Sanjai Bhagat and Bernard Black, 'Do Independent Directors Matter?' (Working Paper No 112, Center for Law and Economic Studies, School of Law, Columbia University, 1996).

27 Benjamin Hermalin and Michael Weisbach, 'The Effects of Board Composition and Direct Incentives on Firm Performance' (1991) 20 *Financial Management* 101.

28 Klein, above n 25.

29 Bhagat and Black, above n 26.

30 Anup Agrawal and Charles Knoeber, 'Firm Performance and Mechanisms to Control Agency Problems between Managers and Shareholders' (Working Paper, North Carolina State University, 1996).

rather than the cause of the slower growth.[31] Indeed, the study by Hermalin and Weisbach showed that the proportion of independent directors tended to increase when a company performed poorly.[32]

The Bhagat and Black study is particularly important because it was the first large-scale, long-time-horizon study in this area.[33] The authors studied the accounting and share-price performance of 957 large US companies from 1983 to 1993. They found that the proportion of independent directors, whether measured directly, in log form, or using dummy variables, had no consistent effect on market-adjusted share-price performance. As in the study of Agrawal and Knoeber,[34] the proportion of independent directors was found to be correlated with slower growth across a variety of accounting variables. However, Bhagat and Black found evidence that it was the slower growth that led to a greater proportion of independent directors, rather than the other way around. Further, when they looked at other (non-growth) accounting measures of performance, Bhagat and Black found no solid evidence that independent directors affected firm performance one way or the other. The results persisted after controlling for board size, company size, and share ownership by the CEO, executive directors, non-executive directors, and external 5% block-holders.

Interestingly, a recent study of 100 small listed US companies found that financial performance was better in companies having a relatively large number of independent directors than in those having a relatively small number of independent directors.[35] Recall that Bhagat and Black used a sample comprising only large listed firms.[36] It may be, therefore, that the effect of independent directors on firm performance differs between small and large firms.

2 *Indirect Studies*

As well as the abovementioned studies that have sought direct evidence of a relationship between board composition and corporate performance, numerous US studies have looked for indirect evidence on the effectiveness of independent non-executive directors. For example, a generally accepted role for independent directors is in disciplining and/or removing the CEO of an underperforming firm.[37] Weisbach found that a board composed of at least 60% independent directors was more likely than a board comprising less than 60% independent directors to dismiss an underperforming company's CEO.[38] These results are

31 Bhagat and Black, above n 26.
32 Hermalin and Weisbach, above n 27.
33 Bhagat and Black, above n 26.
34 Agrawal and Knoeber, above n 30.
35 Catherine Daily and Dan Dalton, 'The Relationship between Governance Structure and Corporate Performance in Entrepreneurial Firms' (1992) 7 *Journal of Business Venturing* 375.
36 Bhagat and Black, above n 26.
37 See, eg, Bosch Committee, above n 4, 9; American Law Institute, above n 3, 112–3.
38 Michael Weisbach, 'Outside Directors and CEO Turnover' (1988) 20 *Journal of Financial Economics* 431. See also Kenneth Scott and Allan Kleidon, 'CEO Performance, Board Types and Board Performance: A First Cut' in Theodor Baums, Richard Buxbaum and Klaus Hopt (eds), *Institutional Investors and Corporate Governance* (1994) 181.

limited by the fact that '[t]he economic significance of the additional firings by 60%-independent boards is small'.[39] There is also some concern that 'independent directors, who have less detailed knowledge of a firm than [executive] directors, are too cautious in replacing a bad CEO while the firm's stock price performance remains respectable'.[40] It is also important to note that Denis and Denis, in a large study of non-takeover-related top management changes in listed US companies from 1985 to 1988, found evidence suggesting that a large proportion of forced resignations were instigated by parties other than the board of directors (including large block-holders, other shareholders, creditors and potential acquirers).[41]

In a different type of indirect study, Rosenstein and Wyatt examined market reaction to the appointment of independent directors. They found that the share prices of firms which appointed additional independent directors increased by a statistically significant, but economically small, amount (0.2%).[42] However, on one interpretation, the results of this study actually accord with the US studies that have found little or no direct evidence of a link between the proportion of independent directors and corporate performance. Appointing

> an additional independent director could boost stock prices because it signals that the company is planning to address business problems, even if adding more independent directors has no effect on the company's ability to address its problems.[43]

B *Qualification and Conclusion*

Even if there was stronger evidence of a link between independent directors and corporate performance, the results of a recent US study indicate that the remedy for a board with few independent directors would lie in substituting independent for affiliated non-executive directors, rather than in simply adding independent directors. In a sample of 452 large US public companies observed from 1984 to 1991, Yermack found an inverse relation between firm market value (as represented by Tobin's Q[44]) and the size of the board of directors.[45]

39 Bhagat and Black, above n 26, 8.

40 Ibid.

41 David Denis and Diane Denis, 'Performance Changes Following Top Management Dismissals' (1995) 50 *Journal of Finance* 1029.

42 Stuart Rosenstein and Jeffrey Wyatt, 'Outside Directors, Board Independence, and Shareholder Wealth' (1990) 26 *Journal of Financial Economics* 175.

43 Bhagat and Black, above n 26, 11.

44 Tobin's Q is the ratio of a company's market capitalisation to the replacement value of that company's assets.

45 David Yermack, 'Higher Market Valuation of Companies with a Small Board of Directors' (1996) 40 *Journal of Financial Economics* 185. Bhagat and Black found a similar relationship although their results were not robust to alternative specifications of the performance measure. That is, when measuring firm performance with variables other than Tobin's Q, they found that the negative relationship between board size and firm performance was significantly weakened: Bhagat and Black, above n 26, 11. See also Theodore Eisenberg and Stefan Sundgren, 'Larger Board Size, Decreasing Firm Value and Increasing Firm Solvency' (Working Paper, Cornell Law School, 1996).

Tests for causation supported the interpretation that past board size influenced current firm value, rather than the opposite.[46] In support of his main finding, Yermack also found that several measures of operating efficiency and profitability were negatively related over time to board size.

The balance of the US research indicates that independent directors may provide only marginal improvements to corporate financial and share-price performance. There is limited evidence of independent directors being more effective in small rather than large companies. There is some conflict between the results of the various studies and it should always be borne in mind that different environmental factors mean that the research results may not be directly applicable in Australia.[47] Nevertheless, the US studies provide some evidence to suggest that corporate Australia should be wary of exhortations about the efficacy and desirability of adding independent directors to company boards on corporate performance grounds.

IV FACTORS LIMITING THE EFFECTIVENESS OF INDEPENDENT DIRECTORS

Economic theory suggests that if an increase in the proportion of independent non-executive directors on a company's board were to bring about a net reduction in agency costs, corporate performance would improve. Why, then, is there so little evidence of a link between board composition and corporate performance? Stapledon details a number of factors which could in theory inhibit detailed monitoring of executive management by independent non-executive directors, and evidence (mostly from the UK) supporting the existence of these factors.[48]

First, some independent non-executive directors, like many affiliated non-executives, are allied to management to such a degree that detached monitoring may be difficult. For instance, non-executive directors commonly owe their positions to the chairperson or the chief executive. Although the shareholders in general meeting formally elect and re-elect directors,[49] traditionally most non-executive directors of listed Australian and UK companies have been *selected* by the board chairperson. This is potentially problematic where the chairperson is either an executive director or an affiliated non-executive director. As at mid-1995, 17 of Australia's Top 100 companies had an executive chairperson and a

46 The opposite hypothesis is that board size arises from prior company performance — with troubled firms adding directors to increase monitoring capacity.

47 Bird, above n 23, 256–7. The present authors are completing an Australian study using the methodology of Bhagat and Black, above n 26.

48 Stapledon, above n 10, 143–6, 200. For US evidence, see Myles Mace, *Directors: Myth and Reality* (1986); Jay Lorsch and Elizabeth MacIver, *Pawns or Potentates: The Reality of America's Corporate Boards* (1989).

49 Under ASX Listing Rule 14.4, the initial appointment of a director must be confirmed by an ordinary resolution at the next AGM; all directors, other than the managing director, must then submit for re-election by the shareholders at least once every three years.

further 38 had an affiliated non-executive director serving as chairperson.[50] AIMA has recognised this problem and recommends that boards should appoint a nomination committee (chaired by an independent non-executive director and a majority of whose members should be non-executive directors) to take responsibility for nominating new board members.[51] Another factor allying non-executive directors to management is that some non-executives are themselves senior executives of other listed companies. As fellow business leaders, it is not uncommon for them to socialise in the same circles as — or to serve on other boards as fellow non-executives with — the senior executives whom they are supposed to monitor.[52] This kind of relationship presumably represents some sort of barrier to vigorous monitoring. There is also the possibility that such non-executives may 'pull their punches ... out of an innate fear of encouraging non-execs on their own boards to rock the boat too often.'[53] A final factor which may ally the interests of non-executive directors too closely with those of management is an excessively lengthy presence on the board. The Cadbury Committee recognised this problem, and its *Code of Best Practice* recommends that non-executives 'be appointed for specified terms and [that] reappointment ... not be automatic'.[54]

A second impediment to effective monitoring by independent non-executive directors is lack of numbers. On many boards the independent non-executive directors are outnumbered by the executive and affiliated non-executive directors.[55] A marketing executive who was one of just two non-executive directors of a UK company whilst it went through a financial and managerial crisis is amongst the proponents of the view that independent non-executive directors should be in the majority on the boards of listed companies.[56] AIMA recommends that boards of listed Australian companies contain a majority of independent non-executive directors.[57]

50 See below Part VI.

51 *AIMA Guidelines*, above n 5, [3.5].

52 See the discussion of multiple directorships below Part VI.

53 Christopher Lorenz, 'Knives are Out in the Boardroom', *Financial Times* (London), 1 May 1992, 11.

54 Cadbury Committee, above n 2, [2.3]. Cf Bosch Committee, above n 4, 25: 'The Working Group considers that all directors should be sent a formal letter of appointment which sets out: ... the term of their appointment (probably three years but renewable). ... The Working Group does not believe that it is necessary for any formal limit to be placed on the period of time a director is able to serve.'

55 Independent directors constituted a majority of the board in only 40 of the Top 100 listed Australian companies as at mid-1995: see below Part VI.

56 Jerry Shively, 'Confessions of a Non-Executive', *Financial Times* (London, United Kingdom), 15 July 1991, 11. See also the proposed Fifth EC Directive on harmonisation of company law: 1983 OJ (C 240) 2, art 21a.

57 *AIMA Guidelines*, above n 5, [3.2].

Third, the position of independent non-executives is weakened further where the board chairperson is not an independent non-executive director. This is so where:

(i) the chairperson is also the CEO;
(ii) the roles of CEO and chairperson are fulfilled by different persons, but the chairperson is an executive; or
(iii) the chairperson, although non-executive, is an affiliated non-executive director.

The most common way in which situation (iii) arises is through the appointment of the retiring CEO as chairperson. As mentioned above, 17 of Australia's Top 100 listed companies at mid-1995 had an executive chairperson and a further 38 had an affiliated non-executive director serving as chairperson. Evidence from the UK suggests that this ought to be a matter of concern. More than 70% of UK non-executive directors surveyed in 1994 said that a major inhibitor to their effectiveness was a dominant chairperson or CEO.[58] AIMA recommends that the board of each listed Australian company be chaired by an independent non-executive director.[59]

A fourth barrier to effective monitoring is the limited time that an independent non-executive director is able to spend on that directorship.[60] Often, he or she would have a full-time position elsewhere and/or would be serving on several other boards. AIMA recommends that the terms of a non-executive director's appointment be contained in a letter of appointment, which should 'where necessary ... require the director to limit the number of the director's other directorships'.[61] The matter of multiple directorships is addressed further in Part VI below.

A fifth inhibitor, which flows partly from the fourth, is that independent non-executive directors generally lack detailed knowledge of the company's business.[62] UK evidence suggests that this problem is compounded by the fact that the main source of information for non-executive directors is the very management team which they are monitoring.[63]

58 BDO Binder Hamlyn, *Non-Executive Directors — Watchdogs or Advisers?* (1994) 11.
59 *AIMA Guidelines*, above n 5, [3.3].
60 BDO Binder Hamlyn, above n 58.
61 *AIMA Guidelines*, above n 5, [3.6]. Cf Bosch Committee, above n 4, 25: 'The Working Group does not believe that it is necessary for any formal limit to be placed [in the letter of appointment] on ... the number of board positions that should be accepted [by a director].'
62 BDO Binder Hamlyn, above n 58, 11; *AIMA Guidelines*, above n 5, [3.6], recommends that newly appointed non-executive directors undergo 'a formal system ... of orientation and education in respect of the business(es) of the company and the workings of the board and its committees'.
63 KPMG Peat Marwick, *Survey of Non-Executive Directors* (1994) 11, identified 'executive directors of the company' as the principal informational source of the 235 UK non-executive directors surveyed.

Finally, there is the fact that independent non-executives are 'merely ... independent of management, rather than *dependent* on shareholders'.[64] Indeed, given the closeness of many independent non-executives to the management whom they are supposed to monitor, it is arguable 'that [true] independence of management *can only be achieved* in a reliable way by making the non-executives dependent on another powerful group within the company'[65] — namely, institutional shareholders. However, institutional investors in both Australia and the UK are almost universally opposed to proposals for their nominees to serve as non-executive directors on the boards of listed companies.[66]

V Are Independent Directors Important for Reasons Other than Corporate Performance?

A *Taking the Lead Where Potential Conflicts of Interest Arise*

1 *Theory*

Even assuming that independent non-executive directors do not enhance corporate financial performance, it is arguable that boards of listed companies should include a certain proportion of independent directors for another reason. As the Cadbury Committee stated:

> Non-executive directors have two particularly important contributions to make to the governance process as a consequence of their independence from executive responsibility. ... The first is in reviewing the performance of the board and of the executive. ... *The second is in taking the lead where potential conflicts of interest arise.* An important aspect of effective corporate governance is the recognition that the specific interests of the executive management and the wider interests of the company may at times diverge, for example over takeovers, boardroom succession, or directors' pay. Independent non-executive directors, whose interests are less directly affected, are well-placed to help to resolve such situations.[67]

However, would not the factors detailed in Part IV[68] limit not only the ability and willingness of independent non-executive directors to monitor the performance of management and the firm, but also their ability and inclination to 'take the lead' in situations of potential conflict of interest? It is submitted that there is at least one significant point of distinction between these two roles. In the US

64 Ronald Gilson and Reinier Kraakman, 'Reinventing the Outside Director: An Agenda for Institutional Investors' (1991) 43 *Stanford Law Review* 863, 881 (emphasis in original).

65 Paul Davies, 'Institutional Investors in the United Kingdom' in D Prentice and P Holland (eds), *Contemporary Issues in Corporate Governance* (1993) 69, 93 (emphasis in original). Similar reasoning has been applied in relation to the independence of auditors: see David Hatherly, 'The Future of Audit: The Case for the Shareholder Panel' (Paper presented at the 17th Annual Congress of the European Accounting Association, Venice, April 1994).

66 Stapledon, above n 10, 149–53, 202–3.

67 Cadbury Committee, above n 1, [4.4]–[4.6] (emphasis added).

68 In particular, the first, second, third and final factors.

and the UK (and to a lesser extent Australia) during the 1980s and 1990s, structural support for the second function mentioned by the Cadbury Committee has been given by the introduction of audit, remuneration and nomination committees of the board. These board committees have institutionalised the role of independent directors as sovereign in situations where the interests of the executive management are prone to conflict with those of the shareholder body. Further, where these committees are composed solely of independent non-executive directors,[69] it is presumably less likely that the autonomy of such directors would be compromised by the influence, direct or indirect, of senior management. There is no analogous institutionalised structure to facilitate the monitoring of managerial performance by independent directors.

The *AWA Case*[70] arguably provides support for this argument. In that case a company brought a successful action for breach of contract against its former auditors. The company's foreign-exchange manager had engaged in speculative foreign-exchange dealings. The company alleged that the auditors had been negligent in, amongst other things, failing to inform the company's board of directors about: (i) weaknesses in the company's system of controls over the foreign-exchange operation; and (ii) the failure of the company's senior executives to remedy identified problems. The company's board did not have an audit committee. Although this is necessarily speculation, it is considered likely that the relevant information would have come to the board's attention sooner if an audit committee including independent non-executive directors had been in existence. The discipline of meeting with an audit committee *specifically* for the purpose of discussing matters relating to the auditors' work would, it is submitted, probably have led to an earlier disclosure by the auditors to the board (via the audit committee) of the company's internal control and reporting problems. If UK best practice is any guide, there is some firm support for this view. Guidebooks of two of the leading UK accounting firms set out model questions for audit committee members to put to executive management, the internal auditors, and the external auditors. Amongst those directed to the external auditors, Arthur Andersen suggests:

- '[w]hat issues or concerns exist that could have a serious adverse impact on the financial or operating stability of the company?';
- '[d]o you believe that these are being addressed by management?'; and
- '[h]as the audit identified any areas of serious concern relative to the overall control environment?'[71]

69 On this matter, see below n 98 and accompanying text.

70 *AWA Ltd v Daniels* (1992) 7 ACSR 759 (NSW Comm Div) ('*AWA Case*'); *sub nom Daniels v Anderson* (1995) 16 ACSR 607 (NSWCA).

71 Arthur Andersen & Co, *Audit Committees for the 1990s* (1992) 29.

Similarly, Ernst & Young suggests:

- '[w]hat were the most significant internal control weaknesses uncovered by the internal and external auditors during the period?';
- '[h]ave the internal and external auditors' comments on internal controls been addressed?';
- '[w]hat are the auditors' opinions on the internal control system, on the quality of the accounting records, and on the timeliness, completeness and accuracy of reports to management?'[72]

2 *Empirical Evidence*

Some recent US studies have addressed the issue of whether independent non-executive directors play an important role in situations of potential conflict of interest. The three areas highlighted by the Cadbury Committee (takeovers, executive remuneration, and boardroom succession), together with a fourth area of potential conflict (financial reporting), have been subjected to empirical analysis in the US. In each case there is evidence that independent non-executive directors do play a valuable role.

(a) Independent Directors and Takeovers

If independent directors genuinely represent the interests of shareholders, and if they strive to maximise shareholder wealth, then their influence should be reflected in the takeover process. This has been confirmed to some extent by the research of Byrd and Hickman who found that, for a sample of 128 takeover bids from 1980 to 1987, takeover acquirers with a majority of independent directors earned, on average, an announcement-date abnormal return of 0% on their acquisitions, while raiders with a majority of executive and affiliated non-executive directors lost, on average, a statistically significant amount.[73] Importantly, there was no difference in abnormal returns when the independence or otherwise of non-executive directors was disregarded — that is, when takeover bidders were differentiated on the basis of whether non-executive or executive directors made up a majority of the board. Therefore, independent non-executive directors, while permitting their company to pay too much when acquiring another company, were not prepared to over-pay as much as affiliated non-executive directors. It should be noted that the relationship between the proportion of independent directors on the board and abnormal returns was found by Byrd and Hickman to be non-linear so that, in relation to their effect on takeover bids, it was possible to have too many independent non-executive directors.

US evidence also suggests that investors perceive a majority of independent directors on a company's board as prima facie proof that the board will use a

[72] Ernst & Young, *New Directions for Audit Committees* (1992) 47–8.

[73] John Byrd and Kent Hickman, 'Do Outside Directors Monitor Managers?' (1992) 32 *Journal of Financial Economics* 195; see also Mary Bange and Michael Mazzeo, 'Board Composition, Board Effectiveness and the Observed Form of Takeover Bids' (Working Paper, Eli Broad Graduate School of Management, Michigan State University, 1996).

poison pill defence[74] in the company's by-laws (articles of association) to generate a higher takeover offer, rather than to frustrate a takeover altogether. Brickley, Coles and Terry found that the average share-price reaction to poison pill adoptions during 1984–86 was significantly positive when the board was controlled by independent directors and significantly negative when independent directors were in the minority.[75] Therefore, putting aside the actual effectiveness or otherwise of independent directors, it may pay a company's shareholders to ensure that the board comprises a majority of independent directors — because they are perceived as maximising shareholder wealth, and this perception may well result in a higher share price, thus creating a self-fulfilling prophesy.[76]

(b) Independent Directors and Executive Remuneration

In a 1992–93 study involving 161 of the 250 largest US listed companies, Newman and Wright found that CEO compensation was greater in firms with remuneration committees that included at least one executive director or affiliated non-executive director ('insider-influenced remuneration committees') than in firms with remuneration committees consisting solely of independent non-executive directors ('independent remuneration committees'), after controlling for firm size, performance, share ownership and CEO tenure.[77] On average, the CEO of a company with an insider-influenced remuneration committee received approximately 20% more remuneration than a CEO of a company with an independent remuneration committee, other things being equal. Another finding was that the association between executive compensation and corporate performance was stronger when there were no executive directors or affiliated non-executive directors on the remuneration committee, especially when firm performance was unfavourable.

In a study covering 167 US firms over the period 1989–91, Sridharan found that the greater the CEO influence over the board of directors, the higher the levels of CEO salary and bonuses.[78] The determinants of CEO influence over the board were: (i) combination of the roles of CEO and chairperson; and (ii) board composition in terms of executive and non-executive directors.

[74] A poison pill defence is, in general terms, a set of provisions in a company's articles of association which has the effect of conferring significant benefits on existing shareholders if a hostile takeover bid occurs.

[75] James Brickley, Jeffrey Coles and Rory Terry, 'Outside Directors and the Adoption of Poison Pills' (1994) 35 *Journal of Financial Economics* 371.

[76] Ibid. Brickley, Coles and Terry also found that, for firms that had adopted a poison pill, the probability that the firm would induce an auction among competing bidders during a control contest was positively related to the fraction of independent directors on the board.

[77] Harry Newman and David Wright, 'Compensation Committee Composition and its Influence on CEO Compensation Practices' (Working Paper, University of Michigan Business School, 1995).

[78] Uma Sridharan, 'CEO Influence and Executive Compensation' (1996) 31 *The Financial Review* 51.

(c) Independent Directors and Boardroom Succession

In a study of 485 US firms over the period 1992–93, Klein found that the companies with the greatest increases in the proportion of independent non-executive directors on their nomination committees, experienced significantly greater share-price returns (both raw and adjusted) than firms with the greatest reduction in independent non-executives on their nomination committees.[79]

(d) Independent Directors and Quality of Financial Reporting

Wright found significant correlations between two measures of financial reporting quality and the composition of companies' board audit committees.[80] The two measures of financial reporting quality employed in Wright's study were: (i) analysts' published evaluations of each sample company's disclosure practices; and (ii) the existence of a Securities and Exchange Commission ('SEC') Accounting and Auditing Enforcement Release against the company or its auditors. The results demonstrated that higher analyst ratings of disclosure practices were associated with firms having lower percentages of affiliated non-executive directors on their audit committees. With respect to SEC Accounting and Auditing Enforcement Releases, the results demonstrated that companies violating SEC reporting standards had a significantly higher percentage of executive and affiliated non-executive directors on their audit committees than companies in an industry- and size-matched control sample.

B *Legal Reasons for Independent Non-Executive Directors*

The conflict of interest justification for independent non-executive directors is not the only reason why Australian companies should treat seriously the issue of board composition and structure. A recent Australian legislative proposal, and US and English case law provide further grounds for such treatment.

The exposure draft of the Collective Investments Bill (Cth) proposes introducing into the Corporations Law a requirement that there be a 'responsible entity' for every registered collective investment scheme. If enacted, the Bill would abolish the existing two-tier regulatory structure for unit trusts and other prescribed interest schemes, under which a scheme must have both a trustee and a management company. Under clause 601FA of the Bill, the responsible entity would have to be a public company holding a dealer's licence authorising it to operate a collective investments scheme. Importantly, clauses 601KA and 601KB would, if enacted, impose a requirement that either: (i) at least half the responsible entity's board be comprised of 'external directors'; or (ii) the responsible entity establish a 'compliance committee', a majority of whose members must be 'external members'. The criteria used by the Bill to define who would qualify as an external director, or an external member of a compli-

79 Klein, above n 25.

80 David Wright, 'Evidence on the Relation between Corporate Governance Characteristics and the Quality of Financial Reporting' (Working Paper, School of Business Administration, University of Michigan, 1996).

ance committee, are similar to the criteria adopted by AIMA, the Bosch Committee, and other organisations to define 'independent director'.

US courts have recognised that independent non-executive directors have an important role to play in the area of shareholder derivative actions. The New York Court of Appeals has gone so far as to say that:

> the substantive aspects of a decision to terminate a shareholders' derivative action against defendant corporate directors made by a committee of disinterested directors appointed by the corporation's board of directors are beyond judicial inquiry under the business judgment doctrine.[81]

The well-known *Prudential Case*[82] involved a derivative action brought by an institutional shareholder in a listed UK company. The English Court of Appeal noted that counsel for the company had told the trial judge that it was:

> the view of the [company's] independent board that any advantage to the company which this action could procure is vastly outweighed by harm being inflicted upon it by the action continuing with the consequent adverse publicity and other side effects.[83]

The Court of Appeal also noted that counsel for the company had stated that the independent board considered itself 'powerless to prevent the [plaintiff shareholder] from pursuing the action'.[84] The Court said that this view may have been based on the supposition that the plaintiff had a personal cause of action against the two defendant directors, independently of the company's cause of action against those directors. Their Lordships continued:

> [t]his supposition, if it existed, was erroneous for reasons which we explain later. It would have been open to [the company] to have issued its own summons before the trial in order to test the right of the [shareholder] to pursue a derivative action, and to have supported it with evidence proving the objectiveness of the board's view and explaining the potential injury to [the company] which would be caused by the proceedings.[85]

81 *Auerbach v Bennett*, 47 NY2nd 619, 623 (1979). The court added that the limit of its role is to 'inquire as to the disinterested independence of the members of [the] committee and as to the appropriateness and sufficiency of the investigative procedures chosen and pursued by the committee' (623–4); *contra Zapata Corporation v Maldonado*, 430 A2nd 779, 788–9 (1981) (Supreme Court of Delaware laying down a more interventionist test). See generally Dennis Block, Stephen Radin and James Rosenzweig, 'The Role of the Business Judgment Rule in Shareholder Litigation at the Turn of the Decade' (1990) 45 *Business Lawyer* 469.

82 *Prudential Assurance Co Ltd v Newman Industries Ltd [No 2]* [1982] Ch 204 ('*Prudential Case*').

83 Ibid 212.

84 Ibid.

85 Ibid; see also 220–1. In a more recent English case, *Smith v Croft [No 2]* [1988] Ch 114, 185, Knox J also contemplated that a committee of independent directors could stymie a derivative action; see D Prentice, 'Shareholder Actions: The Rule in *Foss v Harbottle*' (1988) 104 *Law Quarterly Review* 341, 345–6.

C *Conclusion*

Theory suggests that independent directors have an important role to play in taking the lead in situations involving a potential conflict between the interests of executive management and the shareholder body. Support for this theory is provided by a number of US empirical studies. The factors that limit the effectiveness of independent directors as monitors of managerial performance would appear not to carry the same weight when independent directors are performing their function as leaders in conflict of interest situations. It is submitted that this is largely explicable by the existence of audit, remuneration and nomination committees (at least where they comprise exclusively independent directors).

In addition, a recent Australian legislative proposal and overseas case law demonstrate that legal factors may in future also need to be taken into account by Australian companies when they consider their board composition.

VI Board Composition and Structure in Australia's Largest Listed Companies

This section details a study of board composition and structure, and multiple directorships in Australia's largest listed companies.[86] Prior to a discussion of the results, there is a description of the sample and methodology used in the study.

A *Sample and Methodology*

The data sample comprised the Top 100 companies, ranked by market capitalisation, listed on the ASX at 29 December 1995.[87] The date of the study is approximately mid-1995, because the information was (as described below) derived from the sample companies' 1995 annual reports — many but not all of which were dated 30 June 1995.

In relation to each of the Top 100 companies, the November 1995 edition of the ASX's *Datadisc* CD-ROM database was used to obtain information on directors' profiles, corporate details, and the statement of directors' interests. The information in *Datadisc* is taken from companies' annual reports. Information on substantial shareholders, board committee composition, and related-party transactions was sourced directly from each company's 1995 annual report (or prospectus, in the case of the four companies that had only recently been floated). These sources revealed no information on board committees for 11 companies (some of which were property or equity trusts, and the rest of which were companies that had recently been floated).

[86] The authors thank the Conference of Major Superannuation Funds Ltd for the financial support that it provided in the initial stages of the study. They also thank the following persons who assisted with the study: Dean Paatsch, formerly of the Australian Institute of Superannuation Trustees; Paul Murphy of County NatWest Australia Investment Management Ltd; and Julie Jacobson of National Mutual Funds Management.

[87] As reported in the *Sydney Morning Herald* (Sydney), 2 January 1996, 33.

Phone calls to the company secretary, Investor Relations office, or both, were used to confirm any data whose accuracy was doubted. For example, all sample companies were contacted to confirm that no female directors had been overlooked. Also, 36 firms were contacted by fax to ascertain which director was the chairperson of various board committees (where this information was not disclosed in the annual report).[88]

Given the increasing influence of institutional shareholders both in Australia and internationally,[89] it was considered appropriate to use the AIMA guidelines[90] as the study's benchmark. AIMA is a representative body for the major investment managers in Australia. Its guidelines were issued 'for the benefit of its members ... and for the information of the companies in which they invest'.[91] At the end of 1995, AIMA's members managed $323 billion in assets, including some $89 billion in Australian equities.[92] Accordingly, the AIMA guidelines can be expected to have a significant influence upon the corporate governance practices adopted by listed Australian companies in the next few years.

In regard to board composition, AIMA suggests that boards of listed Australian companies contain a majority of independent directors.[93] In regard to board structure, AIMA recommends that the board of each listed Australian company be chaired by an independent director, and have an audit committee, a remuneration committee and a nomination committee.[94] The guidelines recommend that these board committees be chaired by an independent director.[95] The guidelines recommend further that the audit committee be composed entirely of non-executive (not necessarily independent) directors, and that at least a majority of the remuneration and nomination committee members be non-executive directors.[96] AIMA defines an independent director as a non-executive director who:

- is not a substantial shareholder of the company or an officer of or otherwise associated directly or indirectly with a substantial shareholder of the company;
- has not been employed within the last three years in any executive capacity by the company or any other group member;
- is not retained as a professional adviser to the company or any other group member or a principal of a firm or company so retained;

88 Responses were received from 33 companies.

89 See Stapledon, above n 10; Theodor Baums, Richard Buxbaum and Klaus Hopt (eds), *Institutional Investors and Corporate Governance* (1994).

90 *AIMA Guidelines*, above n 5.

91 Ibid [1.4].

92 AIMA, *Funds Under Management Survey as at 31 December 1995: Results and Analysis* (1996).

93 *AIMA Guidelines*, above n 5, [3.2].

94 Ibid [3.3], [3.5].

95 Ibid [3.5].

96 Ibid [3.5].

- is not a significant supplier or customer of the company or any other group member or an officer of or otherwise associated directly or indirectly with a significant supplier or customer;
- has no significant contractual relationship with the company or any other group member other than as a director of the company; and
- is otherwise free from any interest and any business or other relationship which could, or could reasonably be perceived to, materially interfere with the director's ability to act with a view to the best interests of the company (the 'residual category').[97]

Before turning to the assumptions that were made in applying these criteria, it is appropriate to make one general comment, and two specific comments, in relation to the AIMA guidelines.

The general comment is that it is very important to bear in mind that the AIMA guidelines do *not* say that someone who lacks independence in regard to a particular company must not serve as a non-executive director on the board of that company. Indeed, in many circumstances an affiliated non-executive director could, through his or her detailed knowledge of some aspect of the company's operations, add considerable value to the board of directors. Affiliated non-executive directors *are* acceptable under the AIMA guidelines, so long as they and the executive directors do not outnumber the independent non-executive directors.

The first specific comment on the guidelines relates to the recommendations on composition of board committees: these recommendations refer to *non-executive* directors. This is somewhat odd, given that AIMA's recommendation on composition of the board itself refers to *independent* non-executive directors. It is unclear why AIMA adopted this 'softer' stance in regard to board committees. It is certainly a questionable approach in light of the results of the studies summarised above in Part V.[98]

The second specific comment concerns the first criterion of non-independence: that the non-executive director is (or is associated with) a substantial shareholder.[99] This is a controversial criterion.[100] The reason is that both theory and several US empirical studies[101] suggest that significant share ownership by directors ensures profit-maximising behaviour. AIMA's rationale for including this criterion is presumably grounded on the potential for larger shareholders to exploit smaller shareholders. For instance, there is US empirical evidence suggesting that substantial shareholders with 5–50% shareholdings are able to

[97] Ibid [3.2].

[98] Note that the Bosch Committee recommended that nomination and remuneration committees comprise at least a majority of independent non-executive directors, and that a majority of audit committee members should 'preferably' be independent: Bosch Committee, above n 4, 22, 30–1, 35.

[99] On the meaning of 'substantial shareholder', see below nn 107–12 and accompanying text.

[100] Note that a similar criterion was adopted by the Bosch Committee, above n 4, 14.

[101] See the studies summarised in Bernard Black, 'The Value of Institutional Investor Monitoring: The Empirical Evidence' (1992) 39 *UCLA Law Review* 895, 917–24.

systematically transfer wealth from other shareholders by means of 'intercorporate "perquisites" — financial and product market transactions at favorable terms to the [substantial shareholder]'.[102] In any event, it is important to remember that a company can comply with the AIMA guideline on board composition even if one (or more) of its non-executive directors is associated with a substantial shareholder, provided that the board includes a majority of independent non-executive directors.

A number of assumptions were employed in the study when evaluating whether directors met the AIMA criteria for independence.

First, bankers were treated as 'professional advisers'. Even if this is not the case, a banker-director would presumably still be classified as non-independent under the significant supplier category or the significant contractual relationship category.

Second, the AIMA criteria refer to 'significant' suppliers, customers and contractual relationships. Due to the vagueness of this term and the paucity of information in the company annual reports used in the study, the term 'significant' was interpreted as any transaction that was disclosed in the annual report. Consequently, some transactions for a few thousand dollars would have been caught under this definition, yet these should easily be outnumbered by the instances where companies acknowledged that such a relationship existed but failed to identify the director concerned.[103] As a result of the latter practice, the study has probably overstated the number of independent directors (because many non-executives who would not meet the AIMA guidelines for independence would have fallen through the net due to non-disclosure of their identity in the summary of related-party transactions).

Third, loans to directors and director dealings in company shares were not treated as independence-impairing transactions.

Fourth, the most common form of an affiliated director under the 'residual category' was a non-executive director who was formerly a partner of a legal, accounting or financial firm, where the firm was still an adviser to the director's company.[104] The only other case falling into the residual category was a former general manager or managing director of a Top 20 shareholder.[105]

Fifth, in regard to the 'former employee' category, the three-year limit set by AIMA was disregarded. This approach was adopted principally because many companies did not disclose how recently the non-executive director had ceased to be an executive officer of the company. Additionally, three years seems an arbitrary and unnecessarily short period when evaluating the effect of former

[102] Stuart Rosenstein and David Rush, 'The Stock Return Performance of Corporations that are Partially Owned by Other Corporations' (1990) 13 *Journal of Financial Research* 39, 50.

[103] Eg, in one annual report, the related-party disclosures contained the following: '[s]ome Directors of [the company's] controlled entities are associated with legal and financial service firms, which derive fees for work provided to the [corporate group]. These services are provided under normal commercial terms and conditions and are trivial in amount.'

[104] There were five instances of this relationship.

[105] There were three instances of this relationship.

employment upon a non-executive director's independence. In effect, the study adopted the yardstick used by the Bosch Committee: whether the director had been employed in an executive capacity 'within the last few years'.[106]

Sixth, in determining whether a director was a non-executive, reliance was placed upon the information disclosed in the directors' profiles and the related-party information. In over 70% of instances, the *Datadisc* information revealed whether a director was an executive or non-executive director — either by the use of those very words or by revealing that the director was in charge of a particular company division or operational arm (hence an executive director). In cases where such information was lacking, the following assumptions were made:

(i) a person was assumed to be a non-executive director of company B if the person was known to be an executive director of company A;
(ii) a person who was formerly a company's managing director was assumed to be a non-executive director of that company; and
(iii) a person with three or more directorships was (subject to any indications to the contrary) assumed to be a non-executive director of all three (or more) companies.

Finally, the 'substantial shareholder' category raised the issue of the meaning of 'substantial shareholder'. On one interpretation, it means a Top 20 shareholder. However, the list of Top 20 shareholders which listed companies are required to disclose annually,[107] is a list of the 20 largest *registered* shareholders. Due to the widespread incidence of nominee shareholders (commonly bank-owned custodian companies used by both institutional and private investors), a list of largest registered shareholders is not a helpful means of identifying the persons with the largest beneficial interests in the company's share capital.[108] Further, the phrase 'substantial shareholder' is actually used in the Corporations Law to refer to a person who is 'entitled' to at least 5% of the voting shares in the company.[109] (Such a person is required to disclose their interest to the company and the ASX.)[110] The concept of 'entitlement' to voting shares is defined so as to catch persons with power to exercise control over the voting and/or sale of the shares.[111] It was assumed, therefore, that the AIMA criterion refers to substantial shareholders required to disclose their interest by virtue of having a 5% or greater entitlement.[112]

106 Bosch Committee, above n 4, 14.
107 See ASX Listing Rule 4.10.9.
108 G P Stapledon, 'The Structure of Share Ownership and Control: The Potential for Institutional Investor Activism' (1995) 18 *University of New South Wales Law Journal* 250, 260–2.
109 Corporations Law s 708.
110 Corporations Law pt 6.7.
111 See Corporations Law ss 12, 30–45, 609.
112 This substantial shareholder information was sourced from ASX, *ASX All Ordinaries Index Companies Handbook* (6th ed, 1995) and Australian Financial Review, *Shareholder: The Handbook of Australian Listed Companies* (9th ed, 1996).

B *Results*

1 *Board Composition and Structure*

As Table 1 shows, whilst there were 690 individuals who held at least one board seat in a Top 100 company, there were 889 board seats (or 'directorships'). The average board therefore comprised 8.89 members.

TABLE 1: Board Composition — Summary of Results

1. Directors	
• Number of directors in Top 100 companies	690
• Number of directorships in Top 100 companies	889
• Average number of directorships on boards of Top 100 companies	8.89
2. Gender	
• Number of female directors in Top 100 companies	27
• Proportion of directors in Top 100 companies who are female	3.9%
• Number of female directorships in Top 100 companies	32
• Proportion of directorships in Top 100 companies held by females	3.6%
• Number of executive directorships in Top 100 companies held by females	3
• Number of non-executive directorships in Top 100 companies held by females	29
3. Non-Executive Directorships	
• Number of non-executive directorships in Top 100 companies	652
• Proportion of Top 100 companies with a majority of non-executive directors	95%
• Average number of non-executive directors on company board	6.52
• Average proportion of non-executive directors on boards of Top 100 companies	73%
4. Independent Directorships	
• Number of independent directorships in Top 100 companies	384
• Independent directorships as a proportion of non-executive directorships	59%
• Proportion of Top 100 companies with a majority of independent directors	40%
• Proportion of Top 100 companies with at least one-third independent directors	66%
• Average number of independent directors on boards of Top 100 companies	3.84
• Average proportion of independent directors on boards of Top 100 companies	43%
5. Chairperson	
• Proportion of Top 100 companies with non-executive chairperson	83%
• Proportion of Top 100 companies with independent chairperson	45%
6. Interlocks and Multiple Directorships	
• Average number of interlocks of Top 100 company with non-Top 100 listed companies	8.22 [a]
• Average number of interlocks of Top 100 company with other Top 100 companies	5.74
• Average number of interlocks of Top 100 company with all listed companies	13.96 [a]

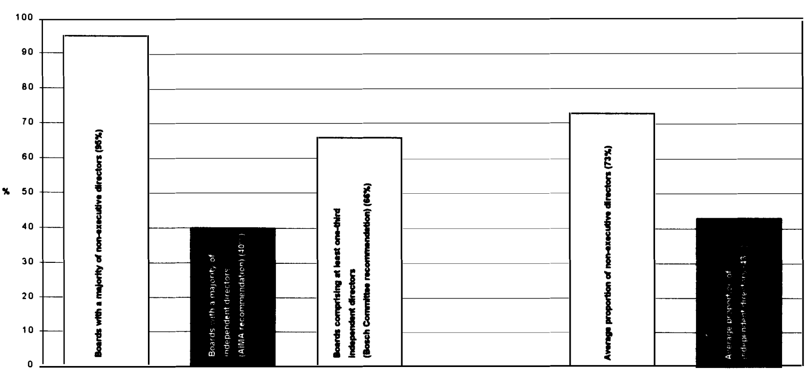
Notes

[a] These figures do not include interlocks between the non-Top 100 listed companies

The study confirmed the anecdotal evidence about the dearth of female directors on the boards of Australia's largest companies. Only 3.9% of directors were women, and only 3.6% of directorships were held by women. These figures are similar to those for Canada and the UK,[113] but are well below the US figures. Women held 10% of directorships in the US Fortune 500 companies in 1996.[114] In 1994, 81% of the Fortune 500 companies had at least one woman on the board, and about one-third had two or more female directors.[115] In contrast, the present study found that only 29% of the Top 100 Australian companies had at least one female director, and only 3% had two female directors. These Australian figures accord with the US figures of the mid-to-late 1970s.[116] The Australian directorships held by women were predominantly part-time positions. Of the 32 board seats held by women at the date of the study, 29 were non-executive directorships and just three were executive directorships.

Of the 889 seats on the boards of the Top 100 companies, 652 (73%) were held by non-executive directors and 237 (27%) were occupied by executive directors. However, only 384 of those 652 non-executive directorships were independent non-executive directorships. Thus, 43% of all Top 100 board seats were held by independent non-executive directors. Perhaps the most fundamental of the AIMA guidelines mentioned above is that boards should contain a majority of independent non-executive directors. At the time of the study, just 40% of the Top 100 companies met this recommendation. The Bosch Committee considered it 'desirable' that at least one-third of the board be independent non-executive directors.[117] In over half (66%) of the Top 100 companies, the board composition was in accordance with this Bosch Committee recommendation (see Figure 1).

FIGURE 1: Board Composition of Top 100 Listed Companies



[113] Ronald Burke, 'Do Women on Corporate Boards Make a Difference? Views of Women Directors' (1995) 3 *Corporate Governance: An International Review* 138; Korn/Ferry International, *Boards of Directors in Australia: Fourteenth Study* (1995) 14.

[114] Bloomberg and Reuter, 'US Women Getting on Board', *The Age* (Melbourne), 13 December 1996, C3.

[115] Sheryle Bagwell, 'It Pays to Make Room at the Top', *The Australian Financial Review* (Sydney), 11 October 1995, 17.

[116] Korn/Ferry International, above n 113.

[117] Bosch Committee, above n 4, 14.

Another important AIMA guideline is that the chairperson should be an independent non-executive director. Table 1 shows that, although 83% of the Top 100 companies had a non-executive chairperson as at mid-1995, less than half (45%) of the Top 100 had an independent director serving as chairperson.

Figure 2 below provides a breakdown of how the 268 affiliated non-executive directorships were classified as such. The six parts of the pie chart in Figure 2 correspond to the six AIMA criteria for independence. Note that the percentages shown in Figure 2 are proportions of the total grounds upon which non-executive directors were classified as affiliated (and therefore they total 100%). The figures in Figure 2 are *not* the percentages of affiliated non-executive directors who did not meet the particular AIMA criterion. If the latter approach had been adopted, the percentages would have totalled more than 100% because in many instances an affiliated non-executive director failed to meet two or more of the AIMA criteria.

Being a substantial shareholder or an associate of a substantial shareholder accounted for 28% of the total grounds upon which non-executive directors were classified as not independent. The next most common ground was being a former executive employee (22%), followed by being (or being associated with) a significant supplier or customer (19%).

FIGURE 2: Factors Contributing to Non-Executive Directors Being Classified as Not Independent

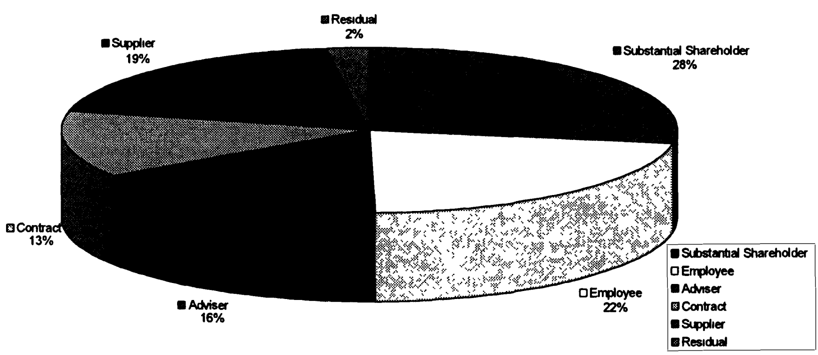


Table 2 below presents data on the incidence, composition and chairperson of the principal 'monitoring' board committees. The study revealed that, for the 89 companies for which information was available, the incidence of committees was: 100% for the audit committee (up from 83% in 1994), 66% for the remuneration committee (up from 54% in 1994), and 19% for the nomination committee (up from 12% in 1994).[118] As Table 2 shows, there were considerably

[118] The 1994 figures are derived from Angus Wells, *Board Committees in Australia*, AIMA Report (1995) 21. The incidence of remuneration and nomination committees in the Top 100 listed Australian companies in 1994 was remarkably similar to the incidence of those committees in

fewer remuneration committees, and far fewer nomination committees, in Australia's Top 100 listed companies in 1995 compared to the UK's Top 100 listed companies in 1993–94.

Only 56% of companies conformed with the AIMA recommendation that the audit committee be composed solely of non-executive directors. However, amongst the firms that had a remuneration committee and/or a nomination committee, the level of conformity with the AIMA guidelines on committee composition was high: 100% for remuneration committees, and 88% for nomination committees. This is not surprising, given that AIMA's guidelines regarding these two committees call for a mere majority of non-executive directors.[119]

AIMA recommends that the chairperson of each of these board committees should be an independent non-executive director. Two-thirds of the firms that had a nomination committee conformed with this recommendation. The rate of conformance was 61% for both audit committees and remuneration committees.

2 *Multiple Directorships*

Whilst compiling information on board composition and structure in the Top 100 companies, the opportunity was taken to gather information on multiple directorships. Issues relating to multiple directorships arise not only in the context of corporate governance but also in the context of restrictive trade practices law.[120] However, as far as corporate governance is concerned, multiple directorships present at least two *potential* difficulties: (i) directors who hold a large number of board seats might find it difficult to attain and maintain an adequate level of understanding of each company's business,[121] and; (ii) directors with more than one board seat may find that they occasionally face conflicts of interest.[122] In some situations, multiple directorships may even impair a director's independence. For the purposes of a study of the relationship

large and medium-sized UK listed companies in 1988 (see Table 2). Note that ASX Listing Rule 4.10.2 requires every listed company to disclose in its annual report whether or not it had an audit committee at the date of the directors' report, and if not, why not. Note also that the Life Insurance Act 1995 (Cth) states that: every life company must have an audit committee (s 90); a majority of the members of the audit committee must be persons who are not executive officers of the company (s 91(3)), and; the chairperson of the company's board cannot serve as the chairperson of the audit committee (s 91(5)).

119 See above n 98 and accompanying text.

120 Robyn Carroll and Michael Thanos, 'Director Interlocks and Part IV of the Trade Practices Act 1974 (Cth)' (1994) 22 *Australian Business Law Review* 411.

121 See above n 62 and accompanying text.

122 Roman Tomasic and Stephen Bottomley, *Directing the Top 500: Corporate Governance and Accountability in Australian Companies* (1993).

TABLE 2: Incidence of Board Committees — Australia and UK
AIMA Guidelines on Committee Composition and Chairperson

	Percentage of Companies with Committee				Composition of Australian Committees 1995			Australian Compliance with AIMA Committee Guidelines 1995[e]	
	UK			Australia					
Committee	1988[a]	1993[a]	1993/94[b]	1995[c]	Executives	NEDs	Independents	Committee Composition[d]	Committee Chairperson[f]
Audit	35%	90%	100%	100%	16%	84%	51%	56%	61%
Remuneration	54%	94%	98%	66%	13%	87%	51%	100%	61%
Nomination	10%	39%	69%	19%	19%	81%	54%	88%	67%

Note

[a] Figures for UK 1988 and UK 1993 are based upon a sample incorporating all quoted companies in the Top 1000 UK industrial companies (measured by sales revenue) at those two dates: Martin Conyon, 'Corporate Governance Changes in UK Companies Between 1988 and 1993' (1994) 2 *Corporate Governance: An International Review* 97, 103-5.

[b] Figures for UK 1993/94 are based upon a sample incorporating only the Top 100 listed UK companies (measured by market capitalisation) at September 1993: Cadbury Committee, *Compliance with the Code of Best Practice* (1995).

[c] Figures for Australia for 1995 are from the present study, and are based upon a sample of 89 companies in the Top 100 listed Australian companies (measured by market capitalisation). It was necessary to exclude 11 companies from the committee sub-samples as either: (i) the 'company' was a listed trust and did not disclose whether or not it had an audit committee; or (ii) the company had recently been floated on the ASX and the float prospectus did not disclose committees.

[d] The AIMA guidelines recommend that the audit committee should consist entirely of non-executive directors; and that the remuneration and nomination committees should include a majority of non-executive directors.

[e] The conformance rate in terms of the AIMA guidelines on committee composition and committee chairperson is based upon the proportion of companies that actually had the relevant committee.

[f] When calculating conformance with the AIMA 'independent committee chairperson' recommendation, it was necessary to exclude from the sub-sample: (i) one company in relation to the chairperson of the audit committee; (ii) two companies in relation to the chairperson of the remuneration committee; and (iii) two companies in relation to the chairperson of the nomination committee (see n 88 and accompanying text).

between remuneration committee composition and CEO compensation, Newman and Wright deemed a non-executive director on the remuneration committee of firm A to be affiliated (or non-independent) if he or she was an executive of firm B *and* the CEO of firm A was on the board of firm B.[123] Their justification is that '[t]he employee of firm B will have incentives to build goodwill with the CEO of firm A who, as a board member of firm B, would be in a position to act beneficially to firm B or its employee in return'.[124] A check revealed that no such relationships existed between directors in the Top 100 listed Australian companies at the date of the study.

The results are presented in the format used by Alexander and Murray.[125] Alexander and Murray defined the relevant terms as follows:

> [l]inks between companies are formed when a single director sits on the boards of two or more companies. ... [W]hile the person holding only two directorships creates but one link, the person holding four directorships creates six links. [The essential point is that the number of links within the network created by a single person increases factorially with each additional directorship they hold. The formula for expansion is *n(n-1)/2*, where *n* is the number of directorships held by an individual.] ... In many studies of interlocking directorships there is an ambiguity between [the terms] network links and interlocks. Counting board positions as an interlock is a characteristic of that board (or director). However, the network link which he or she constitutes will be counted again when looked at from the point of view of the other board. There is no clear definition in the literature as to whether an "interlock" is the board level unit or the network link. ... [W]e will refer to network links and interlocks as separate phenomena. The number of interlocks, by counting definition, will be double the number of network links.[126]

Figure 3, which is reproduced from Alexander and Murray, shows diagrammatically how a person holding four directorships creates six network links.

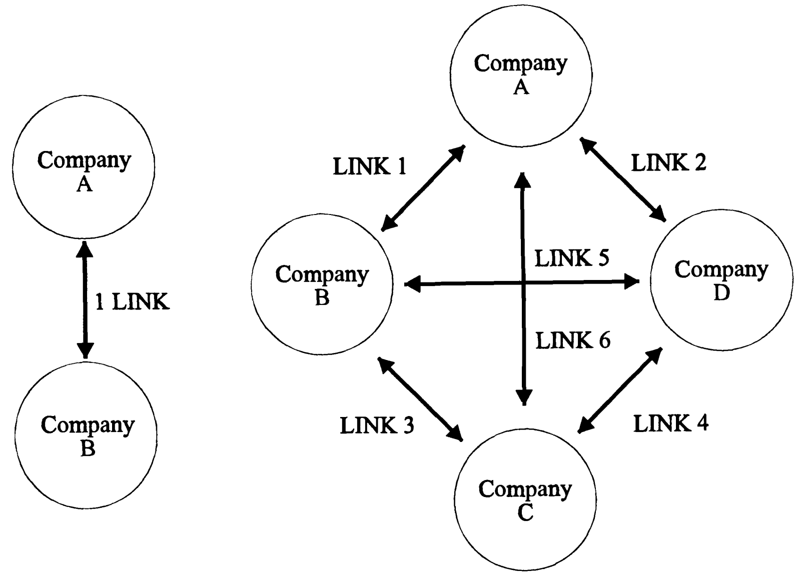
123 Newman and Wright, above n 77.

124 Ibid 6.

125 Malcolm Alexander and Georgina Murray, 'Interlocking Directorships in the Top 250 Australian Companies: Comment on Carroll, Stening and Stening' (1992) 10 *Company and Securities Law Journal* 385. Note that there is a more rigorous approach in this area which looks at interlocks between directors as opposed to interlocks between corporate boards. Alexander adopted this more rigorous approach and found 'a startling concentration of position not apparent when [the focus was] only on the interorganisational linkages': Malcolm Alexander, 'Business Power in Australia: The Concentration of Company Directorship Holding Among the Top 250 Corporates' (1994) 29 *Australian Journal of Political Science* 40, 50.

126 Alexander and Murray, above n 125, 388–9.

FIGURE 3: Multiple Directorship, Network Links and Company Interlocks



One person holds two directorships: one network link (two interlocks) only created.

One person holds four directorships: six network links (twelve interlocks)

Source: Malcolm Alexander and Georgina Murray, 'Interlocking Directorships in the Top 250 Australian Companies: Comment on Carroll, Stening and Stening' (1992) 10 *Company and Securities Law Journal* 385, 391.

Tables 3 and 4 present the results of the current study. A substantial majority (81%) of persons serving on the boards of the Top 100 companies as at mid-1995 held just one Top 100 board seat. Only 132 (19%) of the 690 total directors held two or more directorships in Top 100 companies, with most (88) of these persons holding just two Top 100 board seats. There were only 15 persons (2% of the 690 total directors) holding four or more Top 100 directorships, but they held 65 (7%) of the 889 total board seats. In the terminology of Alexander and Murray, there were 287 network links in existence, and thus 574 interlocks between firms — giving an average of 5.74 interlocks per company.

TABLE 3:
Top 100 Listed Companies — Multiple Directorships and Network Links, 1995.

Directorships Held by Single Directors [A]	Network Links Created [B]	Directors Holding [A] Directorships [C]	% of Directors Holding [A] Directorships	Number of Network Links [B] x [C]
1	0	558	80.87%	0
2	1	88	12.75%	88
3	3	29	4.20%	87
4	6	12	1.74%	72
5	10	1	0.14%	10
6	15	2	0.29%	30
Total Network Links				287
Total Interlocks				574
Interlocks per Firm				5.74

Note: Methodology derived from Alexander and Murray, above n 125.

Table 4 also provides a summary of comparative statistics for the years 1959, 1979, 1986, 1991 and 1995. It is difficult to make a useful comparison between the results obtained in the present study and those from the earlier studies, however, because the earlier studies all covered the largest 250 companies (measured by either assets or revenue), whereas the current study covered the largest 100 companies (measured by market capitalisation). Some people who hold board seats in Top 100 companies also hold directorships in listed companies outside the Top 100. In fact, as reported in Table 1, the present study found that the average Top 100 company had 8.22 interlocks with non-Top 100 listed companies.

VII THE RELATIONSHIP BETWEEN FIRM SIZE AND BOARD COMPOSITION/STRUCTURE

The data gathered in the study were used to see whether there is any relationship between board composition/structure and firm size (measured by market capitalisation) in Australia. Initially, this part of the study was to contain regression analysis[127] exploring the relationship between market capitalisation and various components of board structure and composition. However, there

[127] 'Regression analysis is concerned with the study of the dependence of one variable, the *dependent variable*, on one or more other variables, the *explanatory variables*': Damodar Gujarati, *Basic Econometrics* (2nd ed, 1988) 14.

TABLE 4: Network of Interlocking Directors — Summary of Comparative Statistics for Australia[a]

	1959[b]	1979 (corrected)[b]	1986[c]	1991 (corrected)[d]	1995[e]
Directors and Directorships (Board Positions)					
Number of companies	250	251	250	250	100
Basis of company selection	assets	assets	assets	revenue	market capitalisation
Total number of directorships	1629	2092	2156	2093	889
Average number of directorships per company	6.6	8.33	8.62	8.37	8.89
Total number of directors	1400	1622	1640	1755	690
Average number of directorships per director	1.16	1.29	1.31	1.19	1.29
Directors Holding Multiple Directorships (Multiple Directors)					
Persons holding one directorship only	1232	1341	1320	1538	558
Persons holding 2 directorships [as a % of all multiple directors]	125 [74%]	168 [60%]	201 [63%]	153 [71%]	88 [67%]
Persons holding 3 directorships [as a % of all multiple directors]	28 [17%]	66 [23%]	69 [22%]	33 [15%]	29 [22%]
Persons holding ≥4 directorships [as a % of all multiple directors]	15 [9%]	47 [17%]	50 [16%]	31 [14%]	15 [11%]
Total number of persons holding multiple directorships	168	281	320	217	132
Multiple directors as a percentage of all directors	12%	17%	20%	12%	19%
Persons holding ≥4 directorships as a percentage of all multiple directors	9%	17%	16%	14%	11%
Links Created by Multiple Directors					
Links created by persons holding 2 directorships	125	168	201	153	88
Links created by persons holding 3 directorships	84	198	207	99	87
Links created by persons holding 2 or 3 directorships [as a % of all links]	209 [67%]	366 [47%]	408 [50%]	252 [45%]	175 [61%]
Links created by persons holding ≥4 directorships [as a % of all links]	102 [33%]	420 [53%]	415 [50%]	302 [55%]	112 [39%]
Links created by all multiple directors	311	768	823	554	287
Network links per company	1.24	3.13	3.29	2.22	2.87
Interlocks per company (network links x2)	2.48	6.26	6.58	4.43	5.74
Average network links per multiple director	1.85	2.80	2.57	2.55	2.17
Average network links per person holding ≥4 directorships	6.80	8.94	8.30	9.74	7.47

[a] Methodology derived from Alexander and Murray, above n 125

[b] Bruce Stening and Wan Tai Wai, 'Interlocking Directorates Among Australia's Largest 250 Corporations 1959-1979' (1984) 20 *Australian and New Zealand Journal of Sociology* 47, as corrected by Alexander and Murray, above n 125

[c] Robyn Carroll, Bruce Stening and Kal Stening, 'Interlocking Directorships and the Law in Australia' (1990) 8 *Company and Securities Law Journal* 290

[d] Alexander and Murray, above n 125, as corrected by the current authors

[e] Current authors' own data

arose significant problems with multicollinearity[128] and functional form[129] and it was therefore decided to delay such a study. Nevertheless, it is still possible to derive some statistical insights into the relationship between these variables by considering the correlation coefficients.[130] It was thought that the results may reveal whether larger firms, as defined by market capitalisation, were more likely to comply with corporate governance requirements. However, as it has not yet been possible to prove causation, there remains the possibility that the correlation coefficients provide insights into the effect of corporate governance policies on firm size. In other words, if there is a significant and positive statistical relationship between market capitalisation and, say, the proportion of independent directors on the board, this may reveal *either* that larger companies are more likely than smaller companies to have a high proportion of independent directors, *or* that having a high proportion of independent directors has a positive effect on the size of the company. In summary, this study does not at this stage seek to prove causation. It merely demonstrates the connection between the variables.[131]

The correlation coefficients are presented below in Tables 5a and 5b. A correlation coefficient of 0.2 was chosen as the arbitrary demarcation between statistically significant and statistically insignificant relationships. This was done because, in a regression equation, two variables with a correlation coefficient in excess of 0.2 will have a t-statistic in excess of 1.96 — which indicates a statistically significant relationship at the 95% level of confidence.

The main variable of interest was the firm's market capitalisation. Even though the sample consisted of only the Top 100 listed companies, there were significant variations in market capitalisation, particularly at the high end of the sample. This warranted use of the natural logarithm[132] of a firm's market

128 'Strictly speaking, the term "multicollinearity" refers to the existence of more than one exact linear relationship' between the explanatory variables in a regression. However, the term is often used to refer to cases involving less than exact linear relationships: Gujarati, above n 127, 284. The existence of multicollinearity in a set of data can make it difficult to isolate the individual effects of explanatory variables on the dependent variable: William Griffiths, R Carter Hill and George Judge, *Learning and Practicing Econometrics* (1993) 431.

129 The 'functional form' of an equation describes the structural relationship between the explanatory variables and the dependent variable. Examples of functional form are linear, reciprocal, log-log and exponential: Griffiths, Hill and Judge, above n 128, 260.

130 The 'correlation coefficient' measures the degree of any statistical relationship (or linear association) between two variables. If variables X and Y move in the same direction, they are positively correlated, and the correlation coefficient will be positive; if X and Y move in opposite directions, they are negatively correlated, and the correlation coefficient will be negative; if X and Y are completely uncorrelated then the correlation coefficient will be zero; and if there is an exact linear relationship between X and Y they are said to be perfectly correlated: Ramu Ramanathan, *Introductory Econometrics with Applications* (1989) 35–6.

131 In the US, the study of board size by Yermack suggested that causation flowed from past board size to current firm value, rather than that firm value determined board size: Yermack, above n 45.

132 A 'logarithm' is defined as the inverse of the exponential function where an 'exponential function' has the form of $Y = a^x$ $(a>0)$ where 'a' is the base of the function and X is the exponent. For a logarithm, $X = \log_a Y$, the logarithm of a number to a given base 'a' is the power to which the base must be raised to give the number. Where the base of the logarithm is *e* then the logarithm is the natural logarithm and is denoted by $Y = \ln X$: Ramanathan, above n 130, 18–19.

capitalisation (lnMK) to normalise the value of these outliers.[133] The other variables were chosen on the basis of elements which are commonly referred to in discussions of corporate governance. The number of executive directors on the board of each Top 100 listed company is denoted #EXECs. Similarly, the number of non-executive directors is denoted #NEDs, and the number of independent directors is denoted #INDEPs. The total number of directors on the board (#DIRs) was found to have a significant correlation with market capitalisation (see Table 5a below); therefore, to allow for the fact that an increase in #EXECs or #NEDs would also be an increase in #DIRs, it was considered logical to control for the number of directors on the board. Accordingly, the variables %EXECs, %NEDs, and %INDEPs represent the proportion of each type of director on the board. Furthermore, since a director can be simultaneously counted in #NEDs and #INDEPs (in fact, the study found that 59% of the non-executive directors were also independent directors) it was necessary to remove this double counting of directors. This was accomplished by introducing the independent variable, #NIDs, which represents the affiliated (or 'non-independent') non-executive directors. Similarly, %NIDs is the proportion of affiliated non-executives on a company board. ILOCKS represents the number of corporate interlocks of a given Top 100 company with all other Top 100 companies. Again, to control for large boards, the variable ILOCKS/DIR was used to measure the number of corporate interlocks for each company when holding board size constant. Finally, several dummy variables[134] were used. AUDIT is '1' if the company had disclosed the existence of an audit committee, and '0' if no such committee was disclosed. REMUN provides the same information for remuneration committees, and NOM for nomination committees. In relation to AIMA guidelines on committee composition, ACHAIR is '1' if the audit committee had an independent chairperson; ANEDs is '1' if the audit committee comprised only non-executive directors; RCHAIR and NCHAIR are '1' if the remuneration and nomination committee chairpersons were independent; and RNEDs and NNEDs are '1' if the remuneration and nomination committees had a majority of non-executive directors. The dummy variable CHAIR is '1' if the company had an independent chairperson and '0' if it did not.

Several statistically significant relationships were found. These indicate that larger firms, as measured by market capitalisation, were more likely to possess the following board characteristics:

- more directors;
- more non-executive directors;
- more independent directors (see also Figure 4);

[133] 'Outliers' are simply the extreme values in the sample.

[134] 'Dummy variables' are used in regression equations to represent the presence of *qualitative* explanatory variables such as gender, religion or season. Typically, the presence or absence of a particular quality or attribute is reflected or 'quantified' by 'constructing artificial variables which take on values of 1 or 0' respectively: Gujarati, above n 127, 431–2.

- a greater percentage of independent directors;
- an independent chairperson;
- a nomination committee;
- a majority of non-executive directors on the nomination committee;
- a remuneration committee;
- a majority of non-executive directors on the remuneration committee;
- an independent remuneration committee chairperson;
- more corporate interlocks with other Top 100 companies;
- a greater percentage of corporate interlocks when allowing for board size.

Interestingly, there was almost no statistical relationship between the number of affiliated non-executive directors and market capitalisation, and there was a negative relationship between the proportion of executive directors on the board and market capitalisation. However, the latter relationship was only statistically significant at the 10% level. Conformance with good corporate governance policies on composition of the audit committee did not have a statistically significant relationship with market capitalisation. Larger firms were no more likely than smaller Top 100 firms to meet the AIMA guideline on audit committee composition.

The number of corporate interlocks of each Top 100 company with each other Top 100 company was significantly and positively related to the market capitalisation of each firm. This was the case when looking at nominal interlocks and when looking at the number of interlocks relative to the size of the board. Again, the direction of causation is unknown. It may be that as directors increase their network of directorships this benefits the companies on whose boards they sit — perhaps through the development of new skills, faster dissemination of new ideas and information, or both — such that these companies grow larger. On the other hand, it seems more likely that, as a firm increases in size, the prestige of its directors increases and as a result those directors are sought more keenly to fill positions on the boards of other companies.

FIGURE 4: Frequency of Independent Directors in Top 100 Companies Ranked by Market Capitalisation

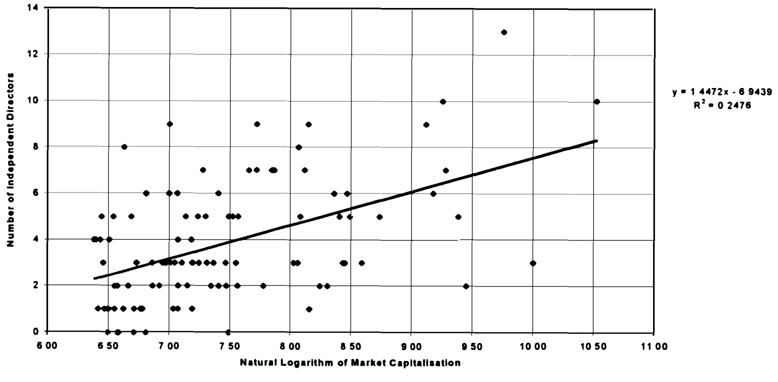


TABLE 5a: Correlation Coefficients

	LnMK	*#DIRs*	*#EXECs*	*#NIDs*	*#INDEPs*	*#ILOCKs*	*%NED*	*Audit Chair*	*Audit Neds*	*Audit*	*REM Chair*
LnMK	1										
#DIRs	0.584554	1									
#EXECs	0.178444	0.327835	1								
#NIDs	0.003756	0.285694	-0.10367	1							
#INDEPs	0.497638	0.626886	-0.08928	-0.42341	1						
#ILOCKs	0.444851	0.418633	-0.10093	-0.03077	0.496077	1					
%NED	0.146699	0.241402	-0.78302	0.308934	0.398432	0.31364	1				
Audit Chair	0.121412	0.05297	-0.01529	-0.10499	0.141189	0.094634	0.076247	1			
Audit NEDs	0.124018	0.102636	-0.20803	0.112144	0.121737	0.074093	0.256604	0.160514	1		
Audit	0.15977	0.15333	-0.09873	0.197646	0.053052	0.005212	0.232189	0.351562	0.324477	1	
REM Chair	0.214561	0.217696	-0.04131	-0.06902	0.292856	0.074587	0.179422	0.171499	0.098069	0.241169	1
NOM Chair	0.160741	0.216923	0.010195	-0.07832	0.273475	0.160409	0.096511	0.066667	0.160514	0.117187	0.342997
%Execs	-0.1467	-0.2414	0.783019	-0.30893	-0.39843	-0.31364	-1	-0.07625	-0.2566	-0.23219	-0.17942
%NIDs	-0.16845	-0.08926	-0.30077	0.882233	-0.61333	-0.11766	0.322678	-0.12973	0.081092	0.146001	-0.15477
%Indeps	0.268979	0.26355	-0.29238	-0.61223	0.879026	0.344019	0.431939	0.179991	0.112465	0.032562	0.280145
Ilocks/#Dirs	0.287166	0.132969	-0.23276	-0.04381	0.283704	0.920413	0.319099	0.044335	0.051783	-0.01913	0.012699
REM Neds	0.256107	0.275663	0.07932	0.264775	0.036338	0.040061	0.147893	0.162088	0.134966	0.413134	0.540322
NOM Neds	0.218424	0.26911	0.087264	0.037748	0.199052	0.157024	0.070701	0.115278	0.032382	0.141846	0.21747
REM	0.297663	0.308324	0.089548	0.238564	0.084181	0.070046	0.154105	0.182989	0.116674	0.421731	0.571856
NOM	0.368456	0.342866	0.140048	0.034737	0.249396	0.160433	0.061862	0.079865	0.116444	0.159106	0.203169
CHAIR	0.20507	0.170356	-0.17214	-0.35322	0.527334	0.194472	0.264714	0.140705	0.05243	-0.06745	0.542942
#NEDs	0.517269	0.873253	-0.17405	0.35126	0.699479	0.488417	0.655481	0.0631	0.21428	0.210743	0.248219

TABLE 5b: Correlation Coefficients (continued)

	NOM Chair	%Execs	%NIDs	%Indeps	Ilocks/#Dirs	REM Neds	NOM Neds	REM	NOM	CHAIR	#NEDs
LnMK											
#DIRs											
#EXECs											
#NIDs											
#INDEPs											
#ILOCKs											
%NED											
Audit Chair											
Audit NEDs											
Audit											
REM Chair											
NOM Chair	1										
%Execs	-0.09651	1									
%NIDs	-0.15306	-0.32268	1								
%Indeps	0.217203	-0.43194	-0.71428	1							
Ilocks/#Dirs	0.084817	-0.3191	-0.01697	0.252113	1						
REM Neds	0.148581	-0.14789	0.156305	-0.03959	0.006467	1					
NOM Neds	0.730095	-0.0707	-0.05257	0.102366	0.080686	0.226558	1				
REM	0.142325	-0.1541	0.128098	-0.00811	0.022261	0.979615	0.219149	1			
NOM	0.736535	-0.06186	-0.08237	0.124233	0.052699	0.223305	0.891516	0.214886	1		
CHAIR	0.368514	-0.26471	-0.42851	0.604047	0.101115	0.118106	0.156409	0.140998	0.179264	1	
#NEDs	0.220849	-0.65548	0.062087	0.425508	0.258649	0.246424	0.235497	0.275193	0.285151	0.266354	1

VIII CONCLUSION

The composition and structure of the board of directors is arguably a key element of corporate governance. Organisations such as AIMA clearly believe that this is the case. However, recent US empirical research casts considerable doubt on whether independent non-executive directors enhance corporate performance. There are several factors which collectively may explain the results of the recent US studies; these factors were detailed in Part IV of the article. There is, however, a strong argument that independent non-executive directors are important for reasons other than corporate performance — in particular, because they have a role to play in situations where there is a potential for conflict between the interests of the executive management and those of the shareholder body. Numerous US empirical studies support this view.

It is therefore significant that, as at mid-1995, less than half of the Top 100 listed Australian companies conformed with key AIMA recommendations on board composition and independence of the chairperson. Further, only 19% of the Top 100 companies had a board nomination committee, and only two-thirds had a remuneration committee (although the incidence of these committees had increased appreciably over the previous year). Where companies had nomination and remuneration committees, they tended to conform with AIMA guidelines on committee composition (but the same could not be said in regard to audit committees). However, this seems to reflect the fact that AIMA's guidelines on committee composition, strangely, do not recommend that independent directors fill any proportion of the committee positions other than the chair. This is a matter that should be revisited by AIMA and its advisers.

Another important finding made in the study reported in this article was that women held a meagre 3.6% of the 889 board seats in the Top 100 companies as at mid-1995. Most (29 out of 32) of these directorships held by women were non-executive positions.