AUSTRALIA INSIDE-OUT: THE CORPORATE GOVERNANCE SYSTEM OF THE AUSTRALIAN LISTED MARKET

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[This article concerns the classification of the corporate governance system of Australia's listed market. Claims are often made that it is an outsider system of ownership and control, similar to that of the UK and the US. Through an examination of share ownership patterns, institutional investor activism, private rent extraction, the market for corporate control and blocks to information flow, this article argues that the corporate governance system of Australia's listed market in fact has many of the characteristics associated with insider systems. The misclassification of the corporate governance system of Australia's listed market has significant impacts for the general classification of insider and outsider systems, as it may be an example of an insider system converging to an outsider system. The misclassification also has significant impacts for the Australian reform agenda, as reforms based on the assumption that the Australian listed market has an outsider system of corporate governance may be inappropriate and damaging.]

CONTENTS

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I INTRODUCTION

Australia's system of corporate governance is regularly described by commentators as forming part of the Anglo-Saxon 'outsider' system of ownership and control.[1] It is said to have an ownership and control system similar to those of the United Kingdom and the United States. These systems are characterised by a securities market with dispersed shareholdings, where shareholders and companies interact on an arm's-length basis, largely determined by market forces. They may be contrasted with the 'insider' systems of countries such as Japan and Germany. These systems are characterised by the relative unimportance of the securities market as a source of finance. The principal sources of finance are banks, families, non-financial corporations and the state. Shareholdings are more concentrated, and shareholders and creditors are more actively involved in the control of companies.

At first sight, the classification of the Australian system of corporate governance as an outsider system appears correct. Many of Australia's largest listed companies have relatively dispersed shareholdings.[2] Moreover, Australia has many of the key institutions[3] present in countries with outsider systems: a securities market, a securities regulator, a takeovers panel, a disclosure regime and outsider corporate governance codes. Finally, it fits with the general assumption that, as a common law system, Australia must somehow be like the UK.

However, questions have recently been raised about the accuracy of this classification. In his political analysis of corporate governance systems, Mark Roe was unable to categorise Australia according to his central thesis that a socialist political system should produce an insider system.[4] Asjeet Lamba and Geof Stapledon have claimed Australia has an insider system of corporate governance.[5] Brian Cheffins has suggested that the Australian system of corporate governance is in transition from an insider system to an outsider system.[6]

1 See, eg, Ian Campbell, 'Foreword to Contemporary Issues in Corporate Governance' (2002) 25 *University of New South Wales Law Journal* 267, 267; Jeroen Weimar and Joost Pape, 'A Taxonomy of Systems of Corporate Governance' (1999) 7 *Corporate Governance* 152, 153–7; John Scott, *Corporate Business and Capitalist Classes* (1997) 3; Michael Bradley et al, 'The Purposes and Accountability of the Corporation in Contemporary Society: Corporate Governance at a Crossroads' (1999) 62(3) *Law and Contemporary Problems* 9, 51.

2 Many Australian listed companies have a combination of arm's-length shareholders (private and institutional investors) and 'insider' shareholders (families, non-financial corporations and the state): see below Part III.

3 This article uses the term 'institutions' to mean 'the humanly devised constraints that shape human interaction. In consequence they structure incentives in human exchange, whether political, social, or, economic': Douglas North, *Institutions, Institutional Change, and Economic Performance* (1990) 3–4.

4 Mark Roe, 'Political Preconditions to Separating Ownership from Corporate Control' (2000) 53 *Stanford Law Review* 539, 543. He identified Australia as left wing (at 562) but having a widely dispersed ownership and control system (at 605).

5 Asjeet Lamba and Geof Stapledon, 'The Determinants of Corporate Ownership Structure: Australian Evidence' (Public Law and Legal Theory Working Paper No 20, Faculty of Law, The University of Melbourne, 2001) 24–5 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=279015>.

6 Brian Cheffins, 'Comparative Corporate Governance and the Australian Experience' in Ian Ramsay (ed), *Key Developments in Corporate Law and Trusts Law: Essays in Honour of Profes-*

This article builds on these earlier works by examining the Australian listed market and some of its key supporting institutions. It argues that the evidence on share ownership and shareholder voting patterns, institutional investor activism, private rent extraction, the market for corporate control and blocks to information flow indicates that the Australian listed market does not have an outsider system of corporate governance. Rather, it has a corporate governance system that has more in common with insider systems.

It is a mistake to view the classification of Australia's system of corporate governance as a matter of purely pedantic inquiry. There are important implications for the general debate on the key elements of corporate governance systems. For example, if, as Cheffins suggests, the Australian system is in the process of converging to an outsider system, much may be learned about the preconditions for convergence by studying this transition. Additionally, Australia is in the process of reforming its corporate governance system based on an assumption that it is an outsider system. If that assumption is incorrect, the reforms may have a destabilising effect. Recognising that the Australian system may have more in common with insider systems would enable a more appropriate response to corporate governance problems.

II The Financial System and Governance Outcomes

To contextualise the examination of the ownership and control of Australian listed companies, this article first discusses the important relationship between the financial system and governance outcomes.

A *Types of Financial Systems*

While all capitalist financial systems are similar, in that their financial sectors consist of various allocation mechanisms, the role of particular channels differs due to historical, social and cultural factors. In insider systems, the roles of banks, families and non-financial corporations are crucial; in outsider systems, the role of securities markets is crucial.

To explain this divergence, it is important to emphasise the existence of complementary relationships between savers, the financial sector and non-financial firms as channels of information flow.[7] The role of information is crucial since it affects the nature, distribution and size of transaction costs by defining the boundaries of each economic actor's rationality.[8] Institutions determine the types of financial relations by 'guiding' the flow of information between economic

sor Harold Ford (2002) 13. In a feature on the National Australia Bank Ltd in 2004, the *Financial Times* commented on the unusual corporate governance environment present in the Australian listed market: 'National Australia Bank Feature', *Financial Times* (London), 14 April 2004, 23.

7 See, eg, Reinhard Schmidt, Andreas Hackethal and Marcel Tyrell, 'The Convergence of Financial Systems in Europe' (Working Paper No 75, Fachbereich Wirtschaftswissenschaften, Johann Wolfgang Goethe-Universität, Frankfurt am Main, 2001) 3–7 <http://www.wiiw.de/publikationen/TheConvergenceofFinancialSyste656.pdf>.

8 See, eg, Hayne Leland and David Pyle, 'Informational Asymmetries, Financial Structure, and Financial Intermediation' (1977) 32 *Journal of Finance* 371.

actors.[9] For instance, institutions that facilitate the flow of information from a corporation towards public investors can decrease the level of uncertainty in securities markets and consequently reduce the transaction costs of securities finance. Mandatory disclosure rules are one such institution. Other institutions, ranging from inadequate securities regulation to defamation laws, may hinder public information flow. When sufficient public information is lacking, high transaction costs deter economic actors from using securities markets. However, financial intermediaries, such as banks, families and non-financial companies, may be able to resolve informational asymmetries by pooling funds and thus internalising financial transactions.[10]

Thus, two fundamental parameters characterise financial systems: the degree of financial 'intermediation' and the degree of financial 'securitisation'. They are related to the two ways of channelling financial resources: the former reflects the importance of private financial intermediaries and the latter reflects the importance of market-based relationships.

B *The Significance for Corporate Governance*

To a large extent, the significance for corporate governance of these differences in financial systems lies in the differences in corporate finance. This is because there is a clear relationship between corporate finance and patterns of share ownership. Subject to the forces of other institutional subsystems, in a share market with an outsider system of corporate governance, one expects to find a general pattern of highly fragmented share ownership. By contrast, in a share market with an insider system, shareholdings should be more concentrated.[11] Concentrated share ownership automatically increases the likelihood of direct shareholder control of companies. On the other hand, if ownership is highly dispersed, shareholder cooperation is difficult[12] and the only option for dissatisfied shareholders is 'exit', that is to sell their shares. Thus, only two financial mechanisms impose managerial discipline. First, the market for corporate control. If shareholders are dissatisfied with the performance of management, enough of them may sell their shares to a single entity to give it sufficient control to replace existing management. Management thus has an incentive to satisfy shareholders. Second, the need to seek capital in the future. If management causes the company to perform poorly, it will be more difficult for it to raise funds by issuing new shares or borrowing money as investors and creditors will be less willing to invest in or lend to the company. Management

[9] For a detailed analysis of specific institutions, see Bernard Black, 'The Legal and Institutional Preconditions for Strong Securities Markets' (2001) 48 *UCLA Law Review* 781.

[10] See Christopher James, 'Some Evidence on the Uniqueness of Bank Loans' (1987) 19 *Journal of Financial Economics* 217; Douglas Diamond, 'Financial Intermediation and Delegated Monitoring' (1984) 51 *Review of Economic Studies* 393.

[11] Erik Berglöf, 'Capital Structure as a Mechanism of Control: A Comparison of Financial Systems' in Masahiko Aoki, Bo Gustafsson and Oliver Williamson (eds), *The Firm as a Nexus of Control* (1990) 237.

[12] Cooperation is not impossible, however. For example, institutional investors do occasionally manage to coordinate their actions: see below Part IV(A).

thus has an incentive to make the company an attractive prospect to potential shareholders and creditors.

In theory, no accountability issues should arise with either system of corporate governance. Where there is an insider system, the divergence between the interests of shareholders and managers — the 'agency problem', to use the terminology of Michael Jensen and William Meckling[13] — does not arise, since there is no separation of ownership and control. In an outsider system, accountability issues do not arise if share markets are efficient such that share prices reflect with relative accuracy the value of corporate operations. Assuming market efficiency, constraints from the market for corporate control or the discipline provided by the need to return to the capital market for more funding will be sufficient to restrain management discretion.

However, even where there is concentrated ownership, shareholder motives are rarely homogeneous. Moreover, stock markets are not always efficient. Consequently, accountability issues arise in both systems. To respond correctly to these issues, one must first attempt to classify a particular system of corporate governance. Of course, neither insider systems nor outsider systems exist in pure form. To characterise a system as one or the other is to describe the degree of intermediation or securitisation. In an insider system, the degree of intermediation will be high and the degree of financial securitisation will be low; in an outsider system, the reverse is true.

III OWNERSHIP PATTERNS IN AUSTRALIA'S PUBLICLY LISTED COMPANIES

Until the 1980s, most of the economic activity occurring in Australia was outside the listed marketplace. Its listed companies were fragmented across a number of state-based stock exchanges, each of which had high shareholder concentration levels.[14] While it is still true that most of Australia's economic activity occurs outside the listed market,[15] it now has a national stock exchange, namely the Australian Stock Exchange ('ASX'). Many of the largest listed

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

[14] See Ted Wheelwright, *Capital Markets and Capital Formation in Australia* (1957) 103–8; David Merrett, 'Capital Markets and Capital Formation in Australia, 1890–1945' (Pt 1) (1997) 37 *Australian Economic History Review* 181; David Merrett, 'Capital Markets and Capital Formation in Australia, 1945–1990' (Pt 2) (1998) 38 *Australian Economic History Review* 135.

[15] As a channel of funds to companies, the Australian Stock Exchange ('ASX') is not as significant as are the stock exchanges in the UK and the US. Indeed, it is an uncontroversial and much-referenced fact that of the top 500 Australian companies, only about 35% are listed on the ASX. In contrast, 63% of the top 500 UK companies and almost all of the top 500 US companies are listed on their respective stock exchanges. See William Carroll and Malcolm Alexander, 'Finance Capital and Capitalist Class Integration in the 1990s: Networks of Interlocking Directorships in Canada and Australia' (1999) 36 *Canadian Review of Sociology and Anthropology* 331, 333–4; Geof Stapledon, 'Australian Sharemarket Ownership' in Gordon Walker, Brent Fisse and Ian Ramsay (eds), *Securities Regulation in Australia and New Zealand* (2nd ed, 1998) 242, 243.

companies have relatively dispersed shareholdings.[16] It is thus often claimed that the ASX has an outsider system of corporate governance.[17]

However, the empirical evidence on ownership of listed shares does not support this claim. In a 1998 study based on data from 1996, Stapledon found that 45% of the companies in the ASX All Ordinaries Index[18] had a 'non-institutional' shareholder[19] holding more than 20% of the shares.[20] This pattern of concentrated ownership also applies to the largest companies. Considering a small sample of Australia's largest companies taken in 1999, Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer found that 45% had a shareholder holding more than 10% of the equity.[21] In comparison, only 10% of the largest listed companies in the UK and 20% of the largest listed companies in the US had a shareholder holding more than 10% of the equity.[22] Tom O'Lincoln's 1996 study suggests that, if anything, shareholdings in Australia have become more concentrated over the course of the twentieth century.[23] He found that while in the early 1950s, the 20 largest registered shareholders in Australia held 37% of the shares in the largest Australian companies, by the early 1990s this had grown to 63%.[24]

The largest and most recent study provides further compelling evidence of ownership concentration. Based on data from 1998, Lamba and Stapledon took a representative sample of 240 listed companies.[25] Of these companies:

- 77% had a non-institutional investor with the largest or only 'substantial holding', that is a shareholding of greater than 5%;[26]
- 72% had a non-institutional investor with at least a 10% shareholding;[27]
- 52% had a non-institutional investor with at least a 20% shareholding;[28] and
- 16% had a non-institutional investor with an absolute controlling shareholding, that is a shareholding of greater than 50%.[29]

16 See above n 2 and accompanying text.

17 See above n 1 and accompanying text.

18 The ASX All Ordinaries Index

> is made up of the weighted share prices of about 500 of the largest Australian companies. Established by ASX at 500 points in January 1980, it is the predominant measure of the overall performance of the Australian sharemarket. The companies are weighted according to their size in terms of market capitalization (total market value of a company's shares).

ASX, *Glossary of Sharemarket Terms* (21 August 2003) <http://www.asx.com.au/webmcq/servlet/com.webmcq.glossary.Glossary?cid=0&alt=1>.

19 These shareholders may be distinguished from 'institutional' shareholders — those organisations such as investment fund managers whose principle purpose is investment.

20 Stapledon, 'Australian Sharemarket Ownership', above n 15, 250.

21 Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer, 'Corporate Ownership around the World' (1999) 54 *Journal of Finance* 471, 493.

22 Ibid.

23 Tom O'Lincoln, 'Wealth, Ownership and Power: The Ruling Class' in Rick Kuhn and Tom O'Lincoln (eds), *Class and Class Conflict in Australia* (1996) 5.

24 Ibid 5, 7.

25 Lamba and Stapledon, above n 5, 10.

26 Ibid 21. A 'substantial holding' is a shareholding whose attached voting rights constitute 5% or more of the total number of votes: *Corporations Act 2001* (Cth) s 9 ('*Corporations Act*').

27 Lamba and Stapledon, above n 5, 21.

28 Ibid.

Considering the evidence by company size reveals that 46% of large companies, 86% of medium-sized companies and 84% of small companies in the sample had a non-institutional investor with at least a 10% shareholding.[30] For large companies, this was most commonly a non-institutional corporate shareholder; in the medium-sized and small companies, this was most commonly a family shareholder.[31] These high share concentrations at all company sizes suggest that, at least in terms of their share ownership patterns, Australian listed companies do not conform to the outsider corporate governance model present in the UK and the US.

Given the historically low levels of shareholder participation in votes in Australia, high share concentrations in ASX companies are even more important in terms of conferring control on these non-institutional 'blockholders'.[32] A study by Corporate Governance International Pty Ltd of voting in 2003 in 100 'widely held'[33] Australian listed companies showed that the holders of only 44% of the eligible share capital voted on director-election resolutions.[34] In general, without a highly controversial issue to motivate them to vote, most shareholders do not. This means that a blockholder does not need a large percentage of the share capital to gain an input into control. In 1996, O'Lincoln estimated that a 5% shareholding would confer an input into control.[35] In light of the empirical evidence on share ownership, a large number of Australian listed companies therefore have blockholders with an ability to exert control.

The existence of these 'significant blockholders' in the context of other relatively dispersed shareholdings is important. The blockholder has the ability to intervene in the affairs of management. Arm's-length shareholders, interested in maximising share value, might benefit from blockholder intervention if that is also the aim of the blockholder. However, that may not be the blockholder's aim. A founder blockholder whose entire income is tied to one company is more risk averse than a diversified investment fund.[36] Where one non-institutional

[29] Ibid.

[30] Ibid.

[31] Ibid 21–2.

[32] Subsequently, a reference to 'blockholders' should be taken to be a reference to non-institutional blockholders.

[33] 'Widely held' companies were defined as those '*without* a major non-institutional shareholder': Corporate Governance International Pty Ltd, *AGM Monitor: Proxy Voting at General Meetings of ASX200 Companies in 2003 and the Growth of Ownership Responsibilities* (2003) 7 <http://www.cgi.au.com/user1/1336/doc/Proxy%20Voting%20Report%202003.pdf> (emphasis in original).

[34] Ibid 8. These participation figures have increased significantly in the past five years. In 1998, the overall participation rate was only 32%: see Geof Stapledon et al, 'Proxy Voting in Australia's Largest Companies' (Research Report, Centre for Corporate Law and Securities Regulation, The University of Melbourne, 2000) 18 <http://cclsr.law.unimelb.edu.au/research-papers/Monograph%20Series/Proxy%20Voting%20Final.pdf>. However, the increase has not been 'to the levels in the major markets of UK (55%) and USA (80%)': Corporate Governance International Pty Ltd, above n 33, 4.

[35] O'Lincoln, above n 23, 6.

[36] Preferences may differ even among investment funds as they may have different investment policies. For example, an 'ethical investment fund' may prefer activities that are socially and environmentally beneficial, whereas another investment fund may prefer activities that generate the greatest profit whatever the social and environmental consequences.

corporate shareholder has a strategic blockholding in another company — such as where it is a major supplier, competitor or customer — industrial strategy considerations will tend to prevail over the desire to maximise financial returns on equity. A blockholder that is also a creditor of the company may be more interested in securing the prompt repayment of loans plus interest than the maximisation of shareholder returns. Moreover, in some cases prestige and family heritage considerations may be important determinants of blockholder behaviour.[37] In all of these cases, other shareholders could be disadvantaged if the blockholder makes self-serving interventions in the management of the company.

However, the empirical evidence discussed thus far simply suggests that blockholders have the *opportunity* to control; it does not demonstrate that blockholders *exercise* such control. If they do, the ownership and control system of Australian listed companies will have more in common with an insider system than an outsider system, even if many companies have a relatively dispersed shareholding.

IV Do Blockholders Exercise Control?

To test whether blockholders exercise control, this article examines a number of aspects of the Australian listed market. First, it considers the evidence of institutional activism. If blockholders are exerting control, there would be some tension between the interests of arm's-length shareholders and the interests of blockholders. One manifestation of this tension would be intervention by arm's-length shareholders that have the capacity to do so. These include 'institutional investors' such as investment fund managers. Thus, if blockholders are exerting control, there should be some evidence of institutional investor activism. Second, this article analyses the extent to which blockholders extract 'private rents' — private benefits the conferral of which are not necessarily in the company's interests. If blockholders are exerting control, there should be some evidence of this behaviour. Indeed, a number of commentators view private rent extraction as a crucial indicator of the existence of an insider system.[38] Third, this article discusses the market for corporate control. If blockholders are exerting control, there should be low levels of hostile takeover activity.

[37] See Simon Learmount and John Roberts, 'Meanings of Ownership of the Firm' (Working Paper No 238, ESRC Centre for Business Research, University of Cambridge, 2002) 9–10 <http://www.cbr.cam.ac.uk/pdf/WP238.pdf>.

[38] See Lucian Bebchuk, 'A Rent-Protection Theory of Corporate Ownership and Control' (Working Paper No 7203, National Bureau of Economic Research, 1999) <http://www.law.harvard.edu/faculty/bebchuk/pdfs/nber7203.99.pdf>; Lucian Bebchuk, 'The Evolution of Ownership Structures in Publicly Traded Companies' (Working Paper, Harvard University, 1999). Julian Franks and Colin Mayer have put forward this idea to explain the differences between the governance outcomes of the UK and the US on the one hand and continental Europe on the other: see Julian Franks and Colin Mayer, 'Ownership and Control of German Corporations' (Discussion Paper No 2898, Centre for Economic Policy Research, 2001) <http://www.cepr.org/pubs/new-dps/dplist.asp?dpno=2898>.

A *Institutional Investor Activism*

As noted in Part I, one of the reasons why Australia's insider status may have gone unrecognised until recently is that it has a well-developed stock market with a relatively dispersed shareholding base in some of its largest listed companies. Superficially, it therefore resembles an outsider system. However, the existence of developed and relatively liquid stock markets does not, of itself, conclusively indicate the existence of an outsider system.

Since the major market controls on management in an outsider system are the market for corporate control and the discipline imposed by the need for listed companies to return to the capital markets for funds, a crucial element is market efficiency. As discussed above, market-based financial systems rely heavily on institutional arrangements that facilitate public information flow, because they reduce the cost of market transactions for dispersed shareholders.[39] However, if control-related information is unavailable or distorted, a market may tend towards intermediation.

Even where control-related information is largely available, high transaction costs can arise if, because of a lack of sophistication or time, investors cannot process and use the information to make efficient investment decisions. This will be the position of small, individual shareholders who are not professional investors. For these shareholders, transaction costs can be so significant that exit is unavailable. For instance, even in a 'hostile takeover' bid (that is, one opposed by management), where shareholders can directly show their approval or rejection of management, many individual investors would find it difficult to decide whether the best option is to sell or to follow management and reject the bid. Unless there are clearly visible signs of managerial failure — such as repeated unsatisfactory dividend distributions, continuous share price drops or blatant private rent extraction by directors — individual investors can be expected to follow management. In that case, the market for corporate control will not significantly restrain managerial discretion and will encourage blockholders to try to gain an input into control. As a result, small individual investors can become locked into a company because they can only sell on disadvantageous terms. At the same time they may be unable to exercise direct monitoring, since they lack the incentive and the resources to obtain or utilise information.

Thus diffuse ownership does not necessarily indicate an outsider system. A firm dominated by management is one possible consequence of the powerlessness of small shareholders. Another possible consequence is that where diffuse ownership is combined with significant blockholders, an insider system may arise. There is a third possibility where a significant proportion of the shares are held by institutional investors. While in the UK and the US such investors generally operate on an arm's-length basis, preferring market-based monitoring mechanisms,[40] they may intervene on major issues. Institutional investors are

[39] See above nn 7–10 and accompanying text.

[40] There are many examples of such market-based monitoring mechanisms. Including share-options as part of managers' remuneration creates a coincidence of interest between managers and shareholders. The market for corporate control disciplines managers: if they do not comply with

different from small, individual shareholders as they have the sophistication and resources necessary to process and utilise the information that is publicly available. In effect, their presence significantly reduces the transaction costs that smaller individual investors have to bear. They are also different from blockholders because not only do they require liquidity and diversification, they also expect share value maximisation. In other words, their investment policies are strictly driven by financial considerations.[41] While the combination of these two characteristics makes institutional investors inherently uncommitted shareholders,[42] the fact that they face lower transaction costs also allows them to participate in corporate control contests more actively and to scrutinise the quality of information flow from companies.[43] Consequently, the institutionalisation of financial assets, and in particular corporate stocks, increases the role of the market for corporate control as a disciplinary mechanism for managers. It also increases the demand for free information flow to the market. Thus, institutionalisation has a role to play in restricting the ability of blockholders to exercise control.[44]

Since the 1950s, there has been a steady increase in the institutionalisation of corporate stocks in the UK and the US. The removal of barriers to capital flow, changes in savings systems and the elimination of fixed commissions, first in the US[45] and later in the UK,[46] dramatically increased trading volume and unleashed

shareholder wishes, the shareholders will start selling their shares and the share price will drop to a level where the company is subject to a takeover in which the managers will be replaced. Disclosure mechanisms ensure that all information is given to shareholders and prevents managers from covering up their mistakes by hiding price sensitive information. Monitoring by non-executive directors acts as an immediate check on executive power at the board level. Institutions like these mechanisms because they are costless. See further John Lowry and Alan Dignam, *Company Law* (2nd ed, 2003) 361.

41 Indeed, one empirical study reveals a link between institutional ownership and dividend payout increases: see Helen Short, Hao Zhang and Kevin Keasey, 'The Link between Dividend Policy and Institutional Ownership' (2002) 8 *Journal of Corporate Finance* 105.

42 In recent years, however, a minority of institutional investors — mostly Anglo-American public pension funds — have faced the 'lock in' effects of concentrated ownership despite their broad diversification strategies, as their assets have grown to unprecedented levels. For those institutions, the 'voice' option — or what is most commonly referred to as 'institutional activism' — is often the only economically rational option. Some index funds also resort to corporate monitoring as a way to 'beat' the market. The literature on this subject is substantial: see, eg, Bernard Black, 'The Value of Institutional Monitoring: The Empirical Evidence' (1992) 89 *UCLA Law Review* 895; Geof Stapledon, *Institutional Shareholders and Corporate Governance* (1996); Carolyn Brancato, *Institutional Investors and Corporate Governance: Best Practices for Increasing Corporate Value* (1997) ch 3.

43 Gary Gorton and Matthias Kahl, 'Blockholder Identity Equity Ownership Structures, and Hostile Takeovers' (Working Paper No 7123, National Bureau of Economic Research, 1999) <http://www.nber.org/papers/w7123>.

44 See Karl Lins, 'Equity Ownership and Firm Value in Emerging Markets' (2003) 38 *Journal of Financial and Quantitative Analysis* 159.

45 By r 19b-3, adopted under the *Securities Exchange Act of 1934*, c 404, 48 Stat 881 (1934), the Securities Exchange Commission prohibited fixed commissions on 1 May 1975. One month later, they were legislatively prohibited by the *Securities Acts Amendments of 1975*, Pub L No 94-29, 89 Stat 97, 107–8 (1975).

46 The prohibition of fixed commissions by the London Stock Exchange ('LSE') officially came into force in October 1986 as part of the financial 'Big Bang'. However, LSE brokers had been unofficially giving discounts to institutional investors since 1983. See Norman Poser, *International Securities Regulation: London's 'Big Bang' and the European Securities Markets* (1991) 24–5.

unprecedented amounts of capital into equity markets.[47] As a result, institutional investors became the largest owners of stock in listed corporations in both the UK and the US (see Tables 1.1 and 1.2).

Table 1.1: Equities Held by Domestic Institutional Investors in the US[48] (Expressed as a Percentage of Total)

Type of Investor	1950	1970	1990	1995	1999	2000	2001
Private pension funds	0.8	8.0	16.8	15.2	11.0	11.4	12.6
State and local pension funds	0.0	1.2	7.6	8.0	6.9	7.6	8.0
Life insurance companies	1.5	1.7	2.3	3.7	4.9	5.4	5.6
Other insurance companies	1.8	1.6	2.3	1.6	1.1	1.1	1.1
Mutual funds	2.0	4.7	6.6	12.1	17.4	18.5	18.6
Closed-end funds	1.1	0.5	0.5	0.4	0.2	0.2	0.2
Bank personal trusts	0.0	10.4	5.4	2.6	1.7	1.6	2.1
Total	7.2	28.2	41.4	43.6	43.2	45.8	48.3

Table 1.2: Equities Held by Domestic Institutional Investors in the UK[49] (Expressed as a Percentage of Total)

Type of Investor	196 3	196 9	197 5	198 1	198 9	199 4	199 7	200 0	200 3
Insurance	10.0	12.2	15.9	20.5	18.6	21.9	23.5	21.0	17.3
Pension funds	6.4	9.0	16.8	26.7	30.6	27.8	22.1	17.7	16.1

47 For instance, the equity turnover in the LSE jumped from about £160.9 billion in 1986 (the year fixed commissions were formally abolished) to £520.9 billion in 1987; it has grown steadily since then to reach almost £2000 billion in 2003: LSE, *Historic Statistics* (2003) 15 <http://www.londonstockexchange.com/NR/rdonlyres/1D1B3D0F-2C59-431E-B22D-A9DC54923312/0/2834.pdf>. See also Ranald Mitchie, *The London Stock Exchange: A History* (2001) ch 12.

48 New York Stock Exchange Inc, *Fact Book Online* (2004) <http://www.nysedata.com/factbook/viewer_edition.asp?mode=table&key=2672&category=12>.

49 National Statistics, *Share Ownership: A Report on Ownership of Shares as at 31st December 2003* (2004) 9 <http://www.statistics.gov.uk/downloads/theme_economy/ShareOwnership2003.pdf>.

Unit trusts	1.3	2.9	4.1	3.6	5.9	6.8	6.7	1.7	2.0
Banks	1.3	1.7	0.7	0.3	0.7	0.4	0.1	1.4	2.2
Investment trusts[50]	11.3	10.1	10.5	6.8	1.6	2.0	1.9	2.1	2.3
Other financial inst					1.1	2.3	2.0	4.6	11.1
Total	30.3	35.9	48	57.9	58.5	61.2	56.3	48.5	51.0

During the 1980s, there was a similar removal of restrictions on capital flow in Australia. The pension system was changed from a 'pay as you go' to a 'funded' system and other financial deregulation took place. As in the UK and the US, these reforms led to large amounts of funds flowing to Australian institutional investors.[51] However, the institutional ownership patterns of listed companies evident in the UK and US are not repeated in Australia.

In 1997, Australian institutional investors owned approximately 35% of the Australian listed share market.[52] This compares with approximately 56% held by UK institutions in the UK listed market and approximately 43% held by US institutions in the US listed market. The pattern also differs as regards foreign investment. Foreign institutional investors additionally held approximately 10% and 32% of the shares in US and UK listed companies by 2002–03.[53] Accurate figures for foreign institutional investment in Australian listed companies are hard to find. This is because of the large number of Australian listed companies that are part-owned subsidiaries of foreign companies. Stapledon put the overall foreign holdings at 29% in 1991[54] and 31.7% in 1997,[55] estimating that only 30–50% of that investment comprises overseas institutional investors holding listed company equities.[56] On these figures, in 1997, foreign institutional investors owned at most approximately 16% of the Australian listed share market. Stapledon thus estimated total institutional ownership in listed Australian companies at 45–50%.[57]

50 Until 1989, investment trusts were classified as 'other financial institutions'.

51 However, the increases in capital flow were not at the levels seen in the US and the UK: see below Table 2.

52 Geof Stapledon, 'Share Ownership and Control in Listed Australian Companies' (Working Paper, Melbourne Law School, The University of Melbourne, 1999) 6 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=164129>.

53 National Statistics, *Share Ownership: A Report on Ownership of Shares as at 31st December 2003* (2004) 7 (UK); New York Stock Exchange Inc, above n 48 (US).

54 Geof Stapledon, 'The Structure of Share Ownership and Control: The Potential for Institutional Investor Activism' (1995) 18 *University of New South Wales Law Journal* 250, 254.

55 Geof Stapledon, 'Share Ownership and Control in Listed Australian Companies', above n 52, 6.

56 Ibid 7.

57 Stapledon, 'Share Ownership and Control in Listed Australian Companies', above n 50, 7. See also Robert Baxt, Ian Ramsay and Geof Stapledon, 'Corporate Governance in Australia: The Evolving Legal Framework and Empirical Evidence' in Low Chee Keong (ed), *Corporate Governance: An Asia-Pacific Critique* (2002) 159, 173.

1 *The Institutional Environment*

It thus appears that institutional investors have a significant presence in the Australian listed market, albeit a smaller one than that in the UK and the US. There should be some tension between the interests of blockholders (with the emphasis on private rent extraction and non-financial considerations) and the interests of arm's-length shareholders, such as institutional investors (with the emphasis on share value maximisation). The presence of institutional investors should diminish small shareholder inaction as the institutions have the sophistication and resources to analyse a company's behaviour on their behalf. Thus, this article now turns to examine whether institutional investors have the ability to impose their expectations on Australian listed companies. This may not be crucial to classifying the system of corporate governance of Australian listed market as an insider or outsider system. However, it should provide some evidence of whether blockholders are in fact exercising control, as they would be unlikely to give up that control without a fight.

In general terms, even where institutional investors are unhappy with the focus of a company's activities, they face a number of difficulties in coordinating their objections. From the outset, their individual focuses may differ: some may be income focused, others may be focused on capital appreciation and others may invest according to an index formula. Even where all are united in their unhappiness, their options may differ. Some may simply use exit as an option. Others may have institutional disincentives to act except in extreme circumstances.[58] If other parts of a fund manager's company provide services to the company in which investments are made, conflicts of interest may make it reluctant to intervene. There is also the significant issue of 'free riding': institutional investors do not want to dedicate time and funds to interventions that create value for rivals. Additionally, while most major institutional investors investing in the UK or the US have a presence there, this is not the case in Australia. Many of the institutional investors in the Australian listed market that are based in the UK and the US have their Australian equities managed from Hong Kong and San Francisco respectively.[59] Distance may thus be a factor that affects the ability of foreign institutional investors to participate actively in corporate control disputes.

Despite the difficulties of coordinated action, at times of crisis institutional investors in the UK and the US do sometimes form what John Scott has described as a 'constellation of interests'.[60] At these times of crisis, institutional pressure can build to effect policy change, as the board of directors of BT Group plc found when it attempted to form an alliance with MCI Communications Corp

[58] For example, performance measures based on an index or the presence of competing funds will usually make fund managers reluctant to bear the costs of monitoring: see Edward Rock, 'The Logic and (Uncertain) Significance of Institutional Shareholder Activism' (1991) 79 *Georgetown Law Journal* 445; Bernard Black and John Coffee, 'Hail Britannia? Institutional Investor Behaviour under Limited Regulation' (1994) 92 *Michigan Law Review* 1997.

[59] Stapledon, 'The Structure of Share Ownership and Control', above n 54, 256.

[60] Scott, above n 1, 48–52.

in the face of institutional disapproval.[61] Institutional investors can even effect the removal of a director, as Cedric Brown of British Gas plc,[62] Charles Saatchi, the founder of Saatchi & Saatchi plc,[63] David Montgomery of Mirror Group plc,[64] and recently Michael Green of ITV plc[65] and Michael Eisner of The Walt Disney Co found to their cost.[66] Moreover, anecdotally, it seems that there is a large amount of institutional investor pressure brought to bear behind the scenes in the UK and the US that does effect change.[67] Since the 1980s, one key feature of the outsider systems in the UK and the US has been the emergence of a body of institutional investors sufficiently large to outweigh the difficulties of coordinated action.[68] In the UK context, Stapledon has suggested that coordinated action to remove management requires a constellation of at least four institutional investors amounting to 20–30% of the equity.[69]

However, in the Australian context, while there have been very high profile examples of institutional investor activism, they have not been particularly successful. Prior to the wave of corporate scandals in the late 1980s, institutional investors in Australia were largely inactive. As Henry Bosch describes it:

> Before the crash of 1987, the term 'corporate governance' was rarely used in Australia and few people gave much thought to the concepts now covered by it. Shareholders were essentially passive … Institutional shareholders paid almost no attention to the way that companies were governed, and if they were dissatisfied with one of their investments, they took the 'Wall Street Walk' and sold their shares.[70]

As a result of major corporate governance failures in the Australian listed markets in the late 1980s, the early 1990s saw a number of aggressive institutional investor campaigns to bring about reform. Such campaigns took place against some of the worst offending surviving companies, including Darrell James Ltd ('Darrell James'),[71] News Corporation Ltd[72] and Coles Myer Ltd

[61] Kristi Essick, 'BT's Abandoned Merger' (1997) 19(46) *InfoWorld* 76; 'Snatching BT's Bride' (1997) 345(8037) *Economist* 19.

[62] See John Parkinson, *Corporate Power and Responsibility: Issues in the Theory of Company Law* (1993).

[63] See Melvyn Marckus, 'Saatchi Anger at "Takeover"', *The Times* (London), 4 January 1994, Business 21.

[64] Anne-Marie Crawford, 'Mirror Group to Pursue Merger as Monty Goes', *Marketing* (London), 29 January 1999, 1.

[65] See Jeff Randall, 'Why Michael Green Had to Go', *BBC News (UK Edition)*, 21 October 2003 <http://news.bbc.co.uk/1/hi/business/3210372.stm>.

[66] Michael Eisner was not removed from the board but was removed as the Chairman of the board. See 'Eisner Removed as Disney Chairman, Remains CEO', *CBC News*, 3 March 2004 <http://www.cbc.ca/stories/2004/03/03/business/disney_040303>.

[67] Rock, above n 58 (US); Black and Coffee, above n 58 (UK).

[68] There is less scope for coordination in the US than there is in the UK because large US institutional investors do not own blocks of shares in companies that are as large as those held by their UK counterparts: see Stapledon, *Institutional Shareholders and Corporate Governance*, above n 42, 106–16.

[69] Stapledon, *Institutional Shareholders and Corporate Governance*, above n 42, 106–16.

[70] Henry Bosch, 'The Changing Face of Corporate Governance' (2002) 25 *University of New South Wales Law Journal* 270, 273.

[71] See Ian McIlwraith, 'Shareholder Revolt Rocks Darrell James', *Australian Financial Review* (Sydney), 9 August 1991, 16.

('Coles Myer').[73] This indicates that institutions were certainly more active than before and is often used as evidence that institutions have been active in bringing about corporate governance reform. However, their ability to bring about long-term change through direct intervention seems negligible.[74] In the case of Darrell James, the reforming institutions were comprehensively defeated by the concerted efforts of family blockholders and, ironically, the support of a large institutional investor.[75]

2 *The Coles Myer Institutional Interventions (1995–2002)*

Many Australian institutional campaigns have a common feature, namely concern at the extent to which blockholders can engage in private rent extraction. The Coles Myer institutional interventions from 1995–2002 provide a good example of the tension between blockholders and institutions.[76] Coles Myer is the largest retail group in Australia. Its shareholding is typical of Australian listed companies in that it is generally dispersed but with some significant blockholders. Crucially, those blockholders have historically exerted high levels of control. The Coles Myer institutional intervention in 1995, which followed the 'Yannon transaction', became a major focus of the movement for corporate governance reform. Solomon Lew, the chairman of Coles Myer, held a large block of shares in the company. He was forced to step down from the chairmanship after it was revealed that Coles Myer was financially assisting a shelf company called Yannon Pty Ltd ('Yannon'). The controversy arose when Yannon bought shares in Premier Investment Pty Ltd ('Premier Investment'), a company through which Solomon Lew controlled his shareholding in Coles Myer. Premier Investment issued the shares to Yannon to assist in funding Premier Investment's purchase of nearly 10% of the issued share capital of Coles Myer. In effect, Coles Myer appeared to be assisting one of its major shareholders and chairman to increase his shareholding in the company significantly. Institutional investors were also disturbed by the extent to which companies connected to Solomon Lew were major suppliers to Coles Myer and by the fact that companies owned by his family were also in direct competition with Coles Myer.

However, it is difficult to see what real change this so called 'boardroom revolution'[77] effected: Solomon Lew remained on the board and continued to engage in related party transactions. In 2002, Solomon Lew's direct interventions in the management of the company and simmering discontent about the size of his related party transactions forced institutions and other blockholders to

[72] See Stapledon, *Institutional Shareholders and Corporate Governance*, above n 42, 192–5, 198–9.

[73] See Malcolm Maiden, 'Trapped in a Maze of Their Making', *The Age* (Melbourne), 14 September 2002, Business 1.

[74] As an example of the largely negative view of Australian institutional interventions, see Jennifer Hill, 'Visions and Revisions of the Shareholder' (2000) 48 *American Journal of Comparative Law* 39, 73.

[75] McIlwraith, above n 71.

[76] For a good overview of the whole saga, see Maiden, above n 73. See also Hill, above n 74, 75–7.

[77] Bosch, above n 70, 275.

act to remove him from the board. They succeeded only after a protracted battle in the media for the hearts and votes of the smaller shareholders. It is important to note here that this institutional investor action was not an action against related party transactions per se, which are rife in Australian listed companies.[78] Rather, it was against one particular director whom the institutions and, crucially, other family blockholders decided had gone too far. Other Coles Myer directors who engaged in substantial related party transactions remained on the board unopposed.

In many ways, the Coles Myer interventions are typical of institutional interventions in Australia. First, coordination is a problem as the institutions may have differing goals. This is illustrated by the fact that there were institutional investors on both sides of the Darrell James intervention.[79] Second, even where coordination problems are overcome, it appears that institutions acting in concert do not yet hold sufficient shares in listed companies to bring about change on their own. Third, if the blockholders are united, the institutions are helpless no matter how just the cause. Fourth, while institutions can bring about change if they act in concert with a family or corporate blockholder, the change will be temporary and limited because of their differing long-term interests. As Stapledon concluded in 1995, 'almost half of Australia's listed companies have a non-institutional shareholder which is in a position of effective or absolute control.'[80]

As a result of these difficulties, institutions have tried, with some success, to bring about new legislative and listing disclosure initiatives.[81] Nevertheless, corporate governance standards in Australian listed companies are not held in high regard by the institutional investment community. In 2001, Russell Reynolds Associates Inc surveyed the 300 largest institutional investors in six of the world's stock exchanges and asked whether companies in their countries adhered to sound corporate governance practices. Japan came last with 97% responding 'no', but Australia came second last with 63% responding 'no'.[82]

This seems to be reflected in the asset allocation strategies of Australian institutional investors. As in the UK and the US, in Australia there has been a massive growth in the funds flowing to institutional investors (see Table 2). However, there has not been a corresponding flow of funds into the Australian listed market. Figures from 1993 reveal that Australian institutions only allocated 28% of their institutional assets to Australian equities, compared with 50–60% in the UK.[83] By 1997, those figures for Australian institutional investor assets had risen to 35% while the UK figures remained static.[84] This is not to suggest that

[78] See below Part IV(B).
[79] See above n 75 and accompanying text.
[80] Stapledon, 'The Structure of Share Ownership and Control', above n 54, 273.
[81] Bosch, above n 70, 275.
[82] Russell Reynolds Associates Inc, 'Russell Reynolds Associates' Survey Finds Increase in Institutional Investor Activism and Influence' (Press Release, 19 June 2001) <http://www.russellreynolds.com/news/prnewsitem.asp?news=192>. See also Leon Gettler, 'Our Bosses Encourage a Culture of Blame and Blind Conformity, Study Finds', *The Age* (Melbourne), 24 July 2003, Business 1.
[83] Stapledon, 'The Structure of Share Ownership and Control', above n 54, 255.
[84] Stapledon, 'Share Ownership and Control in Listed Australian Companies', above n 54, 7.

there is a proper weighting for such investment. However, compared with the two major outsider systems, Australian institutional investors have chosen to remain outside the Australian listed market because, it is submitted, it has an insider system of corporate governance.

Table 2: Financial Assets of Institutional Investors in Australia, the UK and the US[85] (Expressed as a Percentage of Gross Domestic Product)

	1992	1993	1994	1995	1996	1997	1998	1999	2000
Aust	61.6	71.9	65.9	86.2	92.4	105.2	115.6	127.9	131.2
UK	131.3	163.0	143.8	164.0	173.4	195.5	203.6	226.7	—
US	127.2	136.3	135.9	151.9	162.9	178.4	192.0	207.3	195.2

B *Private Rent Extraction*

The evidence on private rent extraction in Australian listed companies also suggests that blockholders are exerting control. In 2003, GovernanceMetrics International Inc conducted a wide-ranging corporate governance review of the largest 50 listed companies in Australia. It was troubled by the large number of related party transactions, described as 'astounding by US or UK standards.'[86] Perhaps more worrying was the fact that only 21 of the companies surveyed had a policy of board scrutiny of related party transactions.[87]

Lucian Bebchuk has suggested that a key determinant of whether an outsider system will emerge is whether there are significant private benefits available to the controllers of listed companies.[88] If there are significant benefits, they have little incentive to give up control and an outsider system will not emerge. In the Australian context, this suggestion has been tested by Lamba and Stapledon.[89] Having established that there were large numbers of blockholders present in Australian listed companies, they found that

> there is a positive and highly statistically significant relationship between the level of related party transactions and whether the blockholder is a widely held corporate entity or a family entity … Interestingly, there is no relationship between the level of related party transactions and the likelihood of the blockholder being a government entity, that is, either the Commonwealth of Australia, a State of Australia, or an overseas government. Thus, higher levels of private benefits are directly related to the likelihood that the controlling block-

[85] 'Recent Trends: Institutional Investor Statistics' (2001) 80 *Financial Market Trends* 45, 46.

[86] Florence Chong, 'Top 50 Guilty of In-House Deals', *The Australian* (Sydney), 10 June 2003, 18. In one company, related party transactions accounted for almost 18% of its revenue.

[87] See GovernanceMetrics International Inc, *GMI Ratings on Australia's ASX50* (2003).

[88] Bebchuk, 'A Rent-Protection Theory of Corporate Ownership and Control', above n 38. See also Franks and Mayer, 'Ownership and Control of German Corporations', above n 38.

[89] Lamba and Stapledon, above n 5.

> holder will either be a corporate entity or a family entity, but not a government entity. … In particular, where private benefits are comparatively high, the company is more likely to have a blockholder with a controlling stake.[90]

The evidence from the Australian listed market thus appears to support the Bebchuk thesis: blockholders have an incentive to remain in control because of the private benefits that it confers.

However, while the thesis explains why blockholders have an *incentive* to remain in control, it fails to explain why blockholders can *retain* such control. In particular, it does not explain why pressures from the market for corporate control and the disclosure regime do not operate to diminish the ability of blockholders to retain control. However, evidence of a weak market for corporate control and a weak disclosure regime would help to explain why blockholder control is not affected by market pressures.

C *The Market for Corporate Control*

In outsider systems, takeovers are viewed as an effective method of managerial discipline.[91] As such, the market for corporate control in Australian listed companies should offer some insight into the type of governance mechanisms in existence within listed companies. An absence or low level of hostile takeover activity may indicate that a market discipline present in outsider systems is lacking in the Australian listed market. One explanation for this is that blockholders are exercising a key control power: whether to sell the company or not. As long as the blockholders are in control, management decisions and blockholder activities that have an adverse effect on share price will not result in a hostile takeover. Hence, there is no market restraint on private rent extraction or management discretion, and management has a significant interest in ensuring that blockholder concerns are met.

At first sight, the presence of significant blockholders within Australian listed companies seems to suggest that a hostile takeover would prove difficult as the blockholder would oppose any change that might lessen its control. In 1995, Stapledon concluded that, on the basis of their concentrated ownership patterns, 40–50% of Australian listed companies were immune to hostile takeover.[92] However, one study of US takeovers in the 1980s found that while the presence of a blockholder associated with management significantly reduced the chances of a successful hostile takeover, there was no such reduction if the blockholder was not affiliated with management.[93] This suggests that the presence of

[90] Ibid 24–5 (citations omitted).

[91] See, eg, Michael Jensen and Richard Ruback, 'The Market for Corporate Control: The Scientific Evidence' (1983) 11 *Journal of Financial Economics* 5. This view is not without its critics: see Andy Cosh and Paul Guest, 'The Long-Run Performance of Hostile Takeovers: UK Evidence' (Working Paper No 215, ESRC Centre for Business Research, University of Cambridge, 2001) 4–5, 30–1 <http://www.cbr.cam.ac.uk/pdf/WP215.pdf>.

[92] Stapledon, 'The Structure of Share Ownership and Control', above n 54, 270. He considered the same percentage immune to institutional intervention.

[93] Anil Shivdasani, 'Board Composition, Ownership Structure and Hostile Takeovers' (1993) 16 *Journal of Accounting and Economics* 167.

blockholders does not necessarily impede hostile takeovers: it depends on their relationship with management. Hence, the strength of the market for corporate control in Australian listed companies may provide a useful indicator of whether blockholders are exercising a key control power and the closeness of their relationship with management.

Inquiry was initially hampered by the surprising lack of empirical work by corporate lawyers on the market for corporate control in Australian listed companies.[94] Most of the empirical work covers total takeovers of both private and public companies. For example, Ian Ramsay estimated that there was a total of 289 takeovers in 1988, of which 24% were opposed, and that this had declined significantly by 1991 to 86 takeovers, of which 26% were opposed.[95] However, data relating to takeovers of private companies says little about the market for corporate control as the shares of such companies are not publicly available and their transfer is often subject to restrictions.

In a larger study over the course of 2002–03, Alan Dignam conducted a survey of hostile takeovers where the target was an Australian listed company (see Figure 1).[96] He found that in the 10 years from 1992–2001, there were 401 takeovers of Australian listed companies. Only 29, or 7.2%, of those takeovers were successful hostile bids. In comparison, Andy Cosh and Paul Guest found that in the UK for the period 1988–98, successful hostile bids averaged just over 20% of total listed takeover activity.[97] In the US for the period 1980–96, the figure was 21%.[98] Dignam also found that from 1992–2001, the directors of Australian listed companies successfully fought off 46 hostile bids, or 61.3% of total hostile bids.[99] This was very different from the situation in the US: while management defences were more common than in Australia, they generally resulted in a higher price being paid for the shares rather than defeat of the hostile bid.[100] In the UK, the London Stock Exchange *Listing Rules* and the rules of the Takeovers Panel are aimed at ensuring management defences are not utilised.[101] This seems to suggest in the Australian context that blockholders and management have a close relationship. It thus appears that Stapledon was correct in his analysis and that blockholders are not easily dislodged. However, his figures of 40–50% immunity seem a little conservative in light of Dignam's data.

94 There have been studies by economists but they have largely focused on managerial motivation: see, eg, Peter Eddey and Roger Casey, 'Directors Recommendations in Response to Takeover Bids: Do They Act in Their Own Interests?' (1989) 14 *Australian Journal of Management* 1.

95 Ian Ramsay, 'Corporate Governance, Shareholder Litigation and the Prospects for a Statutory Derivative Action' (1992) 15 *University of New South Wales Law Journal* 149, 154.

96 See Alan Dignam, 'The Takeovers Panel and the Market for Corporate Control in Australian Listed Companies' (2005) 23 *Company and Securities Law Journal* 59.

97 Cosh and Guest, above n 91, 36. In fact, it averaged 23% for the entire period from 1970–98.

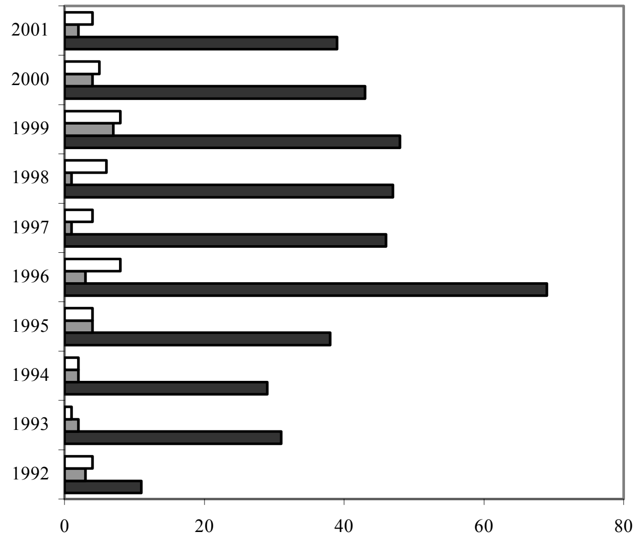
98 G William Schwert, 'Hostility in Takeovers: In the Eyes of the Beholder?' (2000) 55 *Journal of Finance* 2599, 2609.

99 The survey does not examine what action directors may have taken to defeat a takeover. It simply notes the correlation between the directors' recommendation and the shareholders' action.

100 Schwert, above n 98, 2624–32, 2638–9. On the range of defences commonly used in the US, see Robert Comment and G William Schwert, 'Poison or Placebo? Evidence on the Deterrence and Wealth Effects of Modern Anti-Takeover Measures' (1995) 39 *Journal of Financial Economics* 3.

101 See generally Lowry and Dignam, above n 40, ch 5.

Figure 1: Hostile Takeovers of Australian Listed Companies (1992–2001)[102]



	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Successful Defence	4	1	2	4	8	4	6	8	5	4
Successful Hostile	3	2	2	4	3	1	1	7	4	2
Total Number of Listed M&A	11	31	29	38	69	46	47	48	43	39

The Australian listed market is therefore characterised by a small amount of hostile takeover activity, a concomitantly large number of friendly transactions and a very successful record of management in fighting off hostile bids. These characteristics suggest not only a strong relationship between management and blockholders, but also that a market discipline mechanism present in the UK and the US is absent from the Australian listed market. Blockholders exercise control over the key decision as to the sale of the company.

V BLOCKS TO INFORMATION FLOW

As discussed in Part II, if there is insufficient public information available, the close and private relationships of an insider system will arise rather than the arm's-length relationships of an outsider system. Evidence of the existence of significant blockholders, low voting levels, institutional investor powerlessness, private rent extraction and small numbers of hostile takeovers points to such close and private relationships and consequently to a systemic tendency towards

102 Alan Dignam, 'The Takeovers Panel and the Market for Corporate Control in Australian Listed Companies' (2005) 23 *Company and Securities Law Journal* 59.

an insider system. In this Part, this article examines evidence of significant blocks to information flow as this may be crucial in determining why such insider relationships have arisen and persisted in Australian listed companies.

Of all the shareholder protection norms, a properly functioning disclosure regime is crucial to ensuring that channels of information flow remain unblocked. This in turn influences corporate governance outcomes.[103] Indeed, the UK Department of Trade and Industry's Company Law Review Steering Group suggests a disclosure regime imposes a more effective discipline on management than the market for corporate control, as non-compliance will be punished when the company returns to the capital markets to raise funds.[104]

A *Does Law Matter?*

In an influential set of articles running from 1998–2003, La Porta et al argued in favour of the 'law matters' thesis, namely that the level of legal protection for shareholders is the key factor in determining corporate governance outcomes.[105] Examining a wide range of countries, they found that where there is weak investor protection, public companies have concentrated ownership patterns. Conversely, where there is strong legal protection, an outsider system will emerge that is more likely to facilitate private sector investment. La Porta et al suggested that weak investor protection has 'adverse consequences for financial development and growth'.[106]

As Cheffins pointed out, the strong subtext is that insider corporate governance systems are underdeveloped and that the outsider system is the superior model.[107] Movement towards the superior model is said to be possible by adopting outsider system shareholder protection norms. Cheffins has criticised the work of La Porta et al for paying little attention to the social, institutional and cultural settings within which these insider systems arose.[108] Moreover, he has

103 See generally Leland and Pyle, above n 8.

104 See Company Law Review Steering Group, *Modern Company Law for a Competitive Economy: Developing the Framework* (2000) [3.164] <http://www.dti.gov.uk/cld/claw_2_3.pdf>.

105 Rafael La Porta et al, 'Law and Finance' (1998) 106 *Journal of Political Economy* 1113; La Porta, Lopez-de-Silanes and Shleifer, 'Corporate Ownership around the World', above n 21; Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer, 'What Works in Securities Law?' (Working Paper No 9882, National Bureau of Economic Research, 2003) <http://www.nber.org/papers/w9882>. There are others who have also put forward this view: see, eg, Franco Modigliani and Enrico Perotti, 'Protection of Minority Interest and the Development of Security Markets' (1997) 18 *Managerial and Decision Economics* 519; Bernard Black, 'The Core Institutions That Support Strong Securities Markets' (2000) 55 *Business Lawyer* 1565; Black, 'The Legal and Institutional Preconditions for Strong Securities Markets', above n 9.

106 La Porta et al, 'Law and Finance', above n 105, 1152.

107 Brian Cheffins, 'Corporate Law and Ownership Structure: A Darwinian Link?' (2002) 25 *University of New South Wales Law Journal* 346, 355. That view was made explicit in a paper to which Andrei Shleifer, one of La Porta's colleagues, contributed: see Mike Burkart, Fausto Panunzi and Andrei Shleifer, 'Family Firms' (Discussion Paper No 1944, Harvard Institute of Economic Research, Harvard University, 2002) <http://post.economics.harvard.edu/hier/2002papers/HIER1944.pdf>.

108 See Cheffins, 'Corporate Law and Ownership Structure', above n 107, 378.

argued that they were naïve in assuming that the ideal has been achieved in the outsider system.[109]

There is also the possibility that La Porta et al have misunderstood the importance of shareholder protection in the emergence of outsider systems. While there can be little doubt about the observation that outsider systems *have* strong investor protection, this does not mean that the existence of shareholder protection *causes* the emergence of an outsider system. Indeed, John Coffee has suggested that the results of La Porta et al may actually reveal that developed markets are a *precondition* for the emergence of strong shareholder protection.[110] Thus, taking a snapshot of current shareholder protection in a particular outsider system could be misleading: it may have emerged after the outsider system was already in place. Coffee's point is compelling given the way outsider systems emerged in the UK and the US. In both countries, the systems emerged without a protective legal environment for shareholders. Rather, the quality control function within the marketplace was fulfilled by the stock exchanges in London and New York, and the brokers attached to them.[111] These private institutions promoted voluntary disclosure and self-dealing rules that provided a certain integrity for the market and those investing in it. Thus, by the time the UK and US had formal legal protection for shareholders, an outsider system had already emerged.[112]

In Australia, blockholders have a dominant presence in the listed market and engage in private rent extraction while protected from the market for corporate control. According to the law matters thesis, this suggests that shareholder protection is weak. However, the level of formal legal protection is at least comparable to that in the UK and the US.[113] Thus, the Australian evidence poses a difficulty for the law matters thesis. If Coffee's criticisms are correct, one should look to private sector institutions, such as the stock exchanges and their brokers, to see if they have failed to carry out similar quality control activities to their UK and US counterparts.

Cheffins has argued that there is some evidence that, as in the UK and the US, brokerage houses in Australia provided some level of quality control and that the stock exchanges had higher voluntary disclosure standards than legally required.[114] However, disclosure standards were not as high as in the UK or US

[109] Ibid.

[110] John Coffee, 'The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control' (2001) 111 *Yale Law Journal* 1, 25–9. This was something of an about-face for Coffee, as he had previously agreed with the law matters thesis: see John Coffee, 'The Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications' (1999) 93 *Northwestern University Law Review* 641.

[111] Cheffins, 'Comparative Corporate Governance and the Australian Experience', above n 6, 26.

[112] See Brian Cheffins, 'Does Law Matter? The Separation of Ownership and Control in the United Kingdom' (2001) 30 *Journal of Legal Studies* 459, 482; Coffee, 'The Rise of Dispersed Ownership', above n 110, 25–9.

[113] Lamba and Stapledon, above n 5, 9.

[114] Cheffins, 'Comparative Corporate Governance and the Australian Experience', above n 6, 27. See also Merrett, 'Capital Markets and Capital Formation in Australia, 1890–1945', above n 14, 198.

and, crucially, were not enforced by the stock exchanges or regulators. As Geoffrey de Q Walker stated in 1967:

> Company affairs are inaccurately and sometimes misleadingly reported, and there is nothing comparable to the United States Securities and Exchange Commission to supervise the methods of raising money from the public. Disastrous company failures due to fraud or incompetency are not uncommon.[115]

This was still the case even in the late 1980s.[116] It is only recently that the lobbying of institutional investors has brought about comparable legislative disclosure standards to those in the UK and the US.[117] However, continuing the historic trend, these disclosure requirements have not been properly enforced. Thus, one of the key differences between the UK and the US securities markets on the one hand and that of Australia on the other is securities regulation.

B *Australian Securities Regulation*

While it is clear that private sector bodies in Australia did not fulfil the same quality control function as in the UK and the US, there is another crucial difference. At a relatively early stage in the UK and the US, that quality control function was either enhanced or taken over by the state.[118] In contrast, in Australia prior to the 1990s, securities regulation was fragmented and very weak. That weakness was revealed in the late 1980s when Australia experienced a huge wave of corporate collapses. Trevor Sykes described it as follows:

> The boom saw a bunch of corporate cowboys financed to dizzy heights by greedy and reckless bankers. Large sectors of Australian industry changed hands. … The ensuing bust saw awesome destruction. … At the end, investors were left excoriating corporate cowboys such as Alan Bond, Christopher Skase and Laurie Connell. While these and other men deserved blame, it should have been spread more widely. Australia, after all, is no stranger to corporate cowboys. The country has had them in almost every decade of its existence.[119]

Raking over the ashes revealed that there was a jigsaw puzzle of regulation. There was no single national regulator, a *Corporations Law* not embodied in a single statute,[120] and six disparate state-based stock exchanges. The regulation was administered by eight corporate affairs commissioners at the state and territory level, each pursuing different priorities with largely inadequate powers

[115] Geoffrey de Q Walker, *Australian Monopoly Law: Issues of Law, Fact and Policy* (1967) 19.

[116] See generally Stephen Bartholomeusz, 'After Enron: The New Reform Debate' (2002) 25 *University of New South Wales Law Journal* 580.

[117] Bosch, above n 70, 275.

[118] In the UK, the Bank of England enhanced the quality control function. In the US, the Securities and Exchange Commission took over the quality control function completely. The Bank of England had an unusual role as regards the LSE: it did not formally regulate it, but rather it 'encouraged' responses to concerns about disclosure standards. On the history of the self-regulatory system in the UK, see Alan Dignam, 'Exporting Corporate Governance: UK Regulatory Systems in a Global Economy' (2000) 21 *Company Lawyer* 70.

[119] Trevor Sykes, *The Bold Riders: Behind Australia's Corporate Collapses* (1994) 1–2.

[120] The *Corporations Law* was in fact a co-operative scheme consisting of the *Corporations Act 1989* (Cth) and the Corporations Acts of the states and the Northern Territory (eg, the *Corporations (Victoria) Act 1990* (Vic)).

and funds, and each applying different corporations laws. Paul Barry commented that 'Australia also had itself to blame for what certain businessmen had been allowed to get away with, because its system of corporate regulation in the 1980s was pathetically inadequate.'[121]

As Alan Cameron stated, reforms took place following the 1980s:

> Attempts had been made at intervals to introduce a national regulator, in order to increase the effectiveness of regulation, but they failed for a mixture of political reasons, the reluctance of the states in particular to give up a source of revenue, and constitutional problems … But the excesses [of the 1980s] finally produced agreement on a deal for the takeover by the federal government.[122]

The reform process eventually produced a national securities regulator — the Australian Securities and Investments Commission ('ASIC') — and a single corporate statute — the *Corporations Act 2001* (Cth). ASIC is empowered to regulate securities and investments, enforce the business and listing rules of financial markets (including the ASX), police the *Corporations Act* and investigate suspicious corporate conduct.[123]

While this new national regulator is an improvement on the previous fragmented state-based system, it is still the product of a complex constitutional compromise between the state and Commonwealth governments.[124] ASIC does not have exclusive control of all aspects of securities regulation. While securities regulation is generally covered by ASIC, matters relating to enforcement — including enforcement policy — are dealt with by the Commonwealth Director of Public Prosecutions and the Commonwealth Attorney-General.[125] The banking industry is regulated by ASIC, but the Reserve Bank of Australia ('RBA') and the Commonwealth Department of the Treasury have a roving regulatory role. The Australian Prudential Regulatory Authority ('APRA'), another national regulator, also regulates the banking industry. Pension funds are supervised by ASIC, APRA and the Australian Taxation Office. The insurance industry is regulated by ASIC, APRA and other state and Commonwealth bodies.[126] As part of the centralising process, in 1987 the state-based stock exchanges merged into a single body, the ASX, which demutualised in 1998. No provision was made for the relationship between the ASX and ASIC, although

[121] Paul Barry, *The Rise and Fall of Alan Bond* (1990) 289.

[122] Alan Cameron, 'Effective Enforcement: The Australian Experience' (Paper presented at the Second International Roundtable on Securities Markets in China, Shanghai, 6–7 June 2002) 5 <http://www.oecd.org/dataoecd/22/16/2755991.pdf>.

[123] See *Australian Securities and Investments Commission Act 2001* (Cth).

[124] On the constitutional complexity of corporations law in Australia, see Sandra Berns and Paula Baron, *Company Law and Governance: An Australian Perspective* (1998) 45–51.

[125] For most of the 1990s, ASIC had a very different view of enforcement from the Director of Public Prosecutions ('DPP') and the Attorney-General. The DPP and the Attorney-General wished to pursue criminal penalties for breaches of securities regulations while ASIC wished to take a softer approach and pursue civil penalties. This sent a damaging set of mixed signals to businesses about the consequence of regulatory breach. See Cameron, above n 122, 7–14.

[126] These include the RBA, the Commonwealth Department of the Treasury, the Motor Accident Authority of New South Wales, the Australian Taxation Office, the Australian Competition and Consumer Commission, the Private Health Insurance Administration Council and the Financial Reporting Council.

this problem has been partially resolved by a continuing Memorandum of Understanding.[127] In summary, ASIC cannot be called a 'single' regulator; rather, it is a 'lead' regulator.

The lack of clarity about the system is a weakness that was revealed in the regulatory failures surrounding a very recent series of corporate collapses.[128] A good example is provided by the collapse of the listed insurance company HIH Insurance Ltd in March 2001. This is Australia's largest corporate collapse to date. A royal commission into the collapse found that it was at least partly attributable to fragmented insurance and securities regulation.[129] APRA was also critically underfunded from its inception, which led directly to a loss of expertise and the undermining of regulatory capability and effectiveness.[130]

Australian listed companies have never been adequately regulated either by the private or state sector. This has meant that crucial institutions that affect corporate governance outcomes by facilitating information flow, such as the disclosure regime, have been neglected. While Australian listed companies are subject to a continuous disclosure regime, it has only been in place since 1994 and there is some doubt about its effectiveness.[131] Indeed, despite the fact that the management of many Australian companies state that ensuring compliance with companies regulation is an important part of their function, a survey conducted by Ernst & Young Australia in 2002 found that the state of compliance structures within many of the firms surveyed did not support that claim.[132] Similarly, while

[127] The Memorandum of Understanding gives ASIC the lead regulatory role: see ASIC, 'ASX Finalises Regulatory Link with ASIC' (Press Release, 23 September 1998) <http://www.asic.gov.au/asic/asic_pub.nsf/byheadline/98%2F292+ASX+finalises+regulatory+link+with+ASIC?openDocument>. In any case, the ASX is not viewed and does not see itself as having a primary role as a regulator: see Jan Eakin, 'ASX Defends Its Focus on Profit', *Sydney Morning Herald* (Sydney), 18 July 2002, 21.

[128] See Department of Foreign Affairs and Trade, *Changing Corporate Asia: What Business Needs to Know* (2002) vol 2, 219 <http://www.dfat.gov.au/publications/changing_corp_asia/>.

[129] Commonwealth, HIH Royal Commission, *The Failure of HIH Insurance* (2003) vol 1, chs 8–9 <http://www.hihroyalcom.gov.au/finalreport/>. APRA, ASIC, various state-based regulators, the Commonwealth Department of the Treasury and the RBA all have some authority for the regulation of insurance or a role in the running of APRA. For a summary of the report, see 'HIH Report', *The Weekend Australian Financial Review* (Sydney), 17–21 April 2003, 12–19.

[130] HIH Royal Commission, above n 129, vol 1, [8.5.5]. The report by John Palmer that was commissioned by APRA itself into the collapse of HIH is more directly critical of the underfunding that led to the loss of so much technical expertise. As it points out:

> another factor influencing the decision to target APRA's average salaries at the lower end of the general employment marketplace was a recommendation of the Wallis Inquiry, accepted by the Government, that the formation of an integrated regulator should generate appreciable cost savings, and guidance from the Treasury to those planning the new organisation that a reduction in overall costs of prudential supervision must be achieved by virtue of APRA's formation.

John Palmer, *Review of the Role Played by the Australian Prudential Regulation Authority and the Insurance and Superannuation Commission in the Collapse of the HIH Group of Companies*, (2002) [9.3.8] <http://www.apra.gov.au/Media-Releases/loader.cfm?url=/commonspot/security/getfile.cfm&PageID=5206>.

[131] See Jennifer Hill, 'Corporate Scandals across the Globe: Regulating the Role of the Director' in Guido Ferrarini et al (eds), *Reforming Company and Takeover Law in Europe* (2004) 225, 229–30.

[132] See Ernst & Young Australia, *National Compliance Survey Results* (2002). The 2003 survey reported significant improvement, however: Ernst & Young Australia, *National Compliance*

surveying compulsory proxy forms, Stapledon had to exclude 15% of his initial sample as they did not include information required by the *Corporations Law*.[133] He raised the question of whether ASIC or the ASX enforced this area at all. In a 2003 study of ASIC enforcement patterns, Helen Bird et al found that in relation to routine offences by public companies (such as failure to comply with disclosure requirements), ASIC adopted a hands-off approach.[134] They concluded that 'ASIC may have adopted a strategy of long-term co-operation with public companies to ensure their general compliance with the *Corporations Law* at the expense of routine infringements of that law.'[135] However, as Bernard Black has noted, lax enforcement undermines legal protection of investors.[136]

Overall, national level regulation is in its infancy in Australia. While ASIC does seem to be growing in stature, it will take some time and further regulatory reform before the system has the funding and the clarity of authority to operate effectively. The historic lack of compliance with companies regulation by companies and the adoption of a hands-off approach by ASIC suggest that the law matters thesis has something to offer: the introduction of a strong investor protection regime may accelerate movement to an outsider system of corporate governance in the Australian listed market.

VI Conclusions

The Australian listed market is characterised by:

- significant blockholders engaged in private rent extraction;
- institutional investor powerlessness;
- a strong relationship between management and blockholders, which results in a weak market for corporate control; and
- a historic weakness in public and private securities regulation, which allows the creation and perpetuation of crucial blocks to information flow.

These characteristics suggest that the system of corporate governance of the Australian listed market has been mischaracterised as an outsider system; rather, it tends towards an insider system.

Why has the system of corporate governance of the Australian listed market been misclassified? One suggestion is that it is currently in a state of flux, moving from an insider system to an outsider system as suggested by the law matters thesis.[137] There is certainly some evidence to support this hypothesis. In 2002, a change in the leadership of ASIC and increased funding led to the adoption of a policy of across-the-board enforcement of disclosure rules. In

Survey Results (2003) <http://www.ey.com/global/download.nsf/Australia/AABS_ComplianceSurvey2003/$file/compliance%20survey2003.pdf>.

133 Geof Stapledon, 'Voting Levels Remain Low in Australia' (2000) 84 *Governance* 6.

134 Helen Bird et al, 'ASIC Enforcement Patterns' (Discussion Paper, Centre for Corporate and Securities Regulation, The University of Melbourne, 2003) <http://cclsr.law.unimelb.edu.au/research-papers/ASIC%20Enforcement.pdf>.

135 Ibid 108.

136 Black, 'The Core Institutions That Support Strong Securities Markets', above n 105, 1577.

137 Cheffins, 'Comparative Corporate Governance and the Australian Experience', above n 6, 26–8.

February 2003, ASIC took court action for the first time in respect of non-disclosure: it filed proceedings against Southcorp Ltd seeking a declaration that its practice of giving selective briefings to favoured shareholders breached its continuous disclosure obligations, and a pecuniary penalty.[138] In November 2003, the parties reached a settlement under which Southcorp Ltd consented to the declaration being made, and the Federal Court subsequently ordered it to pay a pecuniary penalty of $100 000.[139]

ASIC's new enforcement policy has already resulted in a change in the way that listed companies treat information. By far the greatest effect of this new enforcement policy has been on companies wishing to return to the capital markets to raise further funds. Companies such as AMP Ltd and Tower Ltd have been forced to disclose negative information before attempting to raise fresh funds, which has resulted in a dramatic, negative effect on their share prices.[140] Additionally, in the 2002–03 reporting year, 27 listed companies had restrictions placed on their capital raising abilities because they failed to comply with financial reporting disclosure requirements.[141] In the same period, 89 listed companies had stop orders issued against them on new share issues because information was missing from prospectuses.[142] This policy change also seems to be having an effect on shareholder participation rates: 2003 saw the highest ever level of shareholder voting in widely held Australian listed companies.[143]

ASIC has also started to address disclosure problems surrounding related party transactions. Under the *Corporations Act*, directors are required to get shareholder approval for any related party transactions that are not at arm's length.[144] In reality, this means that the board can decide whether a transaction is at arm's length or not and disclose accordingly.[145] As a result, disclosures under the *Corporations Act* represent only the tip of the iceberg as regards related party transactions. In any event, ASIC found that almost three quarters of the docu-

138 See ASIC, 'ASIC Files Proceedings against Southcorp' (Press Release, 26 February 2003) <http://www.asic.gov.au/asic/asic_pub.nsf/byheadline/03-070+ASIC+files+proceedings+against+Southcorp?openDocument>.

139 See ASIC, 'Southcorp Settles with ASIC over Market Disclosure' (Press Release, 27 November 2003) <http://www.asic.gov.au/asic/asic_pub.nsf/byheadline/03-376+Southcorp+settles+with+ASIC+over+market+disclosure?openDocument>; *Australian Securities and Investments Commission v Southcorp Ltd [No 2]* (2003) 130 FCR 406.

140 See Anthony Hughes, 'Tower Loss Rocks Both Sides of Tasman', *The Age* (Melbourne), 22 May 2003, Business 1; Leonie Wood, 'Funds Blast "Climate of Fear"', *The Age* (Melbourne), 23 May 2003, Business 1. ASIC has also clamped down on suspicious disclosures made shortly after a capital raising: see Allison Jackson, 'Expected Child Cares Downgrade Sparks ASIC Probe', *The Age* (Melbourne), 22 May 2003, Business 1.

141 See ASIC, 'ASIC Acts on Late Disclosure' (Press Release, 17 July 2003) <http://www.asic.gov.au/asic/asic_pub.nsf/byheadline/03-224+ASIC+acts+on+late+disclosure?openDocument>. See also Gabrielle Costa, 'Investors Still Kept in the Dark over Bonus Payments, ASIC Says', *The Age* (Melbourne), 23 July 2003, Business 1.

142 See ASIC, 'Putting the Stop to Defective Prospectuses' (Press Release, 21 July 2003) <http://www.asic.gov.au/asic/asic_pub.nsf/byheadline/03-231+Putting+the+stop+to+defective+prospectuses+?openDocument>.

143 See Corporate Governance International Pty Ltd, above n 33, 8.

144 *Corporations Act* s 208(1).

145 For an overview of the regime, see Phillip Lipton, 'The Practice of Corporate Governance in Australia: Regulation, Disclosure and Case Studies' in Low Chee Keong (ed), *Corporate Governance: An Asia-Pacific Critique* (2002) 105, 111–18.

ments it examined that related to disclosures in the 2002–03 financial year failed to provide enough information to shareholders for them to make an informed decision.[146] Most commonly, that failure related to the value of the transaction.[147] In August 2004, ASIC began 'a campaign to crack down on related party disclosure documents'.[148] The recent 'CLERP 9'[149] amendments regarding continuous disclosure infringement notices and civil penalty liability for those involved in continuous disclosure breaches should accelerate this process.[150]

One of the issues raised by the HIH Royal Commission was the culture of complacency within the board of HIH Insurance regarding conflicts generally.[151] The Commission focused in particular on disclosure of related party transactions.[152] Related party transactions were common, but no procedures were in place to deal with them. Indeed, the chairman of the company did not see this as part of his role at all.[153] The Commission described how one director considered that his personal interests were so well known that he had no need to disclose them.[154] Another failed to provide sufficient information to allow the other directors to decide whether a related party transaction that he disclosed was in the company's interests.[155] As a result of this complacency, the Commission recommended that the disclosure requirements of the *Corporations Act*, the relevant accounting standards and the ASX *Listing Rules* be reviewed as a matter of priority to ensure clear and comprehensive disclosure of directors' remuneration and other benefits in whatever form.[156] The CLERP 9 amendments on remuneration of directors and executives, and disclosure rules, reflect this concern.[157]

In essence, since 2002, key institutions regulating the Australian listed market have acted to unblock channels of information flow. As a result, the environment

[146] ASIC, 'ASIC Acts on Conflicts of Interest' (Press Release, 22 July 2003) <http://www.asic.gov.au/asic/asic_pub.nsf/byheadline/03-232+ASIC+acts+on+conflicts+of+interest?openDocument>. See also ASIC, 'ASIC Acts on Conflicts of Interest in Public Companies' (Press Release, 8 January 2004) <http://www.asic.gov.au/asic/asic_pub.nsf/byheadline/04-006+ASIC+acts+on+conflicts+of+interest+in+public+companies?openDocument>.

[147] ASIC, 'ASIC Acts on Conflicts of Interest', above n 146. For other common defects, see ASIC, 'ASIC Cracks Down on Related Party Disclosure' (Press Release, 10 August 2004) <http://www.asic.gov.au/asic/asic_pub.nsf/byheadline/04-257+ASIC+cracks+down+on+related+party+disclosure?openDocument>. For examples of where ASIC has taken action, see ASIC, 'ASIC Acts on Conflicts of Interest in Public Companies', above n 146.

[148] ASIC, 'ASIC Cracks Down on Related Party Disclosure', above n 147.

[149] Corporate Law Economic Reform Program Proposals for Reform, *Paper No 9* (2002) <http://www.treasury.gov.au/documents/403/PDF/Clerp9.pdf>.

[150] See *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (Cth) sch 6.

[151] HIH Royal Commission, above n 129, vol 3, [23.2.6].

[152] Ibid vol 3, [23.6].

[153] Ibid vol 3, [23.2.6].

[154] Ibid vol 3, [23.6.1].

[155] Ibid vol 3, [23.6.3].

[156] Ibid vol 1, [6.2.8] (Recommendation 1).

[157] See *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (Cth) schs 5, 7.

may become more favourable to securitisation than intermediation. The changes may thus be the catalysts that move the system of corporate governance of the Australian listed market towards an outsider system. If so, it would seem to endorse the law matters thesis that adopting shareholder protection norms is crucial to the emergence of an outsider system, so long as one accepts that some level of private or state enforcement is essential. However, in their most recent work, La Porta et al claimed that there is no evidence that state enforcement benefits stock markets and that there is strong evidence that laws facilitating private regulation through disclosure and liability rules enforceable by shareholders are the key factors.[158] If the corporate governance system of the Australian listed market is indeed moving towards an outsider system, this would support their earlier thesis. However, because the transition has been led by regulatory enforcement, this seems to run contrary to their latest work. Only time will tell and Australia may provide an interesting test case for both their claims.

Even if a change to an outsider system of ownership and control occurs, there may not necessarily be any benefit as a result. This is noted by Cheffins:

> Once it is recognised that the trade-offs between diffuse and concentrated ownership mean it cannot be taken for granted that the Berle-Means corporation is inherently superior, the Darwinian inferences that can be drawn from the law matters thesis need to be recast … In sum while the law matters thesis seems to offer a clear and urgent message for policy-makers, the practical realities of corporate ownership mean that the true situation is considerably more complex.[159]

Of course another view is that the corporate governance system of the Australian listed market is not in a state of flux at all: the view that it is an outsider system may simply be wrong. If so, a central assumption of Australia's recent reform process — that the reform initiatives from the UK and the US should be adopted in Australia — may be incorrect. This raises the possibility that rather than solving the corporate governance problems of the Australian listed market or converting its system of corporate governance to an outsider system, the reform process could in fact destabilise the market. It must be borne in mind that the reform process started in the 1980s was as a result of a massive wave of corporate failures, but that it did not stop a second series of such collapses in recent years. The failure to recognise that the corporate governance system of the Australian listed market has more in common with insider systems than outsider systems could lead to further instability for Australia's corporate sector.

Corporate governance outcomes are the result of complex interactions between institutions that differ according to the cultural, social and economic conditions

[158] La Porta, Lopez-de-Silanes and Shleifer, 'What Works in Securities Laws?', above n 105, 16–18.

[159] Cheffins, 'Corporate Law and Ownership Structure', above n 107, 378. There is a vast literature (mostly from the US) advocating the superiority of outsider systems: see, eg, Henry Hansmann and Renier Kraakman, 'The End of History for Corporate Law' (2001) 89 *Georgetown Law Journal* 439. However, there is a growing dissenting view that, certainly in imperfect markets, insider systems are superior: see, eg, Franklin Allen and Douglas Gale, 'A Comparative Theory of Corporate Governance' (Working Paper No 03-27, Wharton Financial Institutions Center, University of Pennsylvania, 2002). Thus, movement of the corporate governance system of the Australian listed market to an outsider system may have negative effects.

in which they emerge. As well as the differences between the corporate governance systems of the UK and the US on one hand and Australia on the other, there are other key differences that are beyond the scope of this article. For example, the industrial relations system in Australia is very different from that in the UK and the US.[160] Australia's listed companies operate in an economy with very high labour standards. It may be that one reason Australian companies can maintain those labour standards is that they do not have the financial demands from their blockholders that UK and US companies have from their arm's-length shareholders. Adopting outsider norms could easily have a detrimental effect on the ability of Australian listed companies to support such high standards. This could be problematic in a country that is currently experiencing a very low birth rate,[161] with an ageing working population inclined to retire early,[162] reliant on attracting skilled labour from overseas and experiencing a wave of outward migration for the first time since the 1970s.[163]

Two major waves of corporate collapses in the Australian listed market indicate that it has urgent corporate governance problems. It is submitted that they stem from the nature of the market's insider system of corporate governance. The result of having blockholders exercising control is that management is protected from bad decisions. Historically, it has not had to disclose bad news. Even where disclosure is now required, the close relationship between management and blockholders ensures that a hostile bid is unlikely. Thus, as long as management does not interfere with blockholder interests, it goes largely unmonitored. Indeed, in companies where blockholders exert direct control, there is no accountability mechanism at all.

Blockholder control can have positive effects as it may encourage growth-oriented policies and stability. However, it can also encourage bad management practices. Unfortunately, these practices seem widespread in the Australian context. One international management comparison study in 2003 found that

> Australian managers lagged behind in 27 of 31 'causal factors' that help shape the culture of organisations. It found 87 per cent of Australian organisations had a culture of blame, indecision and mindless conformity.[164]

[160] See generally Jill Rubery and Frank Wilkinson (eds), *Employer Strategy and the Labour Market* (1994); Julian Franks and Colin Mayer, 'Capital Markets and Corporate Control: A Study of France, Germany and the UK' (1990) 10 *Economic Policy* 189. Another difference is the competition regime in Australia, which is designed to regulate competition in Australia's highly concentrated economy: see Robyn Carroll and Michael Thanos, 'Director Interlocks and Part IV of the *Trade Practices Act 1974* (Cth)' (1994) 22 *Australian Business Law Review* 411; Walker, above n 115, 14.

[161] Australian Bureau of Statistics, *Births*, ABS Catalogue No 3301.0 (2001) 6.

[162] Simon Kelly, Ann Harding and Richard Percival, 'Live Long and Prosper? Projecting the Likely Superannuation of the Baby Boomers in 2020' (Paper presented at the 2002 Australian Conference of Economists Business Symposium, Adelaide, 4 October 2002) 2 <http://www.natsem.canberra.edu.au/pubs/cp02/2002%5F011/cp2002_011.pdf>.

[163] Graeme Hugo, Dianne Rudd and Kevin Harris, 'Emigration from Australia: Economic Implications' (Information Paper No 77, Committee for Economic Development of Australia, 2001) <http://www.ceda.com.au/ResearchNew/Publications/CedaPubs/Emigration.html>.

[164] See Gettler, above n 82.

The solutions to corporate failures in outsider systems such as the UK and the US have been based largely on ensuring the accountability of management to shareholders. Such solutions would be unlikely to solve the accountability problem in the Australian context because part of the problem is that management is in reality accountable only to blockholders. Solutions that increase the accountability of management to shareholders may therefore only increase the accountability of management to blockholders. However, their interests differ significantly from those of arm's-length shareholders, such as small individual shareholders and institutional shareholders. While there are real corporate governance problems in the Australian listed market, adopting wholesale norms exclusively from the UK and the US runs the risk of not only failing to solve those problems but of actually making them worse.