

THE NEW AUSTRALIAN SYSTEM OF CORPORATE GOVERNANCE: BOARD GOVERNANCE AND COMPANY PERFORMANCE IN A CHANGING CORPORATE GOVERNANCE ENVIRONMENT

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Abstract

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This paper investigates the changing duties and responsibilities of boards and directors of Australian public companies. The corporate governance environment in Australia is currently going through a period of significant transformation raising the question of whether in this fluid and shifting environment company and board performance can still be assessed largely on the basis of profit, share price and dividends generated over the short term. These almost certainly will continue for some time to be the key metrics of company and board performance and it is hard to see how it could be otherwise. Nevertheless, a growing chorus of influential stakeholders is calling for the introduction of a more balanced and comprehensive suite of performance indicators that better reflect the realities of corporate governance early in the Twenty-first Century. The paper examines how these stakeholders are reshaping corporate governance in Australia and also calling for a reconsideration of the way in which performance is assessed.

Keywords: Corporate Governance, Boards and Directors, Shareholders, Stakeholders, Regulation, Risk, Culture, Climate Change, Social Licence to Operate, Social Responsibility, Sustainability, Ethics and Values, Whistleblowing, Anti-Bribery and Corruption

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1. INTRODUCTION

This paper considers the extent to which an Australian publicly-listed (public) company's performance can be attributed to the governance performance of its board. A primary question also addressed therefore is how company performance itself should be evaluated. Of particular interest will be whether, as Australia's system of corporate governance goes through a process of significant reformulation and change, the conventional metrics of profit, share price and dividends can any longer together be taken as the sole or most important and accurate gauge of a company's performance and by

extension a board's performance as well. It is obvious then that the paper addresses largely through an Australian lens the question of what indicators other than these conventional metrics can be used to ensure a more balanced and comprehensive picture of company and board performance is produced than has traditionally been possible. Even with its distinctly Australian focus, however, there are good grounds for believing that the relevance of any answers offered in the paper extends well beyond the Australian context to other countries and national economies. Just as in Australia so in other jurisdictions around the world, the question of what criteria should be used to

measure company and board performance is becoming an increasingly urgent one as company boards and executives confront a number of significant environmental, political and social challenges.

The following section critically reviews recent academic literature addressing the change and transformation through which corporate governance is going. The corporate governance literature is sometimes an agent of change, more often it tries to make sense of changes that are in process or that have already occurred. This change, and less frequently a deeper structural or systemic transformation, is an inevitable product of the ways in which company boards, executive managers, corporate regulators, shareholders and other key stakeholders have attempted to manage or mitigate the environmental, political, and social challenges and risks confronting the companies in which they have a stake. Change can also occur as these actors look to the future and seek ways of turning risks and challenges into opportunities or, when this is not possible, of nullifying them in some way. Often, change comes about as a result of influential actors trying to find ways of not allowing history to repeat itself thereby avoiding another disaster like the Global Financial Crisis. The Trump Presidency has thrown up challenges and risks on each of these levels and these have been registered in various ways at home in the United States and abroad in the countries it trades with (China is the obvious case in point). In the midst of all this change and transformation, corporate governance as a set of principles, a field of practice and an academic discipline has learned or been forced to evolve and adapt. The literature review is chiefly concerned with how this process of evolution and adaptation has unfolded.

After reviewing the literature, the paper moves on to provide a brief, introductory overview of the existing system of corporate governance in Australia. It then investigates and evaluates in considerably more depth the new (4th) edition of the Corporate Governance Principles and Recommendations (hereafter *Principles and Recommendations* or simply *Principles*). The Corporate Governance Council of the Australian Securities Exchange (ASX) first released the new edition in Draft form for stakeholder consultation and set 27 July 2018 as the closing date for submissions (the role of the Corporate Governance Council is explained in the section of Australia's existing corporate governance system). The Council then circulated a Consultation Paper in May 2018 and released the final version of the *Principles* in February 2019. This is due to come into force for financial years commencing on or after 1 January 2020. The paper's examination of the *Principles and Recommendations* (Draft and final versions) focuses on those sections that can potentially make an important contribution to current Australian and global debates about the criteria by which company, and board, performance should be measured. Of particular interest is the inclusion in the Draft of the new edition of the principles of the social licence to operate, acting in a socially responsible manner, and policies on whistleblowing and anti-corruption and bribery. The absence in the final version of any

explicit reference to the social licence to operate will receive particular attention.

Having reviewed the Consultation Draft and final version of the new edition of *Principles and Recommendations*, the chapter goes on to consider some of the more interesting and provocative responses to the governance implications of both versions of the document. It considers, in particular, the reaction to the two versions of the AICD, Australia's pre-eminent organisation representing company directors, the views of ASIC¹, Australia's chief corporate regulator (introduced in the following section), and the evaluations of ACSI, a large and influential organisation representing and advocating for Australian institutional investors and asset owners². These several perspectives and viewpoints together are helping to define the contours of the ongoing Australian and global debate about board governance and company performance, what performance means and how it should be measured, and about corporate governance and its role and purpose more generally.

2. THE CHANGING CORPORATE GOVERNANCE ENVIRONMENT: A REVIEW OF THE RECENT LITERATURE

There can be little doubt that corporate governance, both as a field of practice and an academic discipline, is undergoing significant change. This change is in response to a number of external environmental, political and social challenges that are forcing company boards and executive managers to rethink corporate strategies, objectives, ways of doing business and methods of engaging with the shareholders and other stakeholders of the companies they oversee. In short, and as this literature review seeks to reveal and explain, addressing these challenges is transforming the meaning, purpose and conduct of corporate governance. It is as well transforming the way in which board performance and company performance are evaluated. The corporation's purpose has in the process been going through a process of dramatic review and redirection as well.

In the United States the Trump Presidency, in particular Donald Trump himself, has compelled boards to rethink their approach to climate change and a range of significant social issues like same sex marriage and LGBTIQ rights. At the same time, it has forced boards, executive managers, investors and shareholders as well as other stakeholders, to start thinking about what the purpose of the corporation, especially their own but more generally as well, should be in this changing corporate governance environment. This in turn is having significant implications for companies' corporate social responsibility and risk management policies, stakeholder engagement strategies, and for the ethical business practices they adopt and how these are enacted (for an interesting exploration of CSR as a self-defence strategy against managerial discretion costs, see Villarón-Peramato, Martínez-Ferrero,

¹ It should be noted that ASIC made no formal or public response to the release of the final version of the 4th edition even though it had commented on the Draft.

² In full, AICD is the Australian Institute of Company Directors and ACSI is the Australian Council of Superannuation Investors.

García-Sánchez, 2016). Marcia Weldon, for example, argues that 'boards of socially responsible companies should not reverse course under the Trump Administration' but should instead 'serve stakeholder interests by staying the course even when legislative changes related to the environment, social issues, and corporate governance may allow firms to relax standards or eliminate programs' (Weldon, 2017; see also Bruner, 2018). This requires 'at a minimum' meaningful engagement with shareholders including full disclosure to them of the likely impacts of changes to environmental and social policies. At a more fundamental level, boards and senior managers have to ask themselves what they are willing to accept or tolerate as they pursue shareholder value, what they mean by shareholder value, and the extent to which both of these align with what shareholders actually want and expect (Weldon, 2017). In a provocative piece about 'letting Trump be Trump', Kelly Carter asks whether shareholders prefer political connectedness or corporate social responsibility and social justice. In Carter's view this is a very significant question because the choice is a mutually-exclusive or binary one (Carter, 2018). In other words, a company can in response to 'shocking' presidential events (she uses the example of Trump's reactions to the 2017 white supremacist rally in Charlottesville Virginia when one counter-protester was run over and killed by a neo-Nazi) either retain its existing political connections or choose CSR and social justice and sever these connections (Carter, 2018). Carter's data set comprises publicly-traded companies that left Trump's Manufacturing Jobs Initiative and Strategic and Policy Forum following his remark that there were 'some very fine people on both sides'. For Carter the 'main finding' of the study reported in her paper is that shareholders prefer political connectedness over CSR and the pursuit of social justice.

Caroline Kaeb's 'essay' 'makes a first attempt to lay out the main parameters of a normative framework for corporate engagement with public policy as part of a broader corporate responsibility paradigm' and seeks 'to provide some guideposts for companies to identify and engage on public policy issues affecting their stakeholders and shaping their business environment' (Kaeb, 2018). Kaeb points out that corporate leaders, and sometimes their shareholders as well, are increasingly happy to be seen as 'agents of social change' and 'advocates on human rights' in the face of, for example, the 'U.S. President's controversial immigration policies'. She acknowledges that the motivations for taking on these roles can be 'complex' ones 'including strong reputational considerations with very tangible business implications' (Kaeb, 2018; Nielson & Thomsen, 2018 explore the role played by the pursuit of legitimacy in firms' selection of CSR communication strategies and practices). It nevertheless is the case that the way corporate leadership engages with public policy has evolved and adapted to the changing business and political environment. These developments have 'important normative implications' calling for 'operational guidance for companies' on how best to put this 'self-proclaimed mandate' into practice. Unfortunately, Kaeb is unable to offer such operational guidance. However, she does suggest

that the UN Guiding Principles on Business and Human Rights, giving effect to the Protect, Respect and Remedy framework, might be a good starting point. While the Guiding Principles do not set out 'nuanced decision points for companies on how to engage proactively with public policy in order to advance societal values and human rights' they do establish 'a normative framework on the corporate responsibility to protect human rights' and an 'indispensable baseline' for the human rights responsibilities of business (Kaeb, 2018).

Jonathan Bonnitcho and Robert McCorquodale point out that due diligence is 'at the heart' of the Guiding Principles. However, they argue that there are two different concepts of 'due diligence' at work in the Guiding Principles. They further claim that this is not acknowledged in the Guiding Principles nor therefore is there any attempt to 'explain how the two concepts relate to one another in the context of business and human rights' (Bonnitcho & McCorquodale, 2017; see also Wettstein & Backer, 2015). While human rights lawyers, according to Bonnitcho and McCorquodale, regard due diligence 'as a standard of conduct required to discharge an obligation', business people typically understand due diligence to be a process that is required to manage business risks (Bonnitcho & McCorquodale, 2017). In their view, 'a business enterprise's responsibility to respect human rights is best understood as comprising two elements: its responsibility for its own adverse human rights impacts and its responsibility for the human rights impacts of third parties with which it has business relationships' (Bonnitcho & McCorquodale, 2017). They believe that this interpretation resolves the fundamental confusion or inconsistency in the Guiding Principles and also has practical relevance in that it clarifies the standard of conduct that businesses are expected to meet to avoid any adverse human rights impacts. In her article on the Guiding Principles and corporate moral agency, Patricia Werhane considers the difficult question of whether corporations should themselves be regarded as having moral rights. Taking the view that 'human rights entail reciprocal responsibilities' Werhane argues 'if, as the Guiding Principles specify, for-profit corporations have responsibilities to protect human rights, then those whose rights are to be protected by corporations have reciprocal obligations to respect corporate rights' (Werhane, 2015). She also argues that corporations are not 'moral persons' or 'individual moral agents'. However, because corporations are 'collective bodies' that are owned, controlled and operated by individual moral agents, it is possible to 'ascribe to corporations *secondary* moral agency as organizations' (Werhane, 2015). This means that corporations and other organisations do have limited rights but these do not exceed the rights of individual persons and are restricted to economic not political engagements and activities (to the extent that these can be distinguished from each other) (Werhane, 2015).

Brian Cheffins discusses the Trump Administration's self-proclaimed deregulatory initiatives - in January 2017, for example, Trump referred to the Dodd-Frank Act as a 'disaster' and threatened to dismantle it - and wonders whether 'government action' as a constraint on company

executives will recede, at least in the short to medium term, should any of these initiatives ever come to fruition (Cheffins, 2019). It appears that Trump was quite serious when he complained about Dodd-Frank because in May 2018 he signed into law the Senate Economic Growth, Regulatory Relief and Consumer Protection Act. There is evidently some debate about whether this new Act effectively repealed and replaced Dodd-Frank that had become law in July 2010 and was intended to restore consumer confidence in the US financial industry following the 'recession' brought on by the GFC. Evidently, many Democrats and Republicans believe that the new act 'doesn't weaken regulations for the largest banks but do agree that it provides 'regulatory relief to smaller banks and financial institution (*sic*) throughout the United States' (Dancer, 2019; see also Crabb, 2019). The repeal or weakening of the Dodd-Frank Act has implications well beyond the financial services industry and the United States. For example, Nicola Dalla Via and Paolo Perego investigate the Conflict Minerals Disclosure (CMD) that is mandatory under Section 1502 of the Dodd-Frank Act (Dalla Via & Perego, 2018). Conflict Minerals comprise coltan (tantalum is extracted from this metallic ore), cassiterite (one of the most important sources of tin), wolframite (the main source of tungsten) and gold which requires no further explanation. These are also known as the T3G minerals. Dalla Via and Perego's study makes a contribution to the environmental, social and governance (ESG) literature which deals with these issues as being central to business strategy and treats ESG reporting as one of the publicly-available outcomes of managerial decision making. In other words, ESG reporting is central to social or public disclosure, stakeholder engagement, reputation management, and the social licence to operate. The Dodd-Frank Act's CMD regime therefore played a crucial, but not completely effective, role in advancing these strategic purposes. As Dalla Via and Perego point out, Trump's proposed 'radical changes' to the Dodd-Frank Act, including 'relaxed' enforcement of its CMD regime, 'would conflict with concurrent initiatives by the European Union, China, Australia and Canada' (Dalla Via & Perego, 2018). They also note that conflict minerals are a 'highly controversial and sensitive topic' that deserves further study in the US and other jurisdictions. It is not, of course, just conflict minerals that are controversial and sensitive. Shane Gunster and Robert Neubauer (2019), for example, investigate 'extractivist development' in Canada and a proposed diluted bitumen pipeline. Gunster and Neubauer look in particular at the way in which the concept of social licence to operate has been converted in Canada from a public relations term intended to facilitate mining and extraction to a figure of speech that can be used by opponents to constrain this sort of development. Australia and other similar countries have witnessed a similar conversion.

David Berger makes the fairly obvious point that there is now 'a growing recognition that the model of stock(share)holder primacy is no longer acceptable, and that corporations must focus on broader purposes, beyond stockholder value' (Berger, 2019). The renunciation or downgrading of shareholder primacy as the corporation's overriding purpose means that it is now far less tenable for a

board to downsize its company's workforce, reduce the wages of its employees, minimise or evade taxes, disregard workplace health and safety obligations, or circumvent environmental regulations simply on the pretext that these will increase the company's profits and share price. This all raises the significant question of what the purpose of the corporation should be if it is not the relentless pursuit of shareholder value. While Berger doesn't and probably cannot provide a definitive answer to this difficult question, he does remark that long overdue is an expanded definition of corporate ownership 'to include stakeholders central to the evolving understanding of corporate purpose' (Berger, 2019; see in this regard Berger's account of public benefit corporations and certified B Corps, both legal entities that provide public benefits not simply shareholder value). As Lynn Stout pointed out several years ago, the view that the sole or at least overriding purpose of the corporation is to maximise shareholder (or, stockholder) value is not fully supported by 'law, history, logic, or the available empirical data' (Stout, 2013). Amongst other things, the belief 'in a single shareholder value' is at odds with a number of realities. It does not fit with the diversity and inconsistency of shareholder interests. It also cannot account for the fact that the interests of stakeholders such as employees, suppliers and consumers are economically important (and, often quite different from those of shareholders) and therefore also worthy of consideration. The belief overlooks as well that maximising shareholder value doesn't offer much help with the problem of keeping control over external costs or of ensuring that a company behaves in a socially responsible manner (Stout, 2013; see also Hussain, Rigoni, & Orij, 2018 who empirically investigate the relationship between corporate governance and triple bottom line sustainability performance through the lenses of agency theory and stakeholder theory). For Thomas Clarke, shareholder value is a 'mythology' and 'one of the most debilitating ideologies of modern times'. Corporate managers are 'incentivized and impelled' to pursue shareholder value which is asserted by agency theory to be the 'ultimate corporate objective'. According to Clarke, the relentless pursuit of shareholder value has 'damaged and shrunk corporations, distracted and weakened managers, diverted and undermined economies, and, most paradoxically, neglected the long-term interests of shareholders' (Clarke, 2015³).

The literature review has provided an introduction to current debates in the corporate governance literature about the meaning and purpose of corporate governance including how stakeholder interests can be served while shareholder value is pursued in a single-minded manner and, indeed, whether shareholder value should any longer be regarded as an end in itself. It has also considered changes in thinking about the purpose of the corporation when shareholder value is no longer taken to be its overriding purpose. The

³ Seen in these terms, the pursuit of shareholder value is closely related to the pursuit of economic growth which also has serious environmental, economic and social consequences. See, for example, Partington, 2019 who points out that many economists argue 'that GDP is incapable of connecting the economy with social and environmental outcomes that determine our wellbeing and the sustainability of the planet'.

literature review also provides a holistic introduction to the investigation that follows of the 4th edition of the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations*. The meaning and purpose of corporate governance, the way in which stakeholder interests should be served, and whether shareholder value should be regarded as an end in itself are all central issues in this investigation. The view adopted here is that only once these important matters have been settled can a meaningful debate begin about board governance and company performance and how governance and performance should be assessed.

3. CORPORATE GOVERNANCE IN AUSTRALIA: BOARD GOVERNANCE AND COMPANY PERFORMANCE

3.1. A brief overview of Australia's existing system of corporate governance: Legal and regulatory dimensions

The Australian Securities and Investments Commission (ASIC) is the Australian corporate, markets and financial services regulator. More prosaically, ASIC is Australia's chief corporate regulator. It is an 'independent Commonwealth Australian Government body' established by the *Australian Securities and Investments Commission Act 2001* that defines its powers and which ASIC itself administers. However, most of ASIC's regulatory activities are carried out under the *Corporations Act 2001*. ASIC has three strategic priorities: 'Promoting investor and financial consumer trust and confidence'; 'Ensuring fair, orderly and transparent markets'; 'Providing efficient and accessible registration' (ASIC, 2018a). Whether or not ASIC as corporate regulator lives up to these priorities and high ideals has been and remains a matter of considerable contention⁴.

Corporations in Australia, and their boards and directors, are required to comply with some pretty light and basic rules and regulations with compliance being overseen by ASIC. For example, an Australian publicly-listed company must have a company secretary and at least three directors. Having fewer than three directors is a breach of the *Corporations Act* for which a non-compliant company can be fined or prosecuted. Directors and company secretaries must also ensure that the company keeps up-to-date and accurate financial and other records and to ensure that the company is solvent (by passing a resolution to this effect at a meeting of the board of directors). Company directors and company secretaries have as well several personal responsibilities imposed by the *Corporations Act* including 'to be 'honest and careful', to know what the company is doing, to ensure that the company pays its debts in a timely fashion and keeps up-to-date and accurate financial records, to act in the best interests of the company rather than their own, and to use any information obtained as a result of being a director of the company in the company's best interests' (Rix and

Chandrakumara, 2017; see also ASIC, 2014, ASIC, 2014a, ASIC, 2014b). Directors also have a duty to disclose at a board meeting any conflicts of interests or personal interests that could potentially impede their ability to act in the best interests of their company. A person who is an undischarged bankrupt or who has a criminal conviction or been convicted of a company law offence is not permitted to be a company director.

The Corporate Governance Council of the ASX represents prominent business, shareholder and industry groups and plays an important role in setting corporate governance standards for companies listed on the ASX⁵. The main purpose of the Council is 'to develop and issue principle-based recommendations on the corporate governance practices to be adopted by ASX listed entities' with a view to enhancing investor confidence and assisting listed entities 'to meet stakeholder expectations in relation to their governance' (ASX, n.d.). The Council's *Corporate Governance Principles and Recommendations* sets out an authoritative list of 'recommended corporate governance practices for entities listed on the ASX that, in the Council's view, are likely to achieve good governance outcomes and meet the reasonable expectations of most investors in most situations' (ASX, 2014). The *Principles and Recommendations* are not surprisingly based on and reflect the ASX Listing Rules but most specifically Rule 4.10.3 which requires a listed entity to include either in its annual report or on its website a 'governance statement' disclosing 'the extent to which the entity has followed the recommendations set by the Council during the reporting period' (ASX, 2018). In other words, Rule 4.10.3 obliges listed entities 'to benchmark their corporate governance practices against the Council's recommendations and, where they do not conform, to disclose that fact and the reasons why' (ASX, n.d.). Should an entity not have followed any of the recommendations it must in its governance statement identify which recommendation or recommendations haven't been followed, provide reasons justifying why it hasn't followed the recommendation/s, and explain whether any alternative governance arrangements have been adopted. This is known as the 'if not, why not' approach, framework or requirement (ASX 2014; ASX, 2018a).

3.2. The changing Australian corporate governance system: A brief introduction and overview

As seen above, in issuing a Consultation Draft of the new edition of the *Principles and Recommendations* the ASX Corporate Governance Council began a process of public consultation with the business, shareholder and industry groups that comprise the Council's membership. The purpose of the Consultation Draft (and, the Consultation Paper) was to seek the views on the proposed changes to the *Principles and Recommendations* of the broad range of stakeholders represented by these groups. The new edition is the fourth and revises and updates the 3rd edition which was published in 2014 (for brief discussion of the 3rd edition, see Rix and Chandrakumara, 2017). The final version of the 4th edition was released in February 2019. The Council

⁴ See, for example, Verrender, 2018, Mottram, Clarke, and Attard, 2018, David, 2018, Danckert, 2018.

⁵ For the full list of Council members, see ASX, 2018a.

noted in its May 2018 Consultation Paper as it did in the Draft and the final version that the *Principles and Recommendations* apply to all listed entities irrespective of their legal form, and whether or not they are established in Australia or in another jurisdiction and are internally or externally managed (ASX, 2018a; ASX, 2019).

As the Consultation Paper put it, the then proposed new, 2019 edition of the *Principles and Recommendations* sought to address 'emerging and global issues' having an impact on corporate governance and how it is or should be practised. The Corporate Governance Council clearly believed that these issues either were not adequately addressed in the 2014 edition or not considered in it at all. In any event, among the emerging and global governance issues that would be addressed in the 2019 version were the social licence to operate, corporate culture and values, whistleblowing and whistleblower protection policies, policies targeting corruption and bribery⁶, board-level gender diversity, and policies addressing cyber risks and risks arising from climate change (ASX, 2018a). The Council also made clear in the Consultation Paper its strong belief that the changes and revisions it was considering for inclusion could be accommodated within the existing 'if not, why not' framework.

It should also be noted here that the changes to the *Principles and Recommendations* the Corporate Governance Council proposed in the Consultation Paper both anticipated and responded to the findings of recent public enquires but, in particular, the significant corporate governance (and, regulatory) failings that were disclosed and exposed in the Hayne Royal Commission. This Commission, formally the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry presided over by Commissioner the Honourable Kenneth Madison Hayne (formerly a Justice of the High Court of Australia), was belatedly and very reluctantly established by the Australian Government in mid-December 2017. The Commission issued an interim report (in three volumes and with a separate Executive Summary) at the end of September 2018 and released a final report at the beginning of February 2019⁷. In establishing the Royal Commission, the Australian Government handed the Commission a remit to 'consider the conduct of banks, insurers, financial services providers and superannuation funds (not including self-managed superannuation funds) and investigate 'how well equipped regulators in particular, the Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA) are to identify and address misconduct' (Morrison and Turnbull, 2018). The Royal Commission's remit, or Terms of Reference, did not extend to a consideration of macro-financial stability or the resilience of

Australia's banks, clearly one of its shortcomings and a significant one at that.

It is not an overstatement to say that the revelations in the Royal Commission of breathtaking misconduct, illegal and unethical behaviour including utter contempt for, and cheating or deception of, customers have led to a crisis of public confidence in Australian banks, in particular, the 'Big Four' (Commonwealth Bank of Australia, National Australia Bank, Westpac, and ANZ) and in other major players in the country's superannuation and insurance industries. Whether or not this crisis of confidence extends to investors and shareholders is perhaps a question that can only be answered over the longer term and allowing for the usual and expected fluctuations in banks' and financial institutions' share prices. In any event, the conduct and behaviour exposed by the Royal Commission have also made a mockery of banks' and financial institutions' codes of conduct and associated ethics and corporate social responsibility 'commitments'. The disclosures in the Royal Commission have as well revealed that Australia's banks have adopted at best a cavalier, tick-a-box approach to corporate governance and the well-established, core principles underpinning it, pre-eminently, transparency and disclosure, responsibility and accountability, and integrity and honesty⁸.

4. THE NEW CORPORATE GOVERNANCE PRINCIPLES AND RECOMMENDATIONS: BOARD GOVERNANCE AND COMPANY PERFORMANCE IN A CHANGING DISPENSATION

4.1. Corporate culture

The principal proposed revisions to the *Principles and Recommendations*, contained in the Consultation Draft, amounted essentially to a significant redrafting of Principle 3 that had in earlier versions simply enunciated a basic expectation that boards and management of listed entities should behave ethically and responsibly. The revision of the text of this Principle in the Draft included a major rewording and extension so that it became 'Instil the desired culture: A listed entity should instil and continually reinforce a culture across the organisation of acting lawfully, ethically and in a socially responsible manner (ASX, 2018b).' As seen above, the Consultation Paper made clear the Corporate Governance Council's belief that by acting in a lawful, ethical and responsible manner a company's board and management can unambiguously demonstrate their understanding of the 'fundamental importance' of the company's social licence to operate and commitment to sustaining this over the longer term (ASX, 2018a). Taking this a large step further, the Consultation Draft referred to a social licence to operate as one of a listed entity's 'most valuable assets' (ASX, 2018b).

As has already been noted above, the final version of the 4th edition makes no explicit reference to the social licence to operate and with its removal

⁶ For some idea of the extent of the problem of bribery and corruption around the world, also demonstrating that it is a very significant corporate governance issue, see Dell and McDevitt, 2018.

⁷ The three volumes of the Interim Report and the Executive Summary can be found at <https://financialservices.royalcommission.gov.au/Pages/reports.aspx>. The Final Report, released on 1 February 2019 and tabled in Parliament on 4 February and also in three volumes, can also be found at this link. Chapter 6 of the Final Report deals with questions and makes recommendations relating to Culture, governance and remuneration in entities across the Australian financial services industry.

⁸ For some of the media, academic and other coverage of the Banking Royal Commission's hearings and disclosures see, for example, Linden and Staples, 2018a, Linden and Staples, 2018b, Braddon and Hooper, 2018, Gergis, 2018, Petschler, 2018, Knight, 2018, Beck and Paton, 2018.

seemingly abandons one of the consultation Draft's principal and most valuable assets⁹. In spite of jettisoning the social licence, however, the final version does slightly expand on the text of Principle 3. This now reads 'Instil a culture of acting lawfully, ethically and responsibly: a listed entity should instil and continually reinforce a culture across the organisation of acting lawfully, ethically and responsibly' (ASX, 2019). The Draft's Commentary on Principle 3 contained a quite lengthy explanation about why the social licence deserves to be regarded as one of a listed entity's most valuable assets. This Commentary provided as well an account of how an entity can go about building and sustaining its social licence by earning and maintaining the trust of a broader range of stakeholders than just its shareholders. The Draft's Commentary also made the point that an entity's ability to support and generate 'long term and sustainable value creation' is based on the trust earned from the different stakeholders (ASX, 2018b; the full Commentary to draft Principle 3 can also be found here).

Recommendation 3.1 in the Draft version reads 'A listed entity should articulate and disclose its core values' (the final version of this Recommendation refers only to 'values'). The Commentary to this Recommendation in the Draft emphasises that because of the importance of an entity's social licence to operate, 'it the statement of *core* values will usually contain a commitment by the entity to complying fully with its legal obligations and to acting ethically and in a socially responsible manner' ASX, 2018b; emphasis added). Not only can a statement of core values 'properly implemented' be the basis on which an entity builds its corporate culture but also encourage 'good decision making' and function as a useful recruitment and retention tool. To serve these purposes, however, an entity's statement of its core values has to be a good deal more than 'a poster on a wall'. On the contrary, the core values must be lived and breathed by the entity, and its board, senior management and employees. This highlights the need for ethical leadership from board and senior management who should lead by example firmly to 'set the tone at the top'. As the Consultation Draft states, 'this includes ensuring that their own actions and decisions are consistent with the entity's stated values and that any conduct by others within the organisation that is inconsistent with those values is dealt with appropriately and proportionately' (ASX, 2018b).

The Commentary to Recommendation 3 in the final version as already noted contains no mention of the social licence and is therefore a good deal briefer than the draft version. However, the final version suggests that in 'formulating its values' a listed entity should 'consider what behaviours are needed from its officers and employees to build long term sustainable value for its security holders including the need for the entity to preserve and protect its reputation and standing in the community and with key stakeholders, such as customers, employees, suppliers, creditors, law makers and regulators' (ASX, 2019; these key stakeholders are the same as those included in the

Draft's commentary on the social licence). While it is ultimately the board that has responsibility for formulating and approving an entity's statement of values, the final version puts more onus than the Draft did on the entity's 'executive team' to 'inculcate' the company's stated values throughout the entire organisation. Inculcating these values across the organisation requires the executive team to ensure that all of the entity's employees acquire 'appropriate training' on its values. In interacting with staff, senior executive should as well continually reference and reinforce the values in this way setting the 'tone at the top' (ASX, 2019).

Consistent with the desire to win the genuine and lasting trust of key stakeholders, and of the public more generally, Principle 3 in both the Draft and the final version also includes new Recommendations 3.3 and 3.4 dealing respectively with the need for a listed entity to have and disclose a whistleblowing policy and an anti-bribery and corruption policy. In both versions, Recommendations 3.3 and 3.4 are divided into parts a) and b). The Commentary in the final version on these two Recommendations is considerably briefer and less detailed than that in the Draft. In the following, the two Recommendations will be considered in turn with the focus being on part a) of each.

Before doing so, however, it needs to be pointed out that in the Draft, Recommendation 3.3b stated that an entity should 'ensure that the board is informed of any material concerns raised under that policy that *call into question the culture of the organisation*' (ASX, 2018b; emphasis added). In the final version, part b) simply states that the entity should 'ensure that the board or a committee of the board is informed of any material incidents reported under the policy' (ASX, 2019) thus converting mere 'concerns' into the harder 'incidents', jettisoning any mention of culture as well as adding reference to 'a committee of the board'. In both versions, Recommendation 3.4a calls for an entity to have and disclose an anti-bribery and corruption policy with the final version stating in 3.4b as it did in 3.3b that the board or a committee of the board should be informed of any material breaches of this policy (there was no reference in Draft 3.4b to a board committee).

4.2. Whistleblowing policy

Recommendation 3.3 states (in both versions) that the purpose of a whistleblower policy is to encourage employees, who in the words of the Draft are 'the best source of information about whether a listed entity is living up to its values', to report suspected unethical, unlawful or socially irresponsible conduct ('socially' is not in the final version). The Draft also calls for listed entities to 'instil and continually reinforce a culture of 'speaking up'. Employees should in addition have confidence that there are 'suitable protections' of their identity and confidentiality to safeguard them from 'retaliation or victimisation' when they 'speak up' (ASX, 2018b). Much of the remainder of the Commentary in the Draft on Recommendation 3.3 deals with the sorts of suspicious behaviour or observed incidents that employees should report under the whistleblowing policy and how these

⁹ For some of the corporate governance and other issues raised by the social licence to operate see, for example, Cullen-Knox et al. 2017, Wright and Bice, 2017, Black, 2018.

should be reported and to whom. It therefore amongst other things also calls for adequate training both for employees about the policy including their rights and obligations under the policy and for managers who are authorised to receive 'whistleblowing reports' about the appropriate way of dealing with any disclosures they receive.

As noted above, the Commentary on this Recommendation in the final version is much briefer than that in the Draft. As in the Draft, the final version acknowledges that employees are usually the best source of information on whether or not an entity is living up to its values and that its whistleblower policy should therefore encourage them 'to speak up about any unlawful, unethical or irresponsible behaviour within the organisation' (ASX, 2019). Beyond this, the Commentary in the final version simply reiterates the Recommendation in slightly longer form and makes no mention of encouraging a culture of speaking up, of the need for adequate whistleblower protections, or of the requirement for appropriate training.

4.3. Anti-bribery and corruption policy

As already seen, in both versions Recommendation 3.4 calls on listed entities to have an anti-bribery and corruption policy and to ensure that their board (committee of the board is added in the final version) is advised of any 'material breaches' of the policy. As both the Draft and final version point out, it is a serious criminal offence to give bribes or other 'improper payments' to public officials because doing so 'can do major damage to a listed entity's social licence to operate' (ASX, 2018b) or 'damage a listed entity's reputation and standing in the community' (ASX, 2019). Amongst other things, and just as was the case with Recommendation 3.3, the Draft's Commentary on this recommendation includes a call for adequate training of managers and employees who could be exposed to bribery or corruption on how these can be detected and appropriate ways of dealing with occurrences of them (ASX, 2018b). There is no mention of the need for training in the final version.

5. THE NEW PRINCIPLES AND RECOMMENDATIONS: SOME MAJOR RESPONSES AND REACTIONS

5.1. Australian Institute of Company Directors (AICD)

Before considering AICD's response to the Consultation Draft, a brief introduction to its role and mission will be in order. The Mission of the Australian Institute of Company Directors (AICD) is, according to its website, 'to provide leadership on director issues and promote excellence in governance to achieve a positive impact for the economy and society' by undertaking 'governance education, director development and advocacy' (AICD, 2018a). The Institute is a national organisation comprising seven state and territory divisions and with a national Board (its 'governing body') consisting of 12 directors; it has a membership of 40,000 including directors and other 'senior leaders from business, government and the

not-for-profit sectors' (AICD, 2018a). As its Constitution points out, the Institute is a public company limited by guarantee having as its key objectives 'through education, to promote excellence, enterprise and integrity in the directors of all corporations, to improve their knowledge and skill with respect to their rights, duties and responsibilities and to inculcate the highest standards of ethics among directors' (AICD, 2016).

With such mission, membership and objectives as these it could too easily be assumed that AICD would simply fall in to line with the draft 4th edition of the ASX's Corporate Governance Council *Principles and Recommendations* and welcome the Consultation Draft with open arms an endorsement which would likely have seen it become the final version with little or no further revision. AICD did seem broadly to welcome the Draft, or at least the opportunity to respond to it in detail, agreeing with the Corporate Governance Council that 'now is an opportune time to review the Principles and consider whether they remain fit-for-purpose in the context of emerging domestic and global issues in corporate governance' (AICD, 2018b: 1). AICD also acknowledged in its submission that the proposed amendments contained in the Draft 'cover many topical and important issues'. It supported as well the 'focus on long-term value creation' and the Draft's recognition of the importance of 'active consideration and engagement by listed entities with stakeholders and community expectations' (AICD, 2018b: 2). However, in its response AICD did as well express a number of what can only be regarded as serious concerns and misgivings that it had about the direction the *Principles and Recommendations* appeared to be taking.

Seeming to ignore the Corporate Governance Council's assurances to the contrary, AICD was principally concerned with the apparent move in the Draft from a 'principles-based approach' to one that it regarded as 'becoming too granular or prescriptive' (AICD, 2018b). In spite of the retention in the Draft of the 'if not, why not' approach, AICD thought the adoption of what it regarded as a more prescriptive approach carried with it a considerable risk of listed entities adhering to the Principles 'as a 'check box' compliance matter rather than as a starting-point for a consideration of their own corporate governance needs' (AICD, 2018b). In addition, in AICD's view more prescriptive and accordingly more demanding expectations like the ones the Council was recommending could deter 'smaller, resource-constrained' companies (which make up the majority of ASX-listed entities) from fully embracing and supporting the spirit and the letter of the redrafted Principles. It took particular exception to 'the increased level of commentary and prescription (from a 38 page third edition to a proposed 55 page fourth edition) which risks detracting focus from the most material issues' as well as 'deviating from established legal frameworks' (AICD, 2018b; the final version is 36 pages in length)¹⁰.

AICD was especially agitated by the inclusion in the Draft of the 'concepts' of 'social licence to operate' and 'acting in a socially responsible manner'. In its view these concepts are 'subjective'

¹⁰ See also AICD, 2017

(the former, even 'highly subjective') and 'fluid' ones. And, for AICD, the concepts not only amount to an addition of unneeded 'complexity and uncertainty' to the already-complex and demanding governance mix but also do not properly reflect the existing 'legal and fiduciary duties of directors', in particular, the statutory duties of directors as laid down in the Corporations Act 2001 (AICD, 2018b). Not only did AICD regard the two concepts as being subjective but, specifically with respect to social licence thought that it carried as well a risk of being 'interpreted differently by different stakeholders' whose interests in any case are 'often complex and competing' (AICD, 2018b).

As for Recommendations 3.3 and 3.4 for entities to have respectively a whistleblowing policy and an anti-corruption and bribery policy, AICD's response was what only can be described as somewhat dismissive if not downright pejorative. In AICD's view, the recommendation to have a whistleblowing policy was essentially redundant (not its term) because the Australian Government was considering the introduction of legislation that will likely impose 'different obligations upon companies' from those being proposed by ASX¹¹. And, AICD thought that the anti-corruption and bribery policy Recommendation ran the risk 'that by focusing on anti-bribery and corruption policies, other equally important issues could be seen as requiring less focus' (AICD, 2018b). AICD provided examples of neither the different obligations nor the other equally important issues to which it was referring.

AICD announced and commented on the release of the final version of 4th edition of the *Principles and Recommendations* in two publications in its on-line journals *Membership Update* and *Company Director*. In the first of these, Sally Linwood (Senior Policy Adviser) and Christian Gergis (Head of Policy) highlighted amongst other things the inclusion in the final version of the requirements for listed entities: to articulate and disclose their values; to have a 'robust' whistleblowing policy (as it noted, this is now particularly important in light of the passing by the Australian Parliament of the enhancing whistleblower protections Act); and, to disclose to the board or a board committee material incidents reported under the whistleblowing policy or material breaches of the anti-bribery and corruption policy (Linwood & Gergis, 2019a). Linwood and Gergis coyly pointed out that the social licence to operate 'did not find its way' into the final version. They also remarked that the social licence 'had been the subject of heated debate' during the consultation process revealing 'a wide gulf of opinion between those who saw the concept as pivotal to business operating in a broader societal context, and others, like the AICD, who believed that such a subjective term had no place in a quasi-regulatory document' (Linwood & Gergis, 2019a). The second AICD publication on the final version, also authored by Linwood and Gergis, essentially provides a re-run of the first publication (Linwood & Gergis, 2019b).

¹¹ In the period between the appearance of the Draft and the release of the final version of the 4th edition of the *Principles and Recommendations*, the Australian Parliament passed the Treasury Laws Amendment (Enhancing Whistleblower Protections) Act 2019 receiving Royal Assent on 12 March 2019. The Act can be found at the following link: <https://www.legislation.gov.au/Details/C2019A00010>.

5.2. Australian Securities and Investments Commission (ASIC)

In ASIC's submission to the Corporate Governance Council providing its commentary on and recommended amendments to the Consultation Draft, it expressed the view that the primary purpose of corporate governance principles and standards should be to provide investors with 'clear disclosure' of a listed entity's 'actual corporate governance practices' and, where necessary, bring about enhancements of these practices (ASIC, 2018b). One of its chief concerns was accordingly that corporate governance statements in Australia, like those required under ASX Listing Rule 4.10.3 (which, as explained above, outlines the 'if not, why not' approach or framework), 'sometimes lack transparency' because they don't always provide an accurate picture of the corporate practices actually followed by an entity. This can mean that entities are required simply 'to disclose the *existence* of a governance policy or framework rather than *how*' the policy or framework is implemented leading to 'inadequate and largely meaningless disclosure' of a 'boilerplate' sort which is merely rolled over without change or revision from one year to the next (ASIC, 2018b). In sum, boilerplate and 'tick the box' disclosure requirements like these 'detract from the objectives of driving improvements in practices or even of setting an effective baseline standard of governance for larger listed entities' (ASIC, 2018b).

ASIC therefore recommended that the Corporate Governance Council consider an alternative model of disclosing against the *Principles and Recommendations* which it believed should ideally provide a 'best practice' model of corporate governance for listed entities. This would require a listed entity to produce:

- 'a standalone document describing its corporate governance framework' that would be made available to investors on the entity's website with a link to this document provided in the entity's Corporate Governance statement;
- 'an annual statement describing the entity's implementation of the corporate governance framework' (ASIC, 2018b).

In addition, ASIC recommended that the ASX actively monitor and assess the disclosures made by entities under the *Principles and Recommendations*. It also thought that the *Principles and Recommendations* should have the function of setting 'a minimum level of governance practices' for larger listed entities which is an expectation 'consistent with the degree of attention given to recent governance failures by these entities highlighted by the Banking Royal Commission and APRA's inquiry into CBA and the need for larger listed entities to be held to a higher standard of conduct (ASIC, 2018b)¹². In view of these considerations, ASIC suggested that the ASX could even consider making all or some of its Listing Rules mandatory for the larger entities on its official list or promoting some recommendations to the status of Listing Rules. As observed above (n. 1), ASIC offered no formal or public response to the release of the final version of the 4th edition.

¹² For the background to and outcomes of APRA's CBA inquiry, see Ryan, 2018 and APRA, 2018.

5.3. Australian Council of Superannuation Investors (ACSI)

ACSI has a membership of 39 Australian and international institutional investors and asset owners which in aggregate 'manage over \$2.2 trillion in assets and own on average 10% of every ASX200 company' (ACSI, 2016). ACSI was established in 2001 to serve as a 'strong and collective' voice for its members 'on environmental, social and governance (ESG) issues' based on their shared belief 'that ESG risks and opportunities have a material impact on investment outcomes.' ACSI's members also believe that as fiduciary investors 'they have a responsibility to act to enhance the long-term value of the savings entrusted to them' and therefore 'collaborate through ACSI to achieve genuine, measurable and permanent improvements in the ESG practices and performance of the companies they invest in' (ACSI, 2016).

In its submission to the Corporate Governance Council's stakeholder consultation on the draft 4th edition of the *Principles and Recommendations*, ACSI welcomed the new edition because it 'reflects evolving perspectives in best practice corporate governance and include a greater emphasis on values, ethics and broader stakeholder accountability'. It accordingly gave strong support to the amendments and additions proposed by the Council that will 'strengthen the Principles and Recommendations and successfully address a range of contemporary governance concerns' and 'provide investors and other stakeholders with improved insight into the robustness and effectiveness of the entities that they invest in' (ACSI, 2018). The contemporary governance concerns that ACSI was glad to see addressed in the new edition include the social licence to operate, corporate values and culture, 'whistleblower rules', anti-bribery and corruption policies, improving diversity, corporate reporting, and climate-related disclosures¹³.

ACSI strongly supported 'the expansion of Principle 3 to include instilling and continually reinforcing a culture across the organisation of acting lawfully, ethically and in a socially responsible manner' because 'a listed entity's social licence to operate is one of its most valuable assets' which can be 'lost or seriously damaged' when the entity, its directors or employees 'are perceived to have acted unlawfully, unethically or in a socially irresponsible manner' (ACSI, 2018). Without referring to any cases in particular, ACSI pointed out that 'recent examples demonstrate that corporate misconduct can have dire consequences for shareholder value'. On the other hand, 'a strong corporate culture can contribute to the attraction and retention of talent, the development and maintenance of reputation and trust and support the effectiveness and efficiency of operational management' as well as contributing to 'financial strength and resilience' (ACSI, 2018). In ACSI's view, 'improved transparency' is another important way of rebuilding the trust of investors and 'a broader

group of stakeholders' and therefore also of assuring that shareholder value can continue to be increased on a sustainable basis.

In a Media Release on 27 February 2019 and in keeping with its counterparts, ACSI welcomed the release of the final version of the 4th edition. It noted that a catalyst for the review of the Principles 'was the desire to address emerging concerns around corporate culture and trust' and also observed that 'the importance of corporate culture, trust and the link to a company's reputation and standing in the community has again been highlighted by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry' (ACSI, 2019). While the Media Release made no mention of the omission of the social licence to operate in the final version - the presence of which in the Draft ACSI had so fulsomely praised - it nevertheless strongly supported 'the new provisions introduced on corporate values and appropriate treatment of stakeholders, corporate culture, diversity, remuneration and risk' (ACSI, 2019). The media release highlighted amongst other things the Recommendations requiring listed entities to articulate and disclose their values and support a healthy culture through having and disclosing a whistle-blower policy and an anti-bribery and corruption policy.

6. CONCLUSIONS: BOARD GOVERNANCE AND COMPANY PERFORMANCE IN THE NEW SYSTEM

The Draft of the 4th edition of the ASX Corporate Governance Council's *Principles and Recommendations* made a valuable (and, frankly quite daring) but sadly short-lived contribution to the hotly debated question, within Australia and globally, about the criteria by which board and company performance should be measured. This is a question that goes to nothing less than the very point or purpose of corporate governance. In the end, then, it is a question about exactly what corporate governance is and why it matters, more correctly, whether it does matter at all.

The Draft made fairly clear the Corporate Governance Council's belief that corporate governance does matter but really only when the interests of stakeholders, other than shareholders and investors, are genuinely taken in to account in the decision making of company boards and directors and resulting actions of executive managers and other employees. These actions and decisions after all are the basis of stakeholders' trust and determine whether a company earns a social licence to operate from them. However, it left largely unaddressed the issue of how company directors, and by extension senior managers as well, should be remunerated because profit, share price and dividend can no longer be taken as the sole or even most important measures of a company's performance at least in the short term. More challengingly in governance terms, it promoted non-shareholder stakeholders to an almost equal footing with their shareholder counterparts and inversely relegated shareholders to mere stakeholders. It therefore remained to be seen whether the Consultation Draft survived in its published form and if it did whether the *Principles and Recommendations* continued to have the authority

¹³ See also ACSI, 2017, ACSI Governance Guidelines. A guide to investor expectations of Australian listed companies. The core principles underpinning ACSI's Governance Guidelines are: Board oversight of all material risks; Sustainable, long-term value creation; Active ownership; Transparency; Licence to operate. A brief explanation of each principle is provided at page 5 of the Guidelines.

that it once had and remained the benchmark it was always intended to be. Promisingly, the fulsome welcome with which ACSI had greeted the new edition suggested that it just might. If so, it would have helped to set the future course for corporate governance as a set of principles, a field of practice and as an academic discipline.

It appears that the *Principles and Recommendations* in its 4th edition does retain the authority it has long held and remains the benchmark governance document for corporate (and, non-corporate) Australia. However, the omission from the final version of the social licence to operate and of the related commentary which highlighted the importance of core values and behaving ethically and in a socially responsible manner suggests that corporate Australia still has a long way to go before long-term and sustainable value creation displaces a self-defeating focus on short-termism. Clearly, organisations like the AICD exerted considerable pressure on the Corporate Governance Council to remove or lessen the strong emphasis on these principles and issues that was one of the Draft's most valuable assets. ACSI obviously had far less influence. It seems then that corporate Australia has yet to fully acknowledge the risk that climate change presents to value creation even in the short term and therefore of the need to change governance principles, structures and

practices to meet this challenge before it is too late. The Corporate Governance Council had valiantly attempted to set corporate Australia on a course of long-term sustainability and resilience but unfortunately it fell at the final hurdle.

7. LIMITATIONS AND FURTHER RESEARCH

The article has several limitations. It has provided an in-depth analysis of important sections of the *Principles and Recommendations* in its Draft and final versions and some commentary on the responses to both versions of several of the Corporate Governance Council's principal stakeholders. There are clearly abundant opportunities for researchers in the future to look at the *Principles and Recommendations* more holistically and to monitor how much impact over the coming 5 to 10 years or so the document has on the conduct in Australia of corporate governance, on company behaviour more generally, and on the reactions of retail and institutional shareholders. There will also be many opportunities for research comparing contemporary developments in Australian corporate governance with developments elsewhere around the world.

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