

THE ROLE OF THE INDEPENDENT NON-EXECUTIVE DIRECTOR IN AUSTRALIA

By

Trevor Lipman

BBus, MBA

A thesis submitted in fulfilment of the requirements
for the degree of
Doctor of Business Administration (DBA)

Macquarie University
Sydney, Australia

February 2008

CERTIFICATION

This thesis is submitted in fulfilment of the requirements of the degree of DBA, in the Macquarie Graduate School of Management, Macquarie University. This represents the original work and contribution of the author, except as acknowledged by general and specific references.

I hereby certify that this has not been submitted for a higher degree to any other university or institution.

Signed:

Trevor Lipman

ABSTRACT

Company directors have been in existence for more than four hundred years. In the past, they were considered to be a necessary part of corporate existence, and were usually appointed to a board by the CEO or chairman. However, they were usually mates from the ‘boys club’ and gained their position from whom they knew, and not from what they were capable of contributing. The appointment of independent directors became more normal, as shareholders looked for a way to wrest control back from management. But what independent directors really do and why they are there is not widely understood. A review of the literature relative to independent directors has identified a gap in the knowledge. This gap is the role of the independent director when considered from a commercial aspect; that is, those who observe or write about independent directors.

This thesis has attempted to generate a theory of the role of the independent director through a review of the literature and a subsequent series of interviews. Grounded theory was the chosen methodology for analysing the data and formulating a theory of the role because it allows the researcher to ground the theory in the data instead of establishing a hypothesis and testing it.

The resulting theory is more complex than it first appears. It was found that the primary role of the independent director is to improve the performance of the board and the company. This role is impacted by a number of factors, the two most influential being the information that is available to the independent directors, and the position of the company. This second factor is defined as the size of the company, where it is in its life cycle, and whether it is experiencing any significant change.

These findings enable a number of recommendations to be made to improve policy and practice, recognising the impact of information and company position on the ability of independent directors to contribute positively. It also raises several areas of further study to continue to refine the understanding of the role of the independent non-executive director in Australia. These include, among others, investigating the role from other viewpoints such as the board chair or company secretary, or researching the link between company position and information available to independent directors.

CONTENTS

<i>Certification</i>	<i>iii</i>
<i>Abstract</i>	<i>iv</i>
<i>List of figures</i>	<i>x</i>
<i>List of tables</i>	<i>xi</i>
<i>List of appendices</i>	<i>xii</i>
<i>Acknowledgements</i>	<i>xiii</i>
Chapter 1 INTRODUCTION	1
1.1 Background to the research	1
1.2 Research problem	4
1.3 Justification for the research	6
1.4 Methodology	8
1.5 Thesis outline	9
1.6 Definitions	11
1.7 Limitations of scope and key assumptions	11
1.8 Conclusion	12
Chapter 2 BACKGROUND	13
2.1 Introduction	13
2.2 The rise of the corporate form entity	13
2.2.1 The birth of the corporate entity	13
2.2.2 The growth of public companies	15
2.2.3 The explosion in invested capital	16
2.3 The governance debate	17
2.3.1 Who controls the power	17
2.3.2 Ownership v control	19
2.4 Power of the board	20
2.4.1 Board power and agency issues	20
2.4.2 Solving the agency issue	21
2.5 The evolution of different types of directors	23
2.5.1 What is a director?	23

2.5.2	Different types of directors	24
2.5.3	Board power and independent directors	26
2.5.4	Mitigating board power	27
2.6	The independent director	28
2.6.1	Determination of independence	28
2.6.2	The rise of the independent director	31
2.7	Summary and conclusion	33
Chapter 3	THEORY AND MOTIVATION	37
3.1	Introduction	37
3.2	The Legal Pillar – the ‘why’	38
3.2.1	Introduction	38
3.2.2	The duty of care and diligence	39
3.2.3	Disclosure of conflict	46
3.2.4	Duty to act for proper purposes	47
3.2.5	Conduct of directors	48
3.2.6	Delegation of duties and reliance on others	50
3.2.7	Summary and conclusion	54
3.3	The Governance Pillar – the ‘how’	55
3.3.1	Introduction	55
3.3.2	Australian Investment Managers Association	62
3.3.3	Cadbury Report	62
3.3.4	Greenbury Report	65
3.3.5	Hampel Report	65
3.3.6	OECD principles	67
3.3.7	Turnbull Guidance	69
3.3.8	Sarbanes-Oxley Act	70
3.3.9	Higgs Report	71
3.3.10	Australian Stock Exchange corporate governance principles	72
3.3.11	Corporate Law Economic Reform Program and other issues	73
3.3.12	Summary and conclusion	79
3.4	The Commercial Pillar – the ‘what’	82
3.4.1	Introduction	82
3.4.2	Performance of the board	84

3.4.3 Effectiveness	86
3.4.4 Monitoring	90
3.4.5 Individual expertise	95
3.4.6 Board committees	96
3.4.7 Summary and conclusion	98
3.5 Chapter summary and research issues	100
3.5.1 Elements of the method employed	100
3.5.2 Analysing the three pillars	104
3.5.3 Identification of the research topic	112
CHAPTER 4 METHODOLOGY	117
4.1 Introduction	117
4.2 Research problem and research design	118
4.2.1 The research problem	118
4.2.2 Research design	119
4.3 Data collection techniques	120
4.3.1 Interviews	121
4.3.2 Questionnaires	123
4.4 Interviews	124
4.4.1 Interview type	125
4.4.2 Interview method	126
4.4.3 The interview questions	127
4.4.4 Pilot interview studies	128
4.5 Data collection	130
4.5.1 Information on companies represented in the research	130
4.5.2 Participant observation	133
4.5.3 Interviews with respondents	135
4.5.4 Limitations of research by interview and how they were handled	139
4.6 Grounded theory	140
4.6.1 Defining grounded theory	140
4.6.2 Short history of grounded theory	143
4.6.3 Criticisms of grounded theory	144
4.6.4 Generating grounded theory	145
4.6.5 How good is the theory?	153

4.6.6 Application of grounded theory in business ethics	154
4.7 Data analysis	155
4.7.1 Open coding	156
4.7.2 Axial coding	157
4.7.3 Selective coding	159
4.8 Developing the grounded theory	160
4.9 Verification, validity and reliability	164
4.9.1 Verification	164
4.9.2 Validity	166
4.9.3 Reliability	167
4.10 Ethical issues	167
4.11 Conclusion – bringing the pillars together	168
 Chapter 5 RESULTS AND ANALYSIS	 171
5.1 Introduction	171
5.2 Open coding of Stage 1 data	172
5.2.1 Initial concepts	172
5.2.2 Initial categories	175
5.3 Axial coding of Stage 1 data	180
5.4 Open coding of Stage 2 data	189
5.5 Refinement of initial categories	191
5.6 Axial coding and development of core categories	194
5.6.1 Personal Attributes	194
5.6.2 Monitoring	197
5.6.3 Performance Enhancement	202
5.6.4 Structure	206
5.6.5 Representative	209
5.6.6 Relationships	212
5.6.7 Information	217
5.6.8 Company Position	221
5.7 Stage 3 data collection	224
5.8 Reconsideration of other collected data	229
5.8.1 Participant observation	229

5.8.2 Interviews with industry experts	231
5.9 Selective coding and selection of the core category	234
5.9.1 Selective coding	234
5.9.2 Selection of the core category	236
5.9.3 Relationships between categories	238
5.10 Theory development	252
5.11 The grounded theory	254
5.12 Conclusion	257
Chapter 6 CONCLUSIONS	259
6.1 Introduction	259
6.2 The results	259
6.2.1 Relating the results to the research problem	261
6.3 Limitations of the study	266
6.4 Contribution to knowledge and to the improvement of professional practice or policy	267
6.4.1 Significance of this research	267
6.4.2 Information	268
6.4.3 Company position	269
6.4.4 Impact on professional practice and policy	270
6.5 Areas for further research	273
6.6 Summary and conclusion	274
References	275
Appendices	291

LIST OF FIGURES

Figure 4.1 The grounded theory process	148
Figure 4.2 Strauss and Corbin's conditions/actions/consequences coding paradigm	159
Figure 4.3 Grounded theory: a sophisticated model (Ezzy, 2002)	161
Figure 4.4 Diagrammatic representation of the grounded theory process	163
Figure 5.1 Strauss and Corbin's conditions/actions/consequences coding paradigm	181
Figure 5.2 Coding paradigm for Category 1: Personal Attributes	182
Figure 5.3 Coding paradigm for Category 2: Monitoring	184
Figure 5.4 Coding paradigm for Category 3: Performance Enhancement	185
Figure 5.5 Coding paradigm for Category 4: Structure	186
Figure 5.6 Coding paradigm for Category 5: Representative	188
Figure 5.7 Coding paradigm for Category 6: Relationships	189
Figure 5.8 Revised coding paradigm for Category 2: Monitoring	202
Figure 5.9 Revised coding paradigm for Category 5: Representative	212
Figure 5.10 Revised coding paradigm for Category 6: Relationships	217
Figure 5.11 Coding paradigm for Category 7: Information	221
Figure 5.12 Coding paradigm for Category 8: Company Position	224
Figure 5.13 Revised coding paradigm for Category 1: Personal Attributes	228
Figure 5.14 Selective Coding: Performance Enhancement as the core category	237
Figure 5.15 Personal Attributes category and relationships with other categories	239
Figure 5.16 Monitoring category and relationships with other categories	241
Figure 5.17 Structure category and relationships with other categories	243
Figure 5.18 Representative category and relationships with other categories	245
Figure 5.19 Relationship category and relationships with other categories	247
Figure 5.20 Information category and relationships with other categories	249
Figure 5.21 Company Position category and relationships with other categories	251

LIST OF TABLES

Table 3.1 Chronology of important corporate governance publications and legislation	61
Table 4.1 Statistical information on companies represented by independent directors interviewed during the research	131
Table 4.2 Sectors containing companies represented by independent directors interviewed during the research, and number represented in each sector	132
Table 4.3 Sectors containing companies represented by independent directors interviewed during the research and number represented in each sector by turnover	132
Table 5.1 Concepts identified in open coding of Stage 1 interviews	174
Table 5.2 Grouping of initial concepts into provisional categories	176
Table 5.3 Grouping of revised concepts into core categories	192

LIST OF APPENDICES

Appendix 1 Number of listed companies on various stock exchanges from 1990 to 2005	292
Appendix 2 Domestic market capitalisation of listed companies on various stock exchanges from 1990 to 2005	294
Appendix 3 List of interview questions	299
Appendix 4 Companies represented by interview respondents. Analysis by Industry Group, Industry and Sub Industry per GICS specifications	300
Appendix 5 Invitation letter sent to respondents	303

ACKNOWLEDGEMENTS

Firstly, I would like to thank my family for their ongoing support while undertaking this project. Their patience and understanding will be rewarded.

Secondly, this thesis would never have been completed, and particularly to the level of quality and structure without the guidance, wisdom and support of my Supervisor, Professor Tyrone Carlin.

The research for this thesis was only possible due to the support of Korn/Ferry Australia, particularly that of Suzanne Williams. Thanks also to Ralph Evans and Mark Carmichael of the Australian Institute of Company Directors and Eric Mayne of the Australian Securities Exchange.

Thanks also to Dr Duff Watkins without whose wise counsel the research topic would never have been formulated.

Finally thank you to my editor, Alison Basden, for her efforts in the language, completeness and consistency of this thesis. Alison has made this thesis more readable than it would otherwise have been.