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

LIST OF FIGURES

LIST OF TABLES

LIST OF APPENDICES

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.

Chapter 1 INTRODUCTION

1.1 Background to the research

The role of the independent director has become more important in recent times, due partly to the increasing number of major corporate collapses experienced in many developed nations. While the media and researchers have concentrated on well-known experiences such as Enron and WorldCom in the United States, Maxwell and BCCI in the United Kingdom, and HIH, AWA and OneTel in Australia, this phenomenon has also occurred in other countries, for example Parmalat in Italy and Swissair in Switzerland.

These companies all had independent directors as members of their boards, but observers wanted to know what these independent directors were doing, and why they didn't prevent these companies from failing. Independent directors became a central theme of good corporate governance, and Sir Adrian Cadbury in his groundbreaking report in 1992 (*The Financial Aspects of Corporate Governance*) recommended that public companies should have a majority of independent directors on their boards. It was further recommended that these independent directors should be given more power, and have independence of mind when making decisions.

The reasons for having independent directors on public company boards are many and varied, and not all apply to each particular situation. They include reducing the power of executive directors (Boyd, 1996; Higgs, 2003), giving the appearance of good corporate governance, bringing ideas to the board from outside the company, being the link between the board and the company's stakeholders, acting as internal advisors, and monitoring the actions of others in the company (CIMA, 2000; Vinten, 2001; Bosch, 2002.

But what is an independent director? The *Corporations Act* does not differentiate between types of directors. Both the Cadbury Report and the ASX *Principles of Good Corporate Governance* set out tests for independence; the latter has recently been revised in an attempt to be more precise. These principles now also take Cadbury's original lead and push for independence of mind when making decisions.

But structure is not everything; merely having a board comprising a majority of independent directors may not be enough. This was the case of HIH. It had a well-structured board at the time of its collapse, but the directors were unable to curb the strength of the CEO and the company failed. The trend is towards independence of mind, and not just being independent in nature.

While best practice for public companies dictates having independent directors on the board, and the trend is for these independent directors to act with greater independence of mind, their actual role on these boards is not completely clear. Companies of various sizes and at different stages of development or change have different requirements of their independent directors. Increasing numbers of shareholders are viewing the independent directors as their agents, and shareholders and other observers want to know what these independent directors are doing. What is their role?

The volume of research into independent directors is considerable, and for the purpose of analysis and discussion in this study can be divided into three distinct 'pillars': Legal, Governance and Commercial[1]. Through each pillar, the role of the independent director can be defined. But there are inconsistencies among the three pillars, particularly in the findings in the Commercial Pillar when compared with both the Legal and Governance pillars.

The influences on the Legal Pillar were the *Corporations Act 2001* and the common law that has developed through a significant number of cases dealing with directors' issues, dating back to 1870[2]. The underlying concepts relating to the role of independent directors in this pillar showed a gradual and logical progression through time. From a legal perspective, these issues relate to directors' duties and follow contemporary thought and practice. Views on certain issues change with time. For example, the issue of liability due to non-attendance at board meetings has changed from no liability to full liability, as the independent directors are required to be always fully informed, regardless of their attendance at meetings. Historically, if they were absent, they could claim no liability due to not being involved in making the decisions at that meeting.

[1] The definition and content of each of the three pillars is detailed in the Introduction to Chapter 3.
[2] Land Credit Co of Ireland v Lord Fermoy (1870) LR 5 Ch App 763

Other issues raised in this pillar have followed similar paths. Two main roles of independent directors are identified: to guide and assist the company's board and senior management, and to monitor the company's management to ensure they are performing to their maximum capabilities and are acting honestly and diligently.

The literature in the Governance Pillar has followed a trend similar to that of the Legal Pillar, a gradual and logical progression over time. Corporate Governance is a much more recent concept, first recognised in the early 1980s (CIMA, 2000; Tomasic, 2001; Vinten, 2001; Bosch, 2002; Nelson, 2002), although common sense would suggest it has existed since the first related cases were heard, as far back as 1870.

Literature in the Legal Pillar originated principally from Australia as the focus of this research is on this jurisdiction; the literature analysed through the Governance Pillar was more widespread, with influences from the United States as well. The most influential report came from the United Kingdom. The *Financial Aspects of Corporate Governance* (Cadbury, 1992) was the first of a series of reports from the United Kingdom, and *Review of the Role and Effectiveness of Non-Executive Directors* (Higgs, 2003) is the most recent. These reports looked at independent directors relative to board structure, senior management remuneration, powers of independent directors, and general good corporate governance. Similar reports have appeared in other countries, reviewing the governance aspects of their own public companies.

The literature in the Governance Pillar is much broader than just these governance reports, however, and includes industry guidelines as established by regulators such as the Australian Securities Exchange and similar regulatory bodies in other countries. Two points should be noted. New or revised regulations have often followed a new governance report, and the reports have recognised differences in certain issues related to the size or nature of the company. But over time, the progress has been logical. The roles of independent directors have been identified as expanding the skills and knowledge of the board as a whole, monitoring the executive directors and senior management, and creating a link between the board and the company's stakeholders.

In contrast, the literature in the Commercial Pillar has had no foundation such as the law or a regulatory environment, and is unstructured and confused. Articles have been authored by many observers in the field, and lack reference to previous authors or concepts. As such, there is no gradual or logical progression through time. The articles were merely written by observers about what they noted, and were often in response to a new law or regulation.

This Commercial Pillar literature, while lacking in logical progression, can be designated into five distinct categories: board performance, monitoring, effectiveness, board committees and individual expertise. Even though it identifies several roles of independent directors – performance enhancement, monitoring and acting as a boundary spanner – the lack of structure and logical progression and the subsequent state of confusion fail to convey confidence that the area has been thoroughly researched, thereby leaving an ideal gap in the literature to be addressed

1.2 Research problem

The aim of this research is to generate a theory with regard to the following statement:

The role of the independent non-executive director in Australia

This aim is set out in a detailed narrative in Chapter 5. However, in broad terms, this thesis argues that the director's role is to improve the performance of the board and of the company. Two issues – information and company position – impact on the role more than any others. Information refers to the nature and quality of information provided to the independent director to enable them to perform their role, while company position refers to the size of the company, its position in its life cycle, or whether it is going through a major change initiative such as an acquisition, divestment, merger or restructure.

As highlighted above, the literature is deficient when analysed from a Commercial point of view. In contrast, the literature analysed through both the Legal and Governance views was found to be logical and progressive. The data analysed through the Legal Pillar were framed around the related common law and the *Corporations Act 2001*, the statute with the greatest impact on directors' duties. The analysis of prominent issues during this research showed that legislators often follow precedent established through common law. The Courts can sometimes move quicker than the legislators, and can bring contemporary logic and practice into their decisions, and often cases are decided on the Justice's interpretation of the facts relative to legislation.

The analysis of the categories of data in this area (detailed in Chapter 3) used the progression of decisions on the issue of the duty of care and diligence as an example of the logical sequence of the common law decisions made over a period of more than 120 years as related to contemporary practice. Chapter 3 also discusses the evolution of the uniform companies legislation from its origin in 1961 to the commencement of *the Corporations Act* in 2001. It was found that while the paths through common law and statute were logical over time, they were by no means straight. However, the deviations were only minor, and were often influenced by the subtle differences in the facts of the cases considered under common law.

The categories in the Governance Pillar, while more widespread than in the Legal Pillar, could also be designated into two sets: industry reports or regulatory principles, again described in more detail in Chapter 3. The industry reports follow two streams, either a succession of reports through the same industry group such as the Financial Reporting Council in the United Kingdom – with a series of five reports from the *Cadbury Report* (1992) to the *Higgs Report* (2003) – or a report published in one country motivating the publishing of a similar report in another country, such as the *Cadbury Report* leading to similar reports in France and South Africa.

The regulatory principles have also evolved over time. Examples are the *ASX Corporate Governance Principles,* which were released in 2003 and revised in 2007. Also, the OECD released its *Principles* in 1999 and revised them in 2004. In some cases, following the release of a set of principles in one country, a similar release occurred in another country. The paths of the principle reviews by the regulatory bodies followed the path of the industry reports, and both are logical and have progressed in an increasingly contemporary manner over time.

As mentioned above, the literature in the Commercial Pillar, unlike that of the Legal and Commercial pillars, had no foundation such as the law or regulations on which to build the frame, and so is widespread and fragmented. The literature is mostly reactive, with articles written in response to an event or a new set of guidelines or principles. The finalisation of the AWA cases motivated many articles, in addition to the Independent

Working Party into Corporate Governance (*Strictly Boardroom*, Hilmer, 1998). Similarly, the release of policy proposals for the Commonwealth Law Economic Reform Program (CLERP, 2003) instigated many articles, including *CLERP Explained* (Baxt et al, 2000). But as each new issue came and went, so did the related articles. There was no continuity from previous issues or articles, each seemingly done independently.

From the logical conclusions able to be made from the analysis of the literature in the Legal and Governance Pillars, the lack of logic in this Commercial Pillar stands out in stark contrast. This gap in the literature calls for research through the Commercial Pillar to conduct a well structured study to create some sense of logic in the literature .

1.3 Justification for the research

The aim of this study, to define the role of the independent non-executive director in Australia, addresses a gap identified in the literature. This area of research is important for a number of reasons.

The number of shareholders owning shares in public companies has increased recently for several reasons, including an increasing number of public companies (discussed in Chapter 2) and compulsory superannuation contributions. As independent directors are considered to be the representatives of shareholders, they have therefore taken on greater responsibilities.

With more major companies failing, shareholders are concerned about their investments, and look to the independent directors to protect these investments. Shareholders want to know what independent directors are doing and how they are protecting investments. Chapter 2 discusses the relationship between shareholders and independent directors in greater detail on the basis of agency theory, and concludes that the shareholders elect the independent directors to act on their behalf.

In addition to shareholders, public companies have a number of other stakeholders: employees, customers, suppliers, regulators and all other groups that are impacted by the company's operations, including environmental groups. These groups want to rely on the independent directors to act independently of the executive directors and senior management, and with the interests of these groups in mind. Legally, however, all directors must act in the best interests of the company, and these stakeholder groups consider that by acting in the best interests of the company, the independent directors will also be acting in the best interests of these groups.

Public companies may be considered to be the backbone of a country's economy; they employ more people than any other group, aside from government, and are responsible for the majority of production. The governance of these companies cannot be left to a few whose motives may not be clear. The independent directors on the boards of these public companies are expected to bring a degree of control to the boardroom, to ensure that the executive directors are not treating the company as their own, but rather managing the company for the benefit of all concerned.

While other research has investigated the role of independent directors, no similar studies have been done in the Australian context. Australia has a unique economy, influenced by the size and spread of its population across a large continent, the associated transport issues, the country's struggles during its formative years affected by its distance from other civilised nations, and now from its trading partners (Blainey, 2001). The experience and lessons from other economies, such as the United Kingdom and the United States, are useful in providing some guidance and helping shape Corporate Governance in Australia, but our unique situation requires a well-structured qualitative study to help to define the role of the independent non-executive director in Australia.

The methodology used in this study has been used to both draw out a definition of the role and uncover other issues that impact on the role. It has enabled the researcher to create a narrative to describe not only what independent directors do, but also how they act and what they bring to the role that enables their contribution to be worthwhile and productive.

1.4 Methodology

One of the purposes of this study was to develop knowledge that can be used in related practice and policy. Grounded theory is considered to be the most appropriate methodology as this fits with the situation being researched (Denzin, 1977), and uses the data to formulate a theory. Grounded theory is a qualitative research methodology that has its roots in phenomenology (Crabtree & Miller, 1999), with data collection through interviews conforming with Creswell's (1998) determination of what forms of information can be used in formulating grounded theory. Grounded theory is developed from the data gathered in the field and subsequently analysed, and so it is said to be 'grounded' in the data. It is not a process of setting a hypothesis and then testing it.

Grounded theory was developed by Glaser and Strauss in 1967, and many researchers and sociologists have subsequently used this methodology to develop theories derived from research in social settings. Grounded theory has gained significant support over time and has been used in many research studies covering an increasing number of sociological and economic areas (see Strauss & Corbin, 1997, for example).

The main source of data was a series of interviews with independent directors, supported by participant observation and discussions with industry experts. Other forms of data collection were considered and discarded. The disadvantages of both focus group interviews and questionnaires outweighed their advantages. One-on-one interviews were considered the technique to provide the best data, and many of the disadvantages of interviews were overcome by the study design. Chapter 4 discusses the methodology in more detail.

In grounded theory, the data are collected and analysed through a systematic coding process to develop the theory. The data collection process can be iterative, with the researcher collecting some data, conducting a preliminary analysis through writing memos and coding the data, then returning to the field to collect additional data and repeat the memo writing and coding process. This continues until no new data are found, following which the researcher completes the coding and analysis, and formulates the grounded theory.

The data are analysed through a coding process which flows from open coding through axial coding to selective coding, as described in Chapter 4. Through open coding, the data are opened up to allow the concepts inherent in the data to be identified. Axial coding moves the focus around a concept and allows the researcher to identify the relationships between the open codes, in order to develop core codes. Finally, selective coding enables the researcher to focus on individual categories, allowing for the selection of the core code. This is the central phenomenon resulting from the axial coding process.

This study initially consisted of 19 stages, culminating in the development of the grounded theory. Two additional stages – comparison with the literature and the contribution to professional practice and policy – are described in Chapter 6.

1.5 Thesis outline

This first chapter introduces the research topic through a brief description of the study and its aims, and highlights some of the more important aspects of the research.

Chapter 2 provides the foundation for this study and gives the background to the development of directors and their increasing importance over time. Specifically, the election of independent directors to company boards recognises the importance of this issue, and helps to bring control back to the shareholders from the company's management, thereby overcoming the issues associated with agency theory.

Chapter 3 analyses the literature related to independent directors. The literature was split into three pillars, each reflecting a different aspect of the topic, and allowing the literature to be sorted into Legal, Governance or Commercial areas of influence. The analysis of the literature in the Legal and Governance Pillars revealed a logical evolution of the role of the independent director through time. But the literature in the Commercial Pillar was found to be unstructured and without foundation, and while some conclusions could be made through this analysis, a gap in the literature was revealed that is addressed by the current study.

Chapter 4 describes the methodology in detail. It justifies the choice of methodology, the use of interviews as the main source of data collection, and the method chosen for analysing the data. This chapter also presents the statistical details of the interview subjects and the public companies of which they were board members at the time of the interviews.

The results and analysis of the research is discussed in Chapter 5. In this chapter, the iterative nature of the data collection process becomes evident as the progression of the analysis shows that the researcher returned to the field to gather additional data on two subsequent occasions. It was only after the third visit that the data were considered to be saturated, and the researcher was able to finalise the analysis and generate the grounded theory. The theory states that the role of the independent director is to improve the performance of the board and of the company. This role is influenced by a number of factors: personal attributes, structure, monitoring, relationships, representative, information and company position. The final two factors have the most influence on the role, and therefore have the greatest impact on practice and policy.

The final chapter discusses the issues raised by this research study, compares these results with the findings in the literature review, and discusses the limitations of the study, the contribution to knowledge and professional practice and policy. The main issues here are the impact on the role of the information provided to the independent directors, as well as the impact due to the position of the company at any time. It was found that there is a fine line between independent directors acting as management, determined by the nature and amount of information provided to them; if they have too much information they may be considered as part of management. Similarly, if the company is going through a period of major change, independent directors tend to be more involved because they can provide expert opinion or advice not otherwise held within the company. The other aspect of company position is the size of the company; smaller companies involve their independent directors more as their small size can limit their ability to attract experienced or adequate staff.

1.6 Definitions

This section briefly defines the different types of directors. These are described in more detail in Chapter 2.

Executive directors are otherwise employed by the company, usually on a full-time basis, and usually as part of senior management, such as the Managing Director / Chief Executive Officer (CEO) or the Finance Director (sometimes known as the CFO).

Non-executive directors are not employed by the company, and may be either non-independent or independent. Those that are not considered to be independent have some other relationship with the company, such as a major shareholder, a major supplier or customer, or a former member of senior management.

Independent directors have no other relationship with the company other than as a member of the board of directors. They are considered to be independent of the board and of management, and tests for independence have been detailed in the *ASX Corporate Governance Guidelines*.

While many of the issues discussed in this study can be related to all three types of directors, the thesis concentrates on issues related to independent directors.

1.7 Limitations of scope and key assumptions

One of the aims of this research was to provide contributions to professional practice and research in the subject area. One of the boundaries set by the researcher limits the role to Australia. While the literature reviewed in Chapter 3 also includes sources from overseas, these are considered in the light of their impact on directors' roles in Australia.

Independent directors, and not executive or non-executive directors, were chosen as the focus of this study because the role of independent directors is of interest to a wide audience simply due to their independence, and what this implies. They have a unique position in the boardroom, and examining their role gives the study focus and purpose.

The data were collected from interviews with 12 directors holding independent positions at the time of the interviews. This number was considered sufficient; indeed, the data were saturated after the tenth interview, with no new data collected in the last two interviews.

1.8 Conclusion

This chapter has laid the foundation for this report. The research problem was introduced, and the research was then justified. The methodology was introduced in some detail following which the more important definitions were covered. The outline of the study has been described and the limitations have been discussed. On this basis, the study follows with a detailed and methodical description of the research.

Chapter 2 BACKGROUND

2.1 Introduction

This chapter provides background information on the emergence of independent directors and why their inclusion on public company boards has become an important part of good corporate governance.

The chapter discusses the history of the company and, with this, the change of control of companies and the issue of ownership and control. Agency theory has become a recognised problem in company management and direction since being first raised by Berle and Means in 1932, and it has impacted on the changing nature of public company boards. As boards have evolved over time and corporate governance has become the main component of managing and directing companies, owners have turned to independent directors in an attempt to regain control of companies.

As the importance of creating boards to include a majority of independent directors is now the preferred structure of regulators in most countries, what independent directors do, and how they go about their role, has taken on greater significance.

2.2 The rise of the corporate form entity

2.2.1 The birth of the corporate entity

Prior to 1844, in the United Kingdom there were three principal ways for businesses to operate: as a sole trader, in a partnership, or as an unincorporated entity. Corporations were allowed by Royal Charter, and by incorporation through special Act of Parliament (Rubner, 1965; Tricker, 2005). The Companies Act of 1844 allowed joint stock companies with limited liability. From this, companies became separate entities with a life of their own, they could continue to operate after the death of those who first formed the company, and the stock could be transferred or sold to others. Liability on the part of the owners was limited to the extent of their equity investment, whereas previously creditors of the earlier forms of businesses could pursue their debts from the individuals involved in those businesses.

The formation of limited liability companies meant that the owners of the company were no longer personally responsible for the debts of the company. Initially, the managers of those companies were not seen to be responsible for the debts of the companies; it was the artificial body of the company itself that bore all liability for contracts entered into in the name of that company (Rubner, 1965). Whereas previously creditors of a business could sue the partners or traders, they were now able to sue only the company for payment of their debts. If the company could not pay, they were out of pocket as there was no recourse to the managers or the directors.

The emergence of joint stock companies had a significant impact on economic advancement, as the limitation of commercial liability of limited liability companies sped up the establishment of large companies, and industrial advancement was accelerated in companies where the management and ownership were different. Two independent resources were brought together through these companies. Businessmen without the necessary capital to form their own ventures were given opportunities to use their skills in business, and owners of capital with little or no business acumen found companies in which they could invest their capital. The number of newly formed companies continued to increase and the initial investors wanted to be able to trade their existing investments for new investments. Also, new investors wanted to invest their capital in new or existing companies, and both of these investors needed a mechanism to transfer this capital.

In the early part of the twentieth century, particularly in the United Kingdom and the United States, the shares of many of these joint stock companies were listed and traded on the stock exchange. Shareholders were able to diversify their investments and new shareholders could invest in companies listed on their local stock exchanges as well as stock exchanges in other countries.

The ownership of public companies became distant from those who managed these companies, and the issue of ownership and control became important. Professional managers took over control of companies, who were then free to pursue their own aims (Muth & Donaldson, 1998). As shareholders were no longer able to be involved in managing the companies, directors were given the responsibility of representing the shareholders. Agency theory can argue that shareholders have lost control of companies, and that their interests can become compromised if the management considers its self-interest ahead of the performance of the company. With agency theory dictating that management cannot be trusted, they in turn must be controlled by the board. Therefore, boards of directors that are independent of management should be responsible for overseeing the managers.

Boards of directors that are not independent may be compromised in their decisions, but boards containing independent directors that apply their independence in their judgements and decision-making should not be compromised and should responsibly represent the shareholders.

2.2.2 The growth of public companies

As mechanisms for sourcing new capital improved, an increasing number of companies became listed on the world's stock exchanges. As an example, the number of companies listed on the London Stock Exchange at the end of 2005 was 3,091, an increase of 21% over 1990, while greater increases were noted in New York (+28%) and in Australia (+51%) over the same time period[3]. Detailed statistics are included in Appendix 1.

The supply of new capital in Australia has come from increased personal wealth as well as changes to the superannuation rules. The supply of new companies seeking listing on stock exchanges has come from the privatisation of government entities, technological advances in science as well as the increase in commodity prices, a result of previous discoveries of certain commodities that were uneconomic to mine now becoming economically viable.

Other issues such as low interest rates and changes in tax regulations have also made equity investments more attractive to investors willing to accept greater risks in seeking higher returns. Increased wages and higher rates of employment leading to greater personal wealth have also provided an increased number of investors with capital available to invest in stock markets (Nichols, 1969). These factors have supported

[3] World Federation of Exchanges. Number of Listed Companies (Secretariat). 22/05/2006.

diversity in public companies in which to invest as well as an increase in demand for liquid investments. This last issue has helped to push up equity prices, along with the increase in public company profitability and the expectation by investors of further capital growth and increased dividends (Nichols, 1969; Byrt, 1981).

2.2.3 The explosion in invested capital

Total market capitalisation in global stock markets has increased significantly with the increase in demand for public company shares, supported by the expectation of capital growth and increased dividends, and the increased number of companies listed on public company stock exchanges. These increases have been significantly higher than the increases seen in the number of companies listed on stock exchanges. For example, total market capitalisation on the London Stock Exchange increased 3.6 times from 1990 to 2005, with higher increases noted in New York (4.94 times) and in Australia (7.45 times) over the same period[4]. Detailed statistics are included in Appendix 2.

As more people are placing their savings and superannuation in investments in public companies, it could be assumed that these investors would place greater scrutiny on the governance regimes of those organisations. Not only could it be likely that the investors would be interested in the management of those companies, but they may also be concerned about the stewardship of the companies, especially in the light of the issues suffered by the shareholders of OneTel, HIH and other similarly affected companies. The scrutiny of the board of directors, and particularly of the independent directors, may be increased. The emphasis on independent directors stems from the understanding that they are elected to the board by the shareholders to look after the interests of the shareholders.

[4] World Federation of Exchanges. Domestic Market Capitalisation (Secretariat). 22/05/2006.

2.3 The governance debate

2.3.1 Who controls the power

While a company's senior management has the responsibility of making decisions regarding the day-to-day management of a company, the major decisions concerning a company are made by the directors and the shareholders (CASC, 1999). The role of the board of directors is to supervise the management of the affairs of the company, while the shareholders' power comes from their responsibility in voting on shareholders' resolutions at the annual or extraordinary general meetings.

The resolutions proposed at these meetings stem either from common law and legislation, or from determinations made through the company's internal documents and statutes. Subjects that are typical of resolutions voted on by shareholders include amending the company's statutory documents and the election of board members; however, the power of shareholders is somewhat lessened by the fragmented ownership (Bouy, 2005).

Shareholders in a large public company cannot, practically, manage the company, and the standard constitution of such a company vests management powers in the board[5] Instead they elect directors to the board. These directors are expected to guide and monitor the management of the company. Shareholders usually meet once each year at the Annual General Meeting, but the board of directors usually meet monthly, and can easily meet more regularly if required. The company's management is active on a daily basis, and is regularly monitored by the board of directors. As the board members and management have a closer relationship that that between the shareholders and the board, it is likely that the board has a greater influence over the company's management.

With ownership separated from management, shareholders have limited means of controlling management, the most effective said to be through the board of directors. Other means are performance-related executive compensation, legal protection of shareholders' rights and the continuing disclosure requirements (Teng et al., 2004).

[5] Corporations Act, 2001 s 198A.

Common Law dictates that shareholders are not able to pass resolutions that interfere with the powers of the company's board[6] but a board of directors may refer a specific issue to the shareholders at an Annual General Meeting for ratification[7].

Tricker (2005) considers that the board of directors is ultimately responsible for the performance and decisions of the company. The board is accountable to the shareholders, and to repay this accountability it should be monitoring the company's management and provide strategic direction to them. With the board of directors being mandated to manage, monitor and supervise the company's management, they have significantly more power over the company's management than do the shareholders. If the shareholders object to how a company's board of directors is performing, they really only have two forms of recourse. The shareholders can either choose not to re-elect those directors that they consider to be under-performing, or they can sell their shares in the company. But with each shareholder having one vote per share held, it would be difficult to convince many shareholders to vote not to re-elect any one director. Large shareholders, such as institutional investors, may have more power as they control a greater number of shares and may have influence through the Investment Managers' Association than any one individual shareholder may have through the Australian Shareholders' Association.

There may be some substance to the argument of each shareholder only having one vote no matter how many shares they own, as proposed in the USA (De Miguel et al, 2005) as this may reduce the power of any one shareholder. However, this may also lead to increased power in the board of directors as no one shareholder, no matter how many shares they hold, would be able to influence any shareholder votes. The only way for shareholders to influence any board decisions is in the election of board members, and as directors are elected for periods of three years before they have to stand for re-election, this power of the shareholders is somewhat diluted.

However, potential directors are not proposed by the shareholders; they are proposed by the board of directors, and more recently through the nominations committee. Further, the board of directors has the ability to appoint directors at times other than at

[6] See Gramophone & Typewriter Ltd v Stanley [1908] 2 KB 89, Shaw & Sons (Salford) Ltd v Shaw [1935] 2 KB 113, Scott v Scott [1943] 1 All ER 528, NRMA v Parker (1986) 6 NSWLR 517.
[7] Winthrop v Winns [1975] 2 NSWLR 666.

shareholder meetings, with these appointments subject to ratification by the shareholders at the next general meeting (Ponssard et al., 2005).

As joint stock companies became more prevalent, and their shareholders grew in number, the control of the organisation passed from the shareholders to those managing the company.

2.3.2 Ownership v control

In their pioneer work published in 1932[8], Berle and Means deduced that shareholders were having a reduced impact on management or control of a company, with the control function being increasingly in the hands of management. They argued that as companies became larger and had more shares on issue, while at the same time investors had increased wealth and the pool of investors therefore grew and diversified, the number of shares owned by the larger shareholders decreased. If the largest shareholders held fewer shares, companies were controlled more and more by managers, and less by the shareholders. Berle and Means referred to this as owner control passing to management control (Nichols, 1969; Tricker, 2005). This separation has the potential to result in a divergence of attitudes between the interests of shareholders and managers, without there being any effective monitoring of the actions of the management (du Plessis et al., 2005).

Over time, control of public companies has moved from a few groups of large or dominating shareholders to those that manage the companies. As shareholdings continue to disperse over a greater number of shareholders, it becomes more difficult for a few shareholders to exert any form of control over a company (Byrt, 1981; Demsetz, 1997). Formal control may still remain in some companies where a single large shareholder remains, usually in the form of the founding family, but informal control has become more common, where managers control the company, no matter what the shareholding pattern may be.

Shareholders own the company and therefore have the right to control the company. However, it is the norm that the control is delegated to the company's management by

[8] The Modern Corporation and Private Property

the shareholders (du Plessis et al., 2005). The shareholders have no authority over the company's management, as there is no effective direct monitoring of the management by the shareholders. This is the responsibility of the board of directors. The shareholders have some control over the composition of the board of directors, and if they do not like how the board is monitoring the company's management, they can decide not to re-elect certain board members. The executive directors are caught between their responsibility as senior members of the company's management and as members of the board of directors, so it is really in the hands of the independent directors to represent the shareholders in their monitoring of the company's management (Muth & Donaldson, 1998).

2.4 Power of the board

2.4.1 Board power and agency issues

Prior to Berle and Means investigating the separation between ownership and control, Adam Smith in *The Wealth of Nations* (1776) wrote of the agency problem associated with the spread of shareholding in joint stock companies. He discussed that directors of joint stock companies would not manage other people's money as well as they would manage their own (Demsetz, 1997). While the shareholders and directors will have a relationship, the directors will always take decisions that maximise their own returns, but which may not always be in the best interests of shareholders (Tricker, 2005). To combat this, a system of checks has been put in place over time, including continuous disclosure requirements, the establishment of audit and other committees, the separation of the CEO and the Chairman, and the increased appointment of independent directors.

The board of directors must be distanced in some way from the company's management. It is expected that at least one executive be a director, usually the CEO, but the greater the independence of the board, the less likely that there will be any management influence on the board. The separation of the creation of strategies by management, and the actions of the board in reviewing and confirming those strategies, are imperative to the profitability of the company (Muth & Donaldson, 1998) and the more independent a board is from management, the more positive an effect will be seen in the firm's performance.

The view that the board of directors represent the shareholders is based on the notion that the most vulnerable investment in a company is the equity investment, as it is subordinate to all other forms of investment in a company, whether they are funds owing to creditors or funds borrowed from any type of lender. The board of directors should not be operational, that is, it should not be involved in the daily operational decisions of the company. Rather, the board should be monitoring those who make the daily operational decisions. The executive directors are also, by definition, members of management, and agency issues are evident when those who monitor the managers are themselves the managers. The board is the main governance mechanism for the shareholders, and the monitoring function will be effective only if the independent directors on the board carry it out (Carroll & Teece, 1999). If the board of directors answered to no one but themselves, the personal costs to the management involved in appointing independent directors would result in no independent directors being appointed to any boards. Any such appointment would only add to the costs of running the company, but more importantly, appointing independent directors does result in a reduction in power of the executive directors.

2.4.2 Solving the agency issue

Recommendations on good corporate governance through appropriate board structures have been a significant issue for some time. The earlier investigations into this issue started in the United Kingdom in the early 1990s with the Cadbury, Greenbury and Hampel Reports. These are discussed in detail in Sections 3.4.2, 3.4.3 and 3.4.4. Briefly, these reports espouse that the role of independent directors is to bring transparency to board decisions, and to allow the board to exercise independent judgement when making those decisions. In an earlier report in 1982, the American Law Institute released a draft of corporate governance principles recommending that boards should consist mostly of independent directors as a means of improving good corporate governance, as these independent directors were less likely to be 'yes men' to management (Carroll & Teece, 1999).

More recently in the United States, the Sarbanes-Oxley Act of 2002 recommended that independent directors would improve the corporate governance of companies. In

Australia, the ASX Corporate Governance Council released recommendations on their preference for independent directors on boards, with the initial recommendations released in 2003 being reviewed and updated in 2007 to place more emphasis on independent judgement and independence of mind.

Due to the size and scale of most public companies, there is a division between the three main players, these being the shareholders, the board and the company's management. The form of the company will also result in inherent costs, the most significant of which is the agency cost that exists due to the difference in interests between the shareholders and the management (Stapledon & Lawrence, 1997). The three components of agency cost are:

- the costs incurred by the shareholders in monitoring the company's management to minimise the divergence between their interests
- 'bonding' costs incurred by the company's management
- the 'residual loss' resulting from the remaining divergence in shareholders' and managers' interests (Stapledon & Lawrence, 1997, p. 153).

Over time, there has been the understanding that boards of directors have different components and that an increase in the proportion of independent directors will benefit the company. While an increase in the proportion of independent directors may not improve the financial performance of the company, this strategy may improve the company's share price as investors conclude that appointing additional independent directors means that the company is looking to address problems with the business (Stapledon & Lawrence, 1997).

Unless they have previously been involved in the industry, outside of any involvement with the company in question, independent directors are unlikely to improve the financial performance of the company as they have less business knowledge of the company and its industry than executive directors, or than non-executive directors with some form of relationship with the company. But the addition of independent directors does give the appearance of good corporate governance, which in itself may give investors more confidence.

2.5 The evolution of different types of directors

2.5.1 What is a director?

The first instance of directors being appointed to oversee a company was in 1600, when the East India Company was established (Keay, 1991; duBois, 1938). This company was formed by a number of traders who were often absent from London for extended periods of time. The owners' view was that as they were not able to oversee the company on a regular basis, they would appoint a Court of Directors to oversee the company on their behalf.

But what is a director? Section 9 of the Corporations Act 2001 gives the following definition:

"director" *of a company or other body means:*

> *(a) a person who:*
>
> > *(i) is appointed to the position of a director; or*
> >
> > *(ii) is appointed to the position of an alternate director and is acting in that capacity;*
> >
> > *regardless of the name that is given to their position; and*
>
> *(b) unless the contrary intention appears, a person who is not validly appointed as a director if:*
>
> > *(i) they act in the position of a director; or*
> >
> > *(ii) the directors of the company or body are accustomed to act in accordance with the person's instructions or wishes.*

Subparagraph (b)(ii) does not apply merely because the directors act on advice given by the person in the proper performance of functions attaching to the person's professional capacity, or the person's business relationship with the directors or the company or body.

Therefore, a person doesn't have to be appointed by the shareholders to be considered a director. Merely the fact that they act as a director, or that others act as though that person is a director, means that they can be considered to be a director (Baxt, 2002a; du Plessis et al., 2005).

2.5.2 Different types of directors

As is evident from the above definition, there are different types of directors. While this study is based on the role of the independent non-executive director, it is important that the distinctions between the different types of directors are clarified.

Executive director

An executive director is a director who is validly appointed to a company's board and is also a full-time employee of that company. It is usual for a company's Chief Executive Officer (CEO) to also be that company's Managing Director. It is also not uncommon for a company's Chief Financial Officer (CFO) to also be that company's Finance Director.

Non-executive director

A non-executive director is one who has been validly appointed to a company's board but is not an employee of that company. A non-executive director may be considered to be either independent or non-independent, depending on what, if any, relationship they may have with the company. Tests of independence determine which category these directors fall in to. These tests of independence are discussed in detail in Section 2.6.1.

Shadow directors

Shadow directors are those covered by the definition in *(b)(ii)* above. That is, they are not appointed as directors, but act through nominees on a board (Baxt, 2002a), or have their advice or guidance taken by the board or company as if they were validly appointed directors. This definition excludes those who are consultants or advisors paid by the company in that capacity (du Plessis et al., 2005).

De facto director

A de facto director takes on a role as if they were a validly appointed director. This can include acts such as negotiating on behalf of the company, signing the company's seal or company cheques (Baxt, 2002a).

Nominee directors

Nominee directors are appointed to a company's board by a party with an interest in that company, such as a major shareholder or a group of creditors. These appointments are usually permitted through the company's articles of association (Baxt, 2002a).

Alternate directors

An alternate director is appointed to fill in for a director when that director is absent. An alternate director will be taken to be acting as a normal director only to the extent of their participation (Baxt, 2002a).

Directors are either executive or non-executive. The other four types of directors are legal terms for others acting in a certain capacity that is determined either by their actions or how they were appointed to a company's board. Neither shadow directors nor de facto directors are appointed to a company's board, but their actions are taken at law to be as though they were directors. Both nominee and alternate directors are appointed to a company's board, and both act on behalf of others.

Definitions and terminology used in this study

Three main types of directors will be discussed in this study: executive directors, non-executive directors and independent directors. Non-executive and independent directors are both non-executive by definition, but each type has a different relationship with the company. Definitions of each class are:

Executive directors are elected to the company's board by its shareholders, and are also employed in some other capacity in the company, usually being part of senior management.

Non-executive directors are also elected to the company's board by its shareholders, are not employed by the company, but do have some type of relationship with the company other than their position as a director. This relationship may be as a major shareholder, supplier or customer, as a consultant or advisor to the company, or as a previous employee of the company, usually in a senior position. In a definitional sense, these types of directors are non-executive non-independent directors.

Independent directors are elected to the board by the company's shareholders, and have no other relationship with the company outside of their position as a director.

2.5.3 Board power and independent directors

Berle and Means (1932) discussed the control of companies passing from owners to managers as more shareholders each owned a lower proportion of shares as companies became larger and had more shares on issue. More recently, du Plessis et al. (2005) describe the same occurrence as control being delegated to the company's management by the shareholders. But it is the responsibility of the board of directors to oversee management. Executive directors are caught between being part of senior management and being members of the board, and Muth and Donaldson (1998) therefore consider that it is the independent directors who should be representing the shareholders in monitoring management.

Adam Smith (1776) had written about the agency problems associated with an increasing number of shareholders in public companies. Before directors had been appointed, shareholders had delegated the running of companies to management. Subsequently, directors were appointed to monitor management on behalf of the owners, but Smith argued that directors would not manage a company's money as they would their own (Demsetz, 1997). This did not solve the practices predicted by agency theory, as first the managers, then subsequently the directors, were considered to make decisions while influenced by agency theory.

The best interests of the owners may not always be most adequately served by executive directors who are, by definition, part of management, but rather by non-executive or independent directors. However, some non-executive directors may have some form of relationship with the company, and the practices predicted by Agency Theory may also affect their decision-making. This is where the importance of independent non-executive directors becomes a significant issue in corporate governance (Bird, 1995).

2.5.4 Mitigating board power

A company's board of directors has significant powers and responsibilities. But boards are self-regulating (Francis, 1997) and systems and procedures must be put in place so interested parties can be comfortable that the process of self-regulation will work. Part of the integrity of self-regulation is the structure of the board. This has been recognised through the various studies and reports into good corporate governance practices.

This requirement for self-regulation has come about because shareholders have lost control of companies to management. Boards of directors have taken the responsibility to represent shareholders (Teng et al., 2004), and therefore should be more accountable to the shareholders (Bouy, 2005). But it is only the independent elements of the board that provide a means for shareholders to take back some form of control (Muth & Donaldson, 1998). Further, as recommended by the ASX, the independent directors should constitute the main board committees, particularly the audit, nomination and remuneration committees (du Plessis et al., 2005; Tricker, 2005).

The most relevant reports on corporate governance are the Cadbury, Greenbury, Higgs and Hampel Reports in the United Kingdom, the Sarbanes-Oxley Act in the United States, The OECD Principles of Corporate Governance, and the Hilmer and Bosch

Reports in Australia. All these reports include recommendations that boards consist of a number of independent directors, and that the major board committees comprise a majority of, or comprise only, independent directors. These reports are discussed in greater detail in the next chapter.

In Australia in 1994, the ASX advised they were going to promote improved corporate governance standards in Australia through their listing rules (Bird, 1995). These rules were to take effect in 1995, and included the use of independent directors as a means of improving corporate governance. The market had already recognised the importance of appointing independent directors to public company boards; the ratio of non-executive and independent directors to executive directors had increased from four directors to four executive directors in the period 1982−1992, to six non-executive and independent directors to two executive directors in 1993 (Bird, 1995). This increase in the proportion of non-executive and independent directors may have been in response to the Cadbury Report in the United Kingdom, which was released in late 1992.

2.6 The independent director

2.6.1 Determination of independence

A number of the more important corporate governance reform papers, including the Higgs Report in the United Kingdom, the Sarbanes-Oxley Act of 2002 in the United States and the ASX Corporate Governance Recommendations in Australia, submit that a company’s corporate governance practices improve with the inclusion of independent directors to the company’s board (du Plessis et al., 2005). However, none of these publications provide a definition of independence.

The ASX Corporate Governance Recommendations does, however, include how the independence of a director can be assessed. The seven criteria to this assessment are that an independent director is a non-executive director and:

1. is not a substantial shareholder (per the Corporations Act 2001 definition) of the company or an officer of, or otherwise associated directly with, a substantial shareholder of the company

2. within the last three years has not been employed in an executive capacity by the company or another group member, or has been a director after ceasing to hold any such employment

3. within the last three years has not been a principal of a material professional adviser or a material consultant to the company or another group member, or an employee materially associated with the service provided

4. is not a material supplier or customer of the company or any other group member, or an officer of or otherwise associated directly or indirectly with a material supplier or customer

5. has no material contractual relationship with the company or another group member other than as a director of the company

6. has not served on the board for a period which could, or could reasonably be perceived to, materially interfere with the director's ability to act in the best interests of the company

7. is free from any interest and any business or other relationship which could, or could reasonably be perceived to, materially interfere with the director's ability to act in the best interests of the company.

The ASX Corporate Governance Recommendations were released in 2003. They were not intended to be a compliance requirement of the ASX, but companies that did not comply with all of the Recommendations were asked to explain why they did not comply. This 'if not, why not' system was intended to provide a system whereby the ASX could create a culture of good disclosure, and that it was up to the company boards to create the culture of good corporate governance.

The ASX Corporate Council indicated that they wanted companies to operate under the Best Practice Recommendations for three or four years, and monitor how the system works in practice during this time. In late 2006 the Council released its proposed changes to the Recommendations, asking for comments to be submitted by early February 2007.

These amendments include changing the direction from an assessment of independence of directors to relationships affecting independent status. The new criteria raised are that all directors should use independence of judgement when working on boards.

'Assessing the independence of directors' is recommended to change to relationships affecting independent status, with the seven criteria listed above to change to five new criteria. In this, a director should not be regarded as independent if the director:

1. is a substantial shareholder of the company or an officer of, or otherwise associated directly with, a substantial shareholder of the company

2. is employed, or within the last three years has been employed, in an executive capacity by the company or another group member, and there has not been a period of at least three years between ceasing such employment and serving on the board

3. has within the last three years been a principal of a material professional adviser or a material consultant to the company or another group member, or an employee materially associated with the service provided

4. is a material supplier or customer of the company or another group member, or an officer of or otherwise associated directly or indirectly with a material supplier or customer

5. has a material contractual relationship with the company or another group member other than as a director of the company.

The ASX Corporate Council is aware of the attitudes towards independence, in particular the means of assessing the independence of directors as well as whether directors use independence of judgement. Independence of judgement can apply to all directors, but it is a difficult concept to use to determine independence because the motivation of each director will be different, and executive directors and non-executive directors will always have at the back of their mind how a particular comment/decision will affect them personally. It is almost impossible for these classes of directors to be considered to be acting independently at all times.

2.6.2 The rise of the independent director

The independent director has become an important part of good corporate governance. This has been recognised by regulators in most countries (refer Table 3.1) in addition to the World Bank and the OECD. In some jurisdictions, regulators have legislated that a minimum number of independent directors be included on public company boards:

- In the Cadbury Report, released in 1992 in the United Kingdom, the important role of independent directors was emphasised as they bring independent judgement into the boardroom.

- The Listing Requirements of the Kuala Lumpur Stock Exchange issued in 2001 requires at least two directors or one-third of board members be independent.

- The Higgs Report, also in the United Kingdom (2003), recommended that at least half of a board of directors be independent.

- The New York Stock Exchange rules, approved by the SEC in 2003, ruled that all listed companies have a majority of independent directors on their boards.

- The ASX Corporate Governance Council released its Principles of Good Corporate Governance and Best Practice Recommendations in 2003. Recommendation 2.1 is that a majority of the board should be independent directors.

- The UK Combined Code of 2004 provides that at least half of the board members be independent directors.

- The OECD Principles of Corporate Governance, released in 1999 and reviewed in 2004, recommended that boards should include a number of independent directors capable of exercising independent judgement. The World Bank supports this view.

But why do these and other regulators recommend that public company boards of directors include a significant number of independent non-executive directors? There are a number of arguments for this position:

- Independent directors form a balancing role to executive directors and senior management (Byrt, 1981; Bird, 1995; Muth & Donaldson, 1998; Tricker, 2005).

- Independent directors should be making decisions in the best interests of the company, and not in self-interest (Byrt, 1981; Cadbury, 1992; Bird, 1995; du Plessis et al., 2005)

- Independent directors are distanced in their selection of a chief executive officer (Byrt, 1981; Bird, 1995).

- Independent directors are distanced on reviewing the performance of the chief executive officer (Francis, 1997).

- Independent directors are distanced on the remuneration policy of senior management (remuneration committee) (Byrt, 1981; Bird, 1995; Stapledon & Lawrence, 1997; Bouy, 2005; Tricker, 2005).

- Independent directors should screen and recommend candidates for board appointment (nominations committee) (Bird, 1995; Francis, 1997; Bouy, 2005).

- Independent directors should constitute all members of the audit committee (Bird, 1995; Francis, 1997; Bouy, 2005; Tricker, 2005).

- Independent directors should take the lead when conflicts of interest arise (Stapledon & Lawrence, 1997).

- Independent directors bring breadth of vision, experience and expertise (Byrt, 1981; du Plessis et al., 2005).

- Independent directors can bring international experience not held by executives (Coulson-Thomas, 1992).

- Independent directors are effective monitors of executive directors and senior management (Carroll & Teece, 1999; du Plessis et al., 2005).

- Independent directors can act as policemen rather than just as monitors (Bird, 1995; Francis, 1997).

- Company boards with a greater number of independent directors are less likely to be sued for misconduct (Carroll & Teece, 1999).

- Independent directors provide unbiased feedback to shareholders and other stakeholders (Francis, 1997).

- Independent directors can provide a mentoring role that is distanced from executives in the company (Francis, 1997).

This is by no means an exhaustive list of arguments why independent directors should be appointed to public company boards. In addition, they undertake many activities that are the same as executive directors, including managing the business of the board, reviewing and approving strategy, ensuring compliance, and many others (Francis, 1997).

The requirement for boards of public companies to comprise a minimum level of independent directors has strengthened considerably in the past 15−20 years, with the arguments for this position supporting an improved level of good corporate governance. Statistically, boards in Australia in the period 1982−1992 averaged eight directors, with four executive and four non-executive directors (Bird, 1995). From 2002 to 2006, a broader annual study by Korn/Ferry shows that the proportion of executive to non-executive directors has increased from 28% executive directors to 72% non-executive directors, to about 26% executive to 74% non-executive directors. With the average board size stabilising at seven directors, the common ratio is now two executive directors to five non-executive directors (Korn/Ferry, 2002; 2006). The reports do not differentiate between independent and non-independent non-executive directors, but the trend has moved away from executive directors.

2.7 Summary and conclusion

As companies have grown and diversified over time, from the original family-owned and family-run company to the major global multinational conglomerate, there have been shifts in who holds the power and control in running the company. The power and control moved from those who owned the company to those who managed the company. Owners lost control and wanted it back to ensure that their investments were protected. During this period, management had control and, through agency issues, became more interested in using their control to further their own interests, rather than making decisions in the best interests of the company.

Boards of directors were then established to oversee management, and regain control on behalf of the owners. Initially, executive directors held the majority of positions on boards, and any non-executive or independent directors were usually appointed due to their relationship with the chairman or executive directors, and merely acted in whichever way their 'masters' wanted them to act. Directors were supposed to represent the shareholders but, similar to the managers, they were making decisions more in their own interests than in the interests of the company.

Owners were again looking for someone who would make decisions that were in the best interests of the company, as this would ultimately benefit the owners. Directors who are independent of management and have no other relationship with the company other than being a director are in this position. While there are some drawbacks to having independent directors on boards, as they may have limited knowledge of the company or its industry (Francis, 1997; duPlessis et al., 2005), they should bring knowledge and expertise that other board members do not have, and bring an independence of mind and judgement. They are elected to the board by the shareholders, and should act only in the best interests of the company while representing the shareholders.

This highlights the importance of the independent director in current and future corporate management, and the important contribution they make towards good corporate governance. But the specifics of what they do in carrying out their duties is unclear. In the next chapter, a broad and detailed review of the related literature identifies the theories underlying the role of the independent director. The literature has been reviewed under three distinct pillars: the Legal Dimension being the why, the Governance Dimension being the how, and the Commercial Dimension being the what.

The following chapters present the grounded theory methodology used to analyse the research undertaken through this study, leading to the presentation of a theory on what the role of the independent director in Australia is, and how this study can develop policies and practices relevant to improving corporate governance through appointing a majority of independent directors to public company boards.

Chapter 3 THEORY AND MOTIVATION

3.1 Introduction

The role of the independent non-executive director in Australia has evolved since the early 1980s. This evolution has been influenced by many factors, the most significant of which was the corporate governance debate. Other influences have come from relevant legislation and common law, and from observers and participants in and around the boardroom.

The following literature review has, for the purpose of this study, been categorised into three pillars: legal, governance and commercial. The first two form a strong two-thirds of the foundation into the search for meaning and understanding of the role of independent directors, but the commercial pillar forms only a weak final one-third of the foundation. A vast amount of literature has been written on independent directors and the issues that impact on their roles. The three-pillar structure was devised to enable a logical analysis of this literature to be completed, as it was considered that each piece of literature could be categorised into one of these pillars.

The first section of this chapter discusses and analyses the relevant common law and legislation, in order to define the role of the independent director from a legal perspective. The conclusions are based on the strong foundation of the legal system, which shows a gradual and logical progression from early contemporary thought to the current position whereby independent directors are held to account for their actions, or inactions.

The second section comprises a review of the governance literature and is based on corporate governance having become an all-encompassing term to describe the role of the board of directors and its constituent members in the direction, control and management of a company. As with the legal pillar, this governance pillar shows a gradual and logical progression that has evolved in the past 25 or so years in response to issues in and around boardrooms.

The commercial pillar as analysed and discussed in the third section represents a relatively new but topical concept. Being topical, it would be expected that a significant number of articles have been written on the subject of the role of the independent director, which is the case. There is little, if any, evidence of a growing awareness by writers of the evolution of this concept, unlike the gradual logical evolution evident in the first two sections. This lack of structure has resulted in the identification of a gap in the research, which forms the basis of this study.

Each of the three pillars leads to the formation of a different characterisation of the role, even though the same definition is used. The precedents set through common law and the progression of legislation identify **why** independent directors should act in the best interests of the company and its stakeholders. The review of the literature specific to corporate governance and the evolution of the associated regulations helps define **how** independent directors are to fulfil the requirements of their roles, and the review of practitioner literature from those involved in the industry shows **what** independent directors are expected to do.

In the last section, the findings from each of the legal, governance and commercial pillars is compared to identify the differences between each pillar, the common areas, the gaps in the literature, and the areas for improvement.

As this research is undertaken in the Australian context and is limited to public listed companies, the definition of an independent non-executive director in Australia as referred to in this research is that as defined in the Principles of Good Corporate Governance and Best Practice Recommendations, developed by the ASX Corporate Governance Council. A detailed discussion is included in Section 2.6.1.

3.2 The Legal Pillar – the 'why'

3.2.1 Introduction

The literature in this pillar comprises the relevant common law and legislation. This literature can be categorised into five individual topics, each of which reviews a distinctive duty of independent directors. These are: duty of care and diligence;

disclosure of and duty of care in conflict situations; duty to act for proper purposes; conduct and responsibility of directors; and delegation of duties. Each of these issues has several components, covering a number of angles on the topic. This section explains why independent directors act as they do, while an overview of different but related issues through time shows the progression of these actions.

This thesis relates to the role of the independent director, and this section has significant references to the duty of directors. While the basic definitions of duty and role differ, they do converge. According to The Shorter Oxford English Dictionary, duty is defined as "*action, or an act, that is done by moral or legal obligation, that which one ought or is bound to do",* while role is defined as "*the part or character which one undertakes, assumes, or has to play. Chiefly with reference to the part played by a person in society or life".* In this thesis, the role is the part played by a person as an independent director, a role he or she has to play once they have agreed to join a company's board. Similarly, the person, once accepting the position as an independent director, has a legal obligation to act as such. These are one and the same; directors are bound to do their duty, just as they must play the role that they have accepted.

3.2.2 The duty of care and diligence

One of the earliest references to corporate governance and the role of independent directors come from the judgement in *Re Cardiff Savings Bank*[9], otherwise known as the Marquis of Bute's Case. The judgement was, at that time, a reflection of contemporary logic, but it would now be significantly different. In this case, the Marquis was a director of the Cardiff Savings Bank and attended only one board meeting in 17 years. While the board made decisions that were to perpetuate fraudulent acts, the Marquis was found not to be liable as he was not present at these meetings. However, there were signs from other cases that if directors were in attendance, they could not use the excuse that their thoughts were elsewhere[10] or that they were sleeping at the meeting and did not hear what was discussed[11].

[9] [1892] 2 Ch 100
[10] Ashurst v Mason (1875) LR 20 Eq 225 at 234
[11] Land Credit Co of Ireland v Lord Fermoy (1870) LR 5 Ch App 763 at 770-771

Directors have a fiduciary duty to the company on whose board they sit and they are expected to exercise reasonable care, skill and diligence in discharging these duties that 'an ordinary man might be expected to take in the circumstances on his own behalf.' (*Re City Equitable Fire Insurance Co Ltd*[12]). These comments by Romer J were made almost 80 years ago and still apply to a certain extent. The origin of the Business Judgement Rule in Australia also came about in this case, as Romer J also stated that directors are not liable for mere errors of judgement. Directors should be expected to pay reasonable attention to the company (Baxt, 2002a). They should not be managing the day-to-day affairs of the company, as this should be delegated to management. This last statement has been the subject of numerous debates, with differing views taken by the judiciary over time, resulting in court decisions that could be considered either conflicting or merely reflecting the progress of current thought and practice over time[13].

The decision in *Re City Equitable Fire Insurance Co Ltd* was on the basis of the decision in *Re Cardiff Savings Bank* some 33 years prior (Cassidy, 1995). That is, if a director was not present at a meeting he could not be held liable for any issues that arose at that meeting; a director was expected to exercise care and diligence in issues that were raised at meetings that he attended (Cassidy, 1995). This decision set precedent for several more recent cases. While one of the judges dissented in the 1988 case of *Metal Manufacturers Ltd. v Lewis*[14], the majority ruling was that if a director did nothing, and did not participate in the company incurring additional debts, then that director could not be held liable for those debts. This is referred to as the 'Sleeping Director' (Baxt, 1990a). As one of the defendants was not involved in the day-to-day running of the company and was not aware of particular transactions, then that director could not be held liable (Baxt, 1992a). The Corporations Act now overrides this common law test in that directors are liable for debts of a company unless they can prove any of the defences under Section 588H. Subsection (4) allows a director to be excused due to illness or other reasons for being absent; inattendance at board meetings for no reason is not a defence. Independent directors are expected to give adequate attention to the matters of the company through their attendance at board meetings, and they are expected to act with care and diligence.

[12] [1925] Ch 407
[13] Corporations Act, 2001 s 180(1) is the current authority.
[14] (1988) 6 ACLC 725

Directors are to be responsible when making decisions, as was seen in the 1989 case of *North Sydney Brick and Tile Company Ltd v Darvall*[15]. In this case, the directors made a decision regarding a takeover without the benefit of all available information (Baxt, 1990b). Directors are expected to take care and present a responsible attitude to their position when making decisions, especially those that affect the future of the company.

The decision in *Statewide Tobacco Services Ltd. v Morley*[16] reinforced this duty of care, with Ormiston J ruling that just because the running of a business was left to management, and the independent director had no input whatsoever, that director was still liable for the company's debts, solely due to her being a director (Sievers, 1993; Baxt, 2000a). The fact that this decision was upheld on appeal further reinforced the court's views on directors and their duties to the companies they represent. The director who was the subject of this case could be considered to be an independent director by the complete lack of interest and participation she showed in the company. She was merely appointed a director of the company by her husband because, at that time, the law required that a company had at least two directors. This is despite the fact that she was a shareholder in the company, that her deceased husband used to be the managing director, and that her son managed the business following the death of her husband.

In this case the independent director did not take any part in the day-to-day running of the company, but was held to be liable for the debts of the company incurred when the company was insolvent (Baxt, 1992a). Therefore, at the time of this case, it could be considered that a role of an independent director is to take part in managing the company, although this could depend on the particular structure of a company. It is possible that 'managing' is taking an extreme view and the issue should be that the independent director should take an active role in contributing through the board.

Directors have an obligation to ensure that the company will be able to pay the debts incurred with the knowledge of directors and this applies to executive, independent and non-executive directors. This was highlighted in the decision in *Group Four Industries Ltd v Brosnan and Anor*[17] where one of the directors who was considered to take no part in the day-to-day running of the company was not found to be liable, as she could not be expected to be aware of the financial condition of the company at that time (Baxt,

[15] (1989) 15 ACLC 230
[16] (1990) 8 ACLC 827
[17] (1990) 10 ACLC 1437

1992a). However, this did not excuse the other director from liability. This decision would indicate that a role of an independent director is to make enquiries of the financial position of the company to enable them to provide positive input to the company's performance.

A significant case around this time was *Commonwealth Bank of Australia v Friedrich and Ors*[18], known as Eise's Case. Eise had represented that the National Safety Council of Victoria was in a good state of affairs and had signed documents incurring further debt. However, some investigation on his part, such as reading documents available to him and asking simple questions of management, would have shown that the council was in financial difficulty (Baxt, 1992a). Independent directors should read and understand information provided to them, ask questions to clarify that information, and question management further if they suspect that they are not being told the truth, or are not being provided with all relevant information (Baxt, 1992b).

The majority of cases before the courts prior to the 1990s involved private companies, but the law does not always distinguish between private and public companies. Nor have the courts distinguished between different types of directors up until this time (Baxt, 2002a). Directors owe a fiduciary duty to their company, and the courts have ruled as such. Directors can be held liable for their actions or inactions, but the courts have also ruled that directors cannot be held liable for all that may go wrong in a company.

The cases of *AWA Ltd v Daniels*[19] and, on appeal, *Daniels v Anderson*[20] involved a number of issues concerning the role of directors, with mention being made by Rogers CJ on the distinction in roles between independent and executive directors (Hii, 1999). Amendments have been made to the Corporations Act (2001) (the Act) subsequent to the AWA cases that increase the standard of care with which directors are expected to comply, per s180(1) of the Act (Baxt, 2002a). Over time, the court's view has moved from the expectation that directors have a duty to act with reasonable care and diligence (1925)[21] to the view that directors are expected to provide reasonable attention to the affairs of the company, while having the ability to delegate their duties to the

[18] (1991) 9 ACLC 946
[19] (1992) 10 ACLC 933
[20] (1995) 13 ACLC 614
[21] Re City Equitable Fire Insurance Ltd Ch 407

appropriate officers of the company. Rogers CJ had noted in his comments on the AWA case that "*as the complexities of commercial life have intensified, the community has come to expect more than formerly from directors whose task it is to govern the affairs of companies"*[22]. Rogers CJ further discussed modern expectations of directors, that they are expected to guide and monitor the company's management, and to understand the business and how the changing economy may affect the business (Cassidy, 1995).

But comments made relative to independent directors contradict this stance. Rogers CJ referred to these directors as non-executive directors and did not believe that they should give constant attention to the company's affairs, as their duties were expected to be limited to appearances and activity at board meetings (Cassidy, 1995):

> *"In contrast to the duties imposed on a managing director, non-executive directors are not bound to give continuous attention to the affairs of the corporation. Their duties are of an intermittent nature to be performed at periodic board meetings, and at meetings of any committee of the board upon which the director happens to be placed. Notwithstanding a small number of professional directors there is no objective standard of the reasonably competent company director to which they may aspire. The very diversity of companies and the variety of business endeavours do not allow of a uniform standard"* [23]

However, the Court of Appeal disagreed with this judgement and ruled on the basis that there were no differences in the obligations of executive and non-executive directors. Rogers (2002) disagreed with this assertion. He contended that executive directors have the day-to-day knowledge of the company's affairs, and can use the company's resources to source additional information, unlike the non-executive directors. In the case of *Australian Securities Commission v Adler*[24], Santow J, when considering the reasonableness of reliance or delegation by a director, considered whether the director was an executive or non-executive director. He cited the earlier ruling of Ipp J in *Permanent Building Society v Wheeler*[25], and admitted that in ASC v Adler the majority

[22] (1992) 10 ACLC 933 at 1013
[23] (1992) 10 ACLC 933 at 1014 - 1015
[24] (2002) 41 ACSR 72
[25] (1994) 11 WAR 109

of the Court of Appeal had moved away from the distinction between different types of directors.

While the auditors of AWA were found guilty of negligence, the company and the chief executive were guilty of contributory negligence. The court did not find against the independent or non-executive directors, as Rogers CJ concluded that directors of large public companies were not expected to have more than a general understanding of the company's business (Baxt, 2002a). This precedent has been followed in subsequent cases.

The issue has been discussed of directors incurring the wrath of the courts due to their inactions. What remains unclear is how far a director can go before the courts view their actions as being unlawful, or beyond the scope of their perceived duties. Indeed, the question remains as to what is the scope of their perceived duties. Independent directors are employed only to participate as a director, not as a full-time employee. Their participation should therefore be limited to the board meetings they attend, or the committees on which they sit (Cassidy, 1995). This was the expectation of Rogers CJ in the AWA case, and was reiterated by Ipp J in *Vrisakis v ASC*[26]. Independent directors should limit their duties to board meetings and special committees. If directors are expected to participate at board meetings then it should be a requirement that they attend these meetings, otherwise they would not be acting with the requisite care, skill and diligence.

Some decisions made by directors in the pursuit of improving the company's performance are not made with care, skill and diligence, and the directors can be held liable for the consequences of these actions (Baxt, 2002b; Segal, 2002). When ASIC took Adler and others to court over the collapse of HIH, the court found that the directors failed to carry out a number of their duties. Directors and officers are in positions whereby they can obtain information that is not available to others, either employees or current or potential shareholders. This information is only to be used for the purpose of enabling the director to carry out their job, and should not be used by the director to obtain personal advantage.

[26] (1993) 11 ACLC 763

Circle Petroleum (Queensland) Pty Ltd v Greenslade[27] involved the former managing director of a joint venture not fully evaluating debts that were owing to the joint venture and not ensuring their repayment. This director was experienced in his industry and understood the risks inherent in the business. The court held that the former managing director breached his duty of care and diligence as he "*failed to exercise the degree of skill and care which could reasonable be expected from a person of his knowledge and experience"*.

This decision follows from that in *Re City Equitable Fire Insurance Co Ltd*[28] in 1925, showing the consistency of past precedents and how they can be applied to a variety of situations. The precedent set 80 years ago thus still holds and confirms that no ruling could be more logical or sensible for transgressions of this nature. However, this decision is a substantial shift from that discussed in the Marquis of Bute's Case[29], where no duty of care existed despite other directors undertaking fraudulent acts.

Summary

In theory, it should be simple for independent directors to act with care and diligence. Over time, courts' expectations in these areas have progressed from the scenario that if a director is not present, they cannot be expected to know what is going on and so should not be liable for anything that goes wrong, to the current standards. Directors are now expected to be present at board meetings unless they have a valid excuse. If absent, they should make enquiries about what happened. In any event, independent directors should make independent enquiry to fully understand the financial position of the company and its ability to pay its debts. Independent directors are expected to use the skills they possess to actively contribute to the running of the company through their positions on the board and its committees, but they should not be held liable for errors in judgement.

[27] (1998) 16 ACLC 1577
[28] (1925) Ch 407
[29] Re Cardiff Savings Bank (1892) 2 Ch 100

3.2.3 Disclosure of conflict

Disclosure of conflict can be seen as an extension of the previous issue as directors have a duty of care to avoid conflict or, if this is not possible, to inform their fellow directors that a conflict exists and advise possible strategies for addressing the situation. Informing fellow directors of a conflict and excusing oneself from participating in any relevant decisions may not adequately fulfil one's duty of care. A conflict arises because a director is otherwise involved in a transaction that may affect the company; therefore that director would have knowledge of the associated risks and has an obligation to inform the board of those risks. Ipp J in *Permanent Building Society (in liquidation) v Wheeler*[30] found that a director who did nothing other than point out a conflict to the board and excuse himself from discussions and decisions regarding that transaction did not act with care, as he did not discuss the potential risks of the transaction with the board.

The duty of the director in circumstances of conflict is not only to disclose a conflict in a potentially detrimental situation, but to declare any conflict, even if the transaction may be beneficial to the company. In *R v Byrnes*[31], the defendants believed that as the transaction was in the best interests of the company, they had no reason to declare their involvement in the transaction. The court took the opposite view.

A conflict would arise when a director is involved in both sides of a transaction and owes a duty of care and diligence to both parties. In such a situation, a director's first instinct would be to act in the best interests of both parties. In the previously discussed case, this could have been possible. However, acting in the best interest of one party may be detrimental to another. Marcus Clark found himself in such a position (*State Bank of South Australia v Marcus Clark*[32]). Any course of action would have been detrimental to one of the parties. His only choice was full disclosure of the conflict to the boards of both companies on which he was a director and to allow the other directors of both parties to negotiate the transaction. In not disclosing the conflict, Marcus Clark was found to be in breach of his duty of care due in the way he handled

30 (1994) 14 ACSR 109
31 (1995) 17 ACSR 551
32 (1996) 14 ACLC 4019

the situation, as well as his duty of care in a conflict situation, and also of negligence in not disclosing certain facts.

A later decision confirmed the position that Marcus Clark should have taken. In *Wambo Mining Corporation Pty Ltd v Wall Street (Holding) Pty Ltd*[33] the directors disclosed the conflict to all parties, advised the benefit to them of the transaction and received approval from the other directors to proceed with the transaction. As the conflict and all other relevant information had been disclosed, the directors were held not to be guilty of their duty of a breach of care in a conflict situation.

Summary

While duty of care has been recognised by the courts for many years, this duty relative to a conflict situation is an extension of the fiduciary status of directors. The trend is consistent, in that directors are expected to act in ways that ensure the company is not harmed and is kept fully informed of any issues that may affect either the good of the company, or the perception that the company is not exposed to any actual or potentially harmful situations.

3.2.4 Duty to act for proper purposes

This section includes, but is not limited to, the improper use of information of which the director is aware but which would not normally be known to the company. Again, this is an extension of the duty of care and diligence. In three of the cases discussed in the previous section – *R v Byrnes*[34], *State Bank of South Australia v Marcus Clark*[35] and *Wambo Mining Corporation Pty Ltd v Wall Street (Holding) Pty Ltd*[36] – directors had information that was not known to the company and they used this information for their personal gain. In the first two cases, the directors acted fraudulently or dishonestly and were found guilty of additional offences. However, in the third case all had been disclosed and therefore the directors were exonerated.

---

[33] (1998) 28 ACSR 654
[34] (1995) 17 ACSR 551
[35] (1996) 14 ACLC 4019
[36] (1998) 28 ACSR 654

In addition to a number of other offences, in *Re HIH Insurances Ltd (in prov liq) and HIH Casualty & General Insurance Ltd (in prov liq); Australian Securities & Investments Commission v Adler*[37], the defendant was found to have improperly used both information and his position for his personal benefit. In a slight contrast to this decision, *Australian Securities & Investments Commission v Whitlam (No 2)*[38], Whitlam was found guilty of improperly using his position, not so much for his personal benefit, but to ensure that votes at a meeting of NRMA Ltd went the way he decided, and not the way shareholders had intended through their proxy votes.

Summary

Directors have access to information that is not generally available to others outside the board, or to very senior management. They should use this information only to assist in their position as a director, and not to make any personal gain. In addition to having knowledge of confidential information, their position on the board puts them in privileged situations, and they must not take advantage of this, either for themselves, or for any related companies or individuals.

3.2.5 Conduct of directors

The conduct of directors goes to the very core of the director making their best possible effort to do what is right for the company. This issue has been before the courts in various forms for well over a century. The topic goes back to what is now seen as an illogical decision in *Turquand v Marshall*[39], whereby the court found that, as long as the company's directors acted within their powers, it did not matter how bizarre their actions were. The shareholders' viewing the directors as incompetent was their problem, as they elected the directors in the first place.

Australian law had its roots in English common law (Cassidy, 1995) which had initially looked to those who appointed the directors to take any blame for the poor

[37] (2002) 42 ACSR 80
[38] (2002) 42 ACSR 407
[39] (1869) LR 4 Ch App 379

performances of directors, as long as the directors complied with the powers assigned to them through their deed. Thus, shareholders suffered if the directors they appointed were honest but unwise. Abstention from performing one's duties as a director had previously been a defence of a breach of duty of care. The argument was that if a director did not know what was happening in the company, he could not be held liable for the poor performance of the company (*Re Denham & Co*[40]). The assumption was that directors did not have any talent, specialised or technical expertise (*Barnes v Andrews*[41]), and therefore were not expected to make any significant contribution to the company, nor investigate possible frauds perpetrated by management or executive directors (Cassidy, 1995).

A director can only reasonably be expected to perform to the extent of their capabilities. Shareholders appoint directors, and if they appoint incompetent directors who have inadequate intelligence or experience, then they cannot expect the directors to perform adequately. The common law test of duty of care does not apply any minimum standard of performance of a director (Cassidy. 1995), as directors can only be expected to perform on the basis of their knowledge and experience.

The conduct of directors includes their duty to the company and its stakeholders. It was first recognised in *Walker v Wimborne*[42] that directors have a duty to the company's creditors, as any adverse duty to the creditors would most likely have a similar effect on the company and its shareholders. This decision was the first to recognise this duty and set the precedent for decisions in many subsequent cases, such as *Kinsela & Anor v Russell Kinsela Pty Ltd*[43]*, Winkworth v Edward Baron Development Co Ltd*[44] and *Jeffree v The National Companies and Securities Commission*[45]. The High Court of Australia in *Spies v R*[46] clarified that directors do not owe any duty directly to creditors, however, in considering the duties they owe to the company, they ought to consider the company's ability to meet its liabilities and this necessitates consideration of the company's obligations to its creditors.

---

[40] (1884) 25 Ch D 752
[41] (1924) 298 Fed 614
[42] (1976) 137 CLR 1
[43] (1986) 10 ACLR 395
[44] (1987) 1 All ER 114
[45] (1989) 15 ACLR 217
[46] (2000) 201 CLR 603

The 'Sleeping Director' (Baxt, 1990a; Sievers, 1993) is a term that has been used for many years to describe company directors who are inactive on a company's board. This goes back to the *Marquis of Bute's Case*[47] and still continues today. This terminology was first used in the decision in *Metal Manufacturers v Lewis*[48] (Baxt, 2002a). In this case it was found by a majority decision that the wife of the managing director, while she was still a director but did not participate in the activities of the company, was not expected to know what was happening in the company. Kirby J disagreed with the decision, and his approach was followed in the decision in *Statewide Tobacco Services v Morley*[49]*,* where the facts were similar. This concept is taken one step further, as was discussed in the decision in *Australian Securities and Investment Commission v Adler and Four Ors*[50]*,* where Santow J stated that a director is "*not relieved of the duty to pay attention to the company's affairs which might reasonably be expected to attract inquiry, even outside that area of expertise".* This statement relied upon comments made in *Re Property Force Consultants Pty Ltd*[51] (Baxt, 2002a).

Summary

Directors are expected to act within the scope of their powers, but should use their knowledge and expertise to maximise their contribution. They have a duty to the company's creditors, as any inappropriate action to these and other stakeholders may be harmful to the company.

3.2.6 Delegation of duties and reliance on others

While a director is expected to pay attention to all of the affairs of the company, no director is expected to be expert in all issues affecting a company, and can rely upon his fellow directors for expertise in certain areas (*Biala Pty Ltd v Mallina Holdings (No 2)*[52]*).* In the judgement of this case, a distinction was made regarding the expectation of

---

[47] Re Cardiff Savings Bank (1892) 2 Ch 100
[48] (1988) 6 ACLC 725
[49] (1992) 10 ACLC 1233
[50] (2002) NSWSC 171
[51] (1995) 13 ACLC 1051 at 1061
[52] (1993) 11 ACSR 785

the executive directors against that of the independent directors. While the executive director had a responsibility to verify the information given to him by a third party, he was excused from doing so due to the trust previously established between these people. If the executive director was allowed to rely on others, the independent directors could not have been expected to take a more proactive role.

The ability of directors to rely upon others goes back to the beginning of the twentieth century. It was rational to allow directors to rely on others to perform the duties delegated to them as it would be impossible for any one director to supervise all activities within a company (*Dovey v Corey*[53]*)*. In all circumstances, the directors must take a sensible attitude, unlike the case of *Dorchester Finance Co Ltd v Stebbing*[54]*,* where directors signed blank cheques without making proper inquiry as to what the cheques were to be used for.

The decisions in a number of cases subsequent to *Biala Pty Ltd v Mallina Holdings (No 2)*[55] reinforce the court's view that as long as the delegation is undertaken responsibly (Corporations Act, section 198D) and reviewed regularly, then the directors should be able to rely on those to whom they have given their delegation. Should those who have accepted the responsibility of delegation act fraudulently, then the directors should be able to escape prosecution if the delegation was carried out correctly. This attitude was taken by the courts in *Re Property Force Consultants Pty Ltd*[56] and in the more famous case of *AWA v Daniels*[57].

In *Daniels v Anderson*[58] the court confirmed most of the findings of the first AWA case, apart from the contributory negligence of the company and the judgement against the chief executive. The directors had delegated a number of duties to others, as can be done under s198D of the Act, and were found not to be responsible for the delegates failing to carry out their duties correctly. In the context of different types of directors, the court in this case effectively found no difference between non-executive and executive directors (Greenhow, 1999).

---

[53] (1901) AC 477
[54] (1927) Ch 407
[55] (1993) 11 ACSR 785
[56] (1995) 13 ACLC 1051
[57] (1992) 10 ACLC 933
[58] (1995) 13 ACLC 614

Subsequent to this, the Business Judgement Rule was legislated into the Act under s180(2). This has given directors the ability to agree to undertake risky transactions following due diligence on the transaction. There is increased risk in any transaction entered into by a company that is apart from the normal transactions that company undertakes. But it is unlikely that a company will grow and increase returns to its stakeholders without some risk. This Rule allows directors to support these transactions once they have reviewed all the ramifications of the transaction and concluded that it is in the best interests of the company to proceed.

The Business Judgement Rule was established through the Corporate Law Economic Reform Program Bill 2003 (the CLERP Bill) and formally legislated what had previously been set by precedent, but in a more precise definition. Indeed, in 1968, in *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co NL*[59]*,* the High Court found that directors have the right to decide on a company's interests as long as decisions were exercised in good faith, and that it is not up to the courts to interfere in or review those decisions. Section 180(2) of the Act sets out the criteria that the courts would review relative to the directors' decision-making process. The specific transaction in question is not the issue; the decision-making process is the issue (Finlay, 1999). The business judgement rule is as follows:

(2) A director or other officer of a corporation who makes a business judgment is taken to meet the requirements of subsection (1), and their equivalent duties at common law and in equity, in respect of the judgment if they:

(a) make the judgment in good faith for a proper purpose; and

(b) do not have a material personal interest in the subject matter of the judgment; and

(c) inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and

(d) rationally believe that the judgment is in the best interests of the corporation.

59 (1968) 121 CLR 483

The director's or officer's belief that the judgment is in the best interests of the corporation is a rational one unless the belief is one that no reasonable person in their position would hold.

Note: This subsection only operates in relation to duties under this section and their equivalent duties at common law or in equity (including the duty of care that arises under the common law principles governing liability for negligence)--it does not operate in relation to duties under any other provision of this Act or under any other laws.

(3) In this section:

***"business judgment"** means any decision to take or not take action in respect of a matter relevant to the business operations of the corporation.*

Summary

Independent directors are invited to join boards due to their expertise in specific areas and their general business management capabilities. They are not expected to have expertise in all areas and should therefore be able to rely on fellow directors with expertise in other areas. However, they still must question their fellow directors to make sure that they are reliable, and to improve their own understanding of these other issues. Directors also delegate responsibilities for actions to management and should be able to rely on what management does, and what they in turn provide to the directors. Again, they should question these sources to make sure that this information is accurate and complete, and also that they fully understand it.

3.2.7 Summary and conclusion

A review of the relevant common law and legislation explains why independent directors are expected to perform their roles on boards and in committees established by boards. This review also identifies why independent directors act as they do. It has been shown how the behavioural expectations of independent directors have evolved over time, in line with the trends in modern business and the economic development of global markets. To perform to the expectations of stakeholders, independent directors are expected to undertake certain roles, such as acting with care and diligence, acting honestly and with integrity, and acting with the legal boundaries of their position, such as responsible delegation. The performance of these roles to the best of one's abilities should result in independent directors bringing a positive benefit to the boards on which they sit.

Independent directors are expected to behave in certain ways, including the avoidance of conflict, acting for proper purposes, and generally doing what is right for the company. This section has identified their duties, which have been established by both common law precedent and legislation. Carrying out these duties is now an obligation of independent directors, and results in them undertaking specific roles.

All required duties follow a common theme of acting in the best interests of the company. Independent directors are now expected to show greater performance and diligence now than they were in the past. Independent directors are elected onto company boards by the shareholders, and are expected to act honestly in all dealings on behalf of all stakeholders. As a greater proportion of the population become shareholders, either through privatisation of former government-owned enterprises, or through the growing level of funds invested through compulsory superannuation contributions, the actions and performance of all board members is coming under greater scrutiny. As the independent directors are the board representatives who are more easily voted in or out by the shareholders, their behaviour and contributions are being monitored more closely, and are now more in the public eye.

Independent directors are not expected to manage the company or to take part in the day-to-day running of the company. They are expected to act honestly and use their skills and knowledge to perform their duties, which can be summarised as two main roles. One is to guide the company's board and senior management, assisting them to better perform their jobs. The other role is to monitor the company's management, to ensure that they are performing to the maximum of their capabilities and acting honestly and diligently.

3.3 The Governance Pillar – the 'how'

3.3.1 Introduction

Corporate governance is a relatively new issue in the management of organisations with the earliest uses of this phrase appearing in the early 1980s (CIMA, 2000; Tomasic, 2001; Vinten, 2001; Bosch, 2002; Nelson, 2002).

The concept has been apparent for a significantly longer period, as evidenced by the Marquis of Bute's Case[60], whereby non-attendance at board meetings was an accepted defence against liability resulting from fraudulent acts affected at these meetings (Cassidy, 1995). There is now an exemption for director's liability should they be absent for good reason (e.g. illness) per the Corporations Act section 588H (4). The law has evolved considerably in the last century or so, with influences through both legislation and precedent established through common law, and is the main control factor that ensures boards follow good corporate governance. However, the Corporations Act does not differentiate between independent directors, non-executive directors and executive directors. The position of common law on this differentiation varies over time.

Corporate governance cannot be easily defined as it has many interlocking components. Sims (2003) attempted to create a definition by combining those of others. It has been stated as "*the system by which companies are directed and controlled*" (Gay & Simnett, 2000). While this is a simplistic view, it encompasses the two main drivers: direction and control.

The elements of corporate governance are many and varied and may be moulded to suit the specific nature of any organisation. A small private company will have fewer corporate governance requirements as its stakeholders are limited in size and in risk, but a large public listed company will have a substantial and complex corporate governance structure as its stakeholders are many and varied, and would be exposed to significant risk.

[60] Re Cardiff Savings Bank (1892) 2 Ch 100

Corporate governance involves every aspect of how a company is run, ensuring that the company and its employees obey all laws relative to its business, and that the interests of all stakeholders are taken into account, especially when decisions are made that affect different stakeholders in different ways. The correct strategy must sometimes be a fine balance and should consider the overall effect on the company, rather than trying to maximise the efficiency or effectiveness of one part. For example, to maximise profits and therefore returns to the shareholders, a company should produce its goods or services at the lowest possible cost. But, being a good corporate citizen, the company must comply with all labour laws and environmental controls, so it cannot use child or slave labour, or means of production that pollute the environment in excess of the allowable level.

The board of directors is the main driving force behind a company's corporate governance strategy. The members of the board are elected by the owners of the company, another way of considering the principals appointing their agents to manage their business. The board of directors itself comprises a number of members, each of whom play a different role in the board process. Recently under considerable scrutiny are the independent non-executive directors. This group is the focus of this research study, as their role is not clear. Their role will most certainly be different when comparing different types and sizes of organisations, but in any one category of organisation, the role should be the same, even though some specific duties may differ due to each individual' expertise, the nature of the company's operations, and many other factors.

While the historical issues and evolution affecting the behaviour of independent directors reflect common law and legislation, the influences exerted by corporate governance are more recent and explain how the expectations of stakeholders and observers have been formed over the past 20 or so years. These influences are also a catalyst for how corporate governance issues have helped establish the current roles and expectations that independent directors are expected to fulfil. Early research on corporate governance revealed a general model, which has since been successively refined. The earliest views emanated from the United States and the United Kingdom and slowly influenced models in other countries (CIMA, 2000). Some researchers see the current refined model as having come too far and being detrimental to the performance of the company. One of the most recent influences is the Sarbanes-Oxley

Act, which has led to increased conformance, possibly at the expense of improved performance or possibly even resulting in decreased performance (Wallis, 2000).

While undertaking the research for the Independent Working Party into Corporate Governance, Hilmer (1998) noted minimal 'authoritative' material in Australia relating to the division of duties and responsibilities within companies. Corporate governance involves several linked concepts, with the central theme being the board of directors, its component parts and how these interrelate with a number of other interested parties. The board comprises the individual members: the chairman, the executive directors and the non-executive directors, some of whom are considered independent. Some boards also have a deputy chairman, but this is more common where the chairman cannot be considered as independent or when the chairman is the Chief Executive Officer. The board interacts with the senior management of the company, its stakeholders, auditors, regulating bodies and the general public. Good corporate governance should ensure that the board and its members act in a proper manner for the benefit of the company and its stakeholders.

Complacency and/or the self-interest of the board members can result in the actions of the board deviating from this goal. This is why boards are ethically required to have directors who are non-executive and can be considered independent. These independent directors perform several important duties that help to ensure that the board acts in the best interests of the company and its stakeholders: being the link between the company and its stakeholders; helping to give the appearance of good corporate governance; monitoring the actions of the chairman, executive directors and senior management; providing specialist expertise; and acting as independent internal advisors to the board and senior management.

Corporate governance cannot be specifically defined, as it will have differing influences in different economies. It remains an emerging concept, but it heavily affects correct corporate behaviour and should ensure that corporations act properly to maximise their shareholders' wealth, while remaining a good corporate citizen. Nevertheless, many authors provide a definition of corporate governance to simply support their particular view. Bosch (2002, p. 270) defines corporate governance as *"the system by which companies, and like organisations, are controlled. It involves the members (shareholders) as well as directors and management, with the relationships between* *these groups being of fundamental importance".* The relationships between the interested parties are important. However, Bosch has omitted the other stakeholders affected by the actions of the company, whose actions are, by definition, driven by the board. These stakeholders include employees and contractors, suppliers and creditors, competitors, customers, and others impacted by any environmental effects the company's operations may have on the ecology. This last point brings into context corporate social responsibility, which companies tend to address only because it is written into their corporate governance guidelines (Horrigan, 2002).

The components of corporate governance in developed economies are viewed as being consistent and necessary for any company to incorporate in its board structure and corporate policy. The components in Australia are in line with those in the United States and the United Kingdom, and most other modern English-speaking countries (OECD, 1997). This model is described as an outsider model, as the board is not seen as controlling the day to day operations of the company, but instead sets strategies and guidelines that the company's management should follow.

There have been a number of corporate collapses in Australia in the past few years, including AWA, One.Tel, HIH, Pasminco, Harris Scarfe and Ansett. These are in addition to much larger collapses in the USA, such as Enron and World Com. Poor corporate governance has been blamed for these collapses (Bartholomeusz, 2002; Sims, 2003). Better corporate governance may have avoided these collapses, whether it had been by better fraud protection, better constituted audit committees, a greater number of independent directors on the board, or better policies and procedures such as determining whether acquisitions should have been made and at what price, and tighter risk policies on hedging of commodity prices. These are all issues for which the board should be responsible (Cadbury, 1992). An absence of accountability through the Chief Executive Officer having almost total control over a company has also led to corporate collapses, such as Bond Corporation and Rothwells (Bosch, 2002).

Companies benefit from good corporate governance. It acts to mitigate risk against fraud (Vinten, 2001; Bosch, 2002) and the natural risks that a company may face in its normal course of business, such as competition risk, environmental risk, financial risks including the effects of movements in interest rates, exchange rates and commodity prices, and the risk of the market losing confidence in the company. This last issue can affect the company's ability to access capital markets to raise further debt and/or equity, which may be necessary for growth. The development of accountability and linking rewards to performance is a further benefit, as this should strengthen overall performance and productivity (CIMA, 2000).

The confidence of suppliers and customers is improved through good corporate governance and also promotes the views that employees and contractors have of the company (Vinten, 2001). The wider market should also accept the company as being a good corporate citizen. Importantly, good corporate governance leads to improved leadership and confidence in the Board, its strategies and its decisions (CIMA, 2000).

Not all experts have the same view of the new emphasis on good corporate governance. Wallis in his Corporate Public Affairs Oration (2000, p. 16) argues that too much emphasis can be placed on corporate governance, probably at the expense of the company's shareholders. He agrees that corporate governance is important and necessary, but does not agree that improved corporate governance improves returns to shareholders.

Wallis' view is supported by Rogers (2002) when discussing FAI Insurance. FAI did not collapse, but the problems within FAI caused the collapse of HIH subsequent to the purchase of FAI by HIH. Rogers outlined the corporate governance practices of FAI, concluding that all the requirements of good corporate governance were present. AWA was in a similar position, but the problem in this instance was that the external auditors reported their concerns to management, not to the board.

Each company should have its own proprietary definition of corporate governance, which would reflect its unique structure and identity. This would take into account the nature of the company's business, its management and management structure, employees and contractors, suppliers and other creditors, shareholders, competitors, the industry in which it operates, the effect of its operations on the environment, and the importance of the company to its local demography, the economy and the countries in which it operates. The board should take all these issues into account to ensure that it appoints the best mix of executive and non-executive directors, particularly those independent directors required for their specific expertise relevant to the company's activities.

This section examines the evolution of the role of the independent director in Australia after 1980 through published corporate governance guidelines and regulations. While the focus of the study is the Australian context, many issues have their origins in overseas-based organisations and special committees such as the International Monetary Fund (IMF), the Organisation for Economic Cooperation and Development (OECD) and the World Bank and therefore the impact of these bodies on the regulatory context in Australia is also discussed.

Table 3.1 overleaf highlights the main relevant reports and legislation on corporate governance, and has been adapted from a report prepared by The Chartered Institute of Management Accountants in the United Kingdom (CIMA, 2000).

The first entry in Table 3.1 is from 1986, just a few years after the establishment of the corporate governance concept. Subsequently, the Treadway Report from the United States aimed at motivating the Securities and Exchange Commission to have listed companies comply with requirements to establish an audit committee whose members were mostly independent directors. This was the first of many such directives issued by various compliance regulators around the world, and as the corporate governance issue has developed a stream of evolving directives have continued.

Table 3.1 Chronology of important corporate governance publications and legislation

Title	Country	Date
Financial Services Act	UK	1986
Treadway Report published	USA	Oct 1987
SEC update listing requirements	USA	1988
Australian Investment Managers Association publish Corporate Practices and Conduct	Australia	1991
Cadbury Committee established	UK	May 1991
Cadbury Report and Code published	UK	Dec 1992
UK Stock Exchange amends Listing Rules, must comply with Cadbury recommendations	UK	Apr 1993
Australian Investment Managers Association publish Corporate Practices and Conduct revised publication	Australia	1993
Greenbury Group established	UK	Jan 1995
Greenbury proposal published	UK	Jul 1995
Australian Investment Managers Association publish Corporate Practices and Conduct revised publication	Australia	1995
UK Stock Exchange amends Listing Rules, must comply with Greenbury recommendations	UK	Oct 1995
Hampel Committee established	UK	Nov 1995
Hampel report published	UK	Jan 1998
OECD Council meeting on Corporate Governance	Global	Apr 1998
Hampel Combined Code published	UK	Jun 1998
OECD Principles of Corporate Governance released	Global	May 1999
Turnbull Guidance published	UK	Sep 1999
Ramsay Report	Australia	Oct 2001
Sarbanes-Oxley Act	USA	Jul 2002
Higgs Report	UK	Jan 2003
Australian Stock Exchange Corporate Governance Principles released	Australia	Apr 2003
Corporate Law Economic Reform Program	Australia	2003
OECD draft revised principles released	Global	Jan 2004
OECD revised principles released	Global	Apr 2004

3.3.2 Australian Investment Managers Association

As institutional investors have increased their levels of ownership of public companies in recent years, they have taken more notice of the corporate governance policies of their potential investment targets. Institutional investors are looking for increased returns as they must compete with others for investor funds, and companies with better corporate governance tend to perform better, as reflected in increased share prices (OECD, 1997; Bosch, 2002; Heracleous & Luh, 2002; Sims, 2003).

The involvement of institutional investors has become more important through the involvement of the Australian Investment Managers Group (AIMG, now known as the Australian Investment Managers Association, AIMA) in the publication of *Corporate Practices and Conduct*. This publication was initially developed by the Business Council of Australia, the Australian Institute of Company Directors, the Australian Stock Exchange and the professional accounting bodies. First published in 1991, subsequent publications in 1993 and 1995 included the support of the AIMG. This publication set out the first Australian standards of good corporate governance, with updates influenced by the Cadbury Report in 1992 and other international statements and reports.

Summary

The AIMA sees good corporate governance as being a more important part of a company's performance over time. Institutional investors are placing a greater emphasis on this, and look more favourably at companies with good corporate governance.

3.3.3 Cadbury Report

Good corporate governance should be an inherent requirement in all companies but as companies vary in size, complexity, ownership structure, traditions and personnel, the formula must be different for each company (Bosch, 1995a). The underlying assumptions and motivations should be consistent, but the final structure will be different for each and every organisation. Merely the fact that companies have different directors with different skills will result in different underlying theories and structures of corporate governance.

Garratt (2003) further supports the use of these principles, which have flowed through the Cadbury, Greenbury and Hampel reports to the 1998 creation of the Combined Codes of the London Stock Exchange. This code has been used as the basis for benchmarking effective corporate governance on the international stage. The ultimate responsibility of the board is to ensure that the company maximises shareholder value while operating as a good corporate citizen. The two do not necessarily flow together, as complying with all regulations is a cost to any organisation, and may detract from maximising profitability and shareholder returns.

While directors' duties have been recognised for some years, the issue has gained in importance only since the early 1990s. The findings and recommendations of three investigations in the United Kingdom – the Cadbury Report in 1992, the Greenbury Report in 1995, and the Hampel Report in 1998 – are important in the Australian context, as they have been taken into account in the Corporate Law Economic Reform Program (CLERP).

The role of independent directors is critical for transparency, and to enable the board to exercise independent judgement when making decisions. Executive directors carry much power in the boardroom, and one of the governance reasons for appointing more independent directors is to reduce the power of executive directors. (Boyd, 1996; Higgs, 2003). The Cadbury, Greenbury and Hampel reports have all made recent contributions to improving corporate governance; such improvement is the goal of changing the role of independent directors.

The Cadbury Report outlines several tests for independence of non-executive directors. These include the director not having been employed by the company in the past few years, the notion that the director has not been retained as a professional adviser by the company, and that the director is not a significant supplier or customer of the company. (Clarke, 1998).

Each of these three tests has some degree of flexibility, as none of them has been specifically defined. How long since a director had been employed can they be considered to be independent? How is significance measured when discussing trading with a company? Does the supplier of a company's stationery have the same influence as the supplier of the company's primary raw material used for production of whatever good or service they produce? These tests have been incorporated into the ASX guidelines for independence.

It is difficult to test independence. Since independent directors must rely on information provided by the company's management and employees to be informed about the company (Turnbull, 1999), that these independent directors cannot then be independent purely due to the source of this information. To maintain independence, these independent directors require independently sourced information, and they must be highly motivated to ensure as much independence as possible while they carry out their duties.

Independent directors should be the key to good corporate governance. While it has been recommended that the majority of directors be non-executive directors (Cadbury, 1992), it is also recommended that the majority of these be independent (Bird, 1995). It is argued that they should be independent not only of the company, but also of management and any other forces that may cause their dealings with the company to be influenced in any way.

The Cadbury Report was commissioned by the UK Stock Exchange in response to the large number of company failures following the economic boom of the 1980s. There was a lack of control by boards over their companies, and sometimes the boards were not even aware what was happening inside the companies. The report recommended that the number and power of independent directors be strengthened (Boyd, 1996; Clarke, 1998).

Summary

The Cadbury Report was the first major inquiry into the area of directors' duties and boards of directors in the UK. It sought to find best practice and made recommendations, including that boards should have more independent directors, and for all board members to have independence of mind when making decisions.

3.3.4 Greenbury Report

The Greenbury Report followed a period of public concern in the United Kingdom at the large pay increases which senior management in recently privatised utilities were awarding to themselves. The report recommended the establishment of remuneration committees made up only of independent directors, who would then decide on the salaries of the senior management (CIMA, 2000). There will always be a conflict of interests with the board or the remuneration committee deciding on the remuneration for senior management including the Chief Executive Officer, and the company's directors. While external consultants are sometimes used to recommend levels of remuneration commensurate with the position relative to the size of the firm and its peers, and the total board remuneration is voted on by shareholders, the final decision is nevertheless made by the board or its committee.

To control this position, board accountability must be transparent, with remuneration linked to performance. Following research into this issue, a Code of Best Practice was developed by the Study Group on Directors' Remuneration (Greenbury, 1995). In addition to being an example of good corporate governance, undertaking this study also gave the impression of being proactive in setting standards that companies should meet.

Summary

The findings of this report recommended that wider powers be given to independent directors to enable them to have a greater involvement in board decisions and board committees, particularly with regard to the remuneration of senior management. This is based on the concept that the independent directors are independent of the board and of management.

3.3.5 Hampel Report

The Financial Reporting Council set up the Hampel Report to review the implementation of the recommendations flowing from the Cadbury and Greenbury reports, and how to promote even higher standards of corporate governance (Hampel, 1998). Recommendations from the report included that the development of independent directors be increased, that a senior independent director be identified (excluding the chairman) and that board committees, including the nomination, remuneration and audit committees, should mostly comprise independent directors (Clarke, 1998).

The Hampel Committee was established in 1995, following the conclusion of the Greenbury Code of Best Practice, and released its report in 1998. In addition to reviewing the implementations of both the Cadbury and Greenbury committees, the brief held by the Hampel Committee was to review the roles of shareholders and auditors in corporate governance. With limited time passing after the release of the Greenbury Report, long-term conclusions on its effectiveness could not be drawn. Furthermore, at this stage the Cadbury Report had not made much impact (CIMA, 2000).

To further the limited progress made to date, the Hampel Committee established a combined code of the recommendations flowing from both the Cadbury and Greenbury committees, as well as expanding the subject to include the new issues of shareholder and auditor impact on corporate governance. This course of action represented a continuing expansion of the progress in improving corporate governance, and while these committees reviewed the situation in the United Kingdom, the result impacted other countries. Both the Bosch Committee and the Australian Investment Managers Association supported the recommendation set by the Hampel Committee in recommending the use of a nomination committee made up of a majority of independent directors to nominate new board members (Stapledon, 1998).

Summary

Following the recommendations of the two previous reports, the Hampel Report called for even greater powers for independent directors, with this group taking a higher position on corporate governance in public company boards. These increased powers were partly to impose an oversight function over the executive directors.

3.3.6 OECD principles

Three major global organisations have issued documents covering the principles of corporate governance: the Organisation for Economic Cooperation and Development (OECD), the International Monetary Fund (IMF) and the World Bank. However, instead of developing their own policies on corporate governance, both the IMF and World Bank have stated that they agree with the policies set down by the OECD. Following an OECD Council meeting in April 1998, at which it was decided to develop a set of corporate governance standards and guidelines, the OECD Principles of Corporate Governance were published in 1999 after endorsement by the OECD Ministers in May 1999. The report also recognises that these principles are evolutionary in nature.

The authors of these principles recognise that each country will have a different mix of legal system, culture, and business infrastructure and therefore these principles can be used as a guide or base for particular principles developed in each specific country. These principles apply mainly to public companies, as these have the most influence on commerce (OECD, 1999), but they should also broadly apply to private companies and not-for-profit organisations.

The fifth of the OECD principles deals with the responsibilities of the board, including the aspect of independence. It further describes the benefits of having independent board members, such as making a significant contribution to the board, bringing an objective view to the evaluation of the performance of the board and of management, and the ability to act as intermediaries where the board and management differ (OECD, 1999). These independent board members should also exercise independent judgement where there is a conflict of interests, and make up most or all of the members of board committees.

These recommendations are not intended to be precisely adopted in each OECD member country, but rather are meant to provide guidelines for principles to be specifically designed for each country when taking into account its own infrastructure, laws and culture. These recommendations have achieved this aim, as they have been adopted in most countries as a base for each specific set of principles.

Being evolutionary in nature, the principles were reviewed in a survey during 2002 and 2003, resulting in a draft-revised set of principles being released in January 2004. The discussion on independent board members in the revision mirrors that of the original principles, with additional suggestions that place a heavier burden on the board, including that the board should advise which directors they consider to be independent, and why. They also recommend that the duties of the chairman and chief executive be split. If this is not so, it is recommended that a senior independent director be nominated to act as the boundary spanner between the board and parties external to the board, such as management or shareholders (OECD, 2004a).

As these principles are evolutionary, so is the concept of corporate governance. Corporate governance is not a static concept as it relies on effective checks and balances (Segal, 2002). Being a relatively new concept, its development and perceived importance continue to grow at a rapid pace. The OECD, in association with the World Bank and the IMF, see the role of corporate governance as providing a structure within which each country will then develop its own policies. This will depend on the stage of economic development in each country, its laws, culture, level of government ownership and wealth. Good corporate governance should ensure that investors will invest in that economy as they will have confidence in the economic processes. The attraction of investment capital is important to the growth and economic development of economies, particularly in third world countries. There is only limited capital, and with current international banking regulations, this capital is easily transferred from one country to another. Developing countries especially need good corporate governance to attract capital to support their growth and development.

The Business Sector Advisory Group on Corporate Governance to the OECD sets out the core principles of corporate governance practice that should be followed: fairness, transparency, accountability and responsibility. Dallas et al. (2003) contend that this can be used as the basis of a corporate governance scoring methodology, at both country and company level. Measurement of corporate governance is not an exact science, and as requirements and implications are different for each culture, laws and individual company structures, a simple method of comparison on this basis against the three broad principles would not be of much benefit.

Summary

The OECD principles promote greater involvement from independent directors. These principles are evolutionary as corporate governance is also evolutionary. The OECD recognises that each country has different laws, infrastructure and cultures and therefore these principles should be used as a framework for each country to use to structure its own policies.

3.3.7 Turnbull Guidance

Turnbull did not extend the advances made by his predecessors, but constructed a framework around these requirements. Cadbury, Greenbury and Hampel developed new strategies to improve corporate governance, most of which revolved around internal controls (CIMA, 2000; Vinten, 2001). Turnbull's framework to make internal control effective was delivered in the form of guidance centred on five main areas. These were the importance of internal control and risk management, maintaining a sound system of internal control, reviewing the effectiveness of internal control, ensuring the existence of a board statement on internal control, and internal audit (Turnbull Report, 1999).

This formed the next part in the natural evolution of the current corporate governance framework. From the establishment of the Cadbury Committee to the release of the Turnbull Guidance was just less than 10 years, but this period was the greatest progress yet made on corporate governance. These committees, all based in the United Kingdom, influenced the importance of good corporate governance on a global scale. Similar reports were released in South Africa (the King Report, 1994), France (the Vienot Report, 1995) and the Netherlands (the Peters Report, 1996). The Ramsay Report in Australia was issued in 2001 and is briefly considered within the next section.

Summary

The Turnbull Guidance used the recommendations of the Cadbury, Greenbury and Hampel reports to establish a framework of good corporate governance through stronger internal controls. This was the next stage in the evolution of good corporate governance as the method of improving company performance and recognition by stakeholders through this process was of benefit to them.

3.3.8 Sarbanes-Oxley Act

Many of the largest corporate collapses in the world occurred in the United States, involving companies such as Enron and Worldcom. A subsequent review of corporate governance issues in the United States resulted in the Sarbanes-Oxley Act of 2002. The Securities and Exchanges Commission has since adopted rules to implement a number of provisions of this act. Many of these rules flow from the recommendations of the committees established in the United Kingdom, but this act goes further. The Hampel Report recommended the establishment of board committees, including remuneration, nomination and audit committees, whose members are mostly independent directors. Sarbanes-Oxley follows these recommendations, with a more strict view on the members of the audit committee, for which it recommends independent directors, not just non-executive directors.

The Sarbanes-Oxley Act goes one step further, legislating the independence of a company's auditors, and setting out other services that a company's auditors may provide in addition to the audit. This is to ensure no conflict of interest, and that a company's management cannot pressure an audit firm with the withdrawal of additional services if they do not provide a clean audit report. This shows further progress in ensuring that companies follow good corporate governance practices; it is an extension of previous requirements, including issues that had not been captured in earlier studies.

In Australia, the Ramsay Report (October, 2001) just preceded the Sarbanes-Oxley Act. This report was commissioned to examine the adequacy of existing professional and legislative requirements in Australia regarding auditor independence and, if necessary, recommend any changes that may be required to ensure auditor independence.

Audit independence has become a critical component of corporate governance. While the auditors are employed by the company, they are acting for the company's stakeholders with their appointment confirmed by a vote of shareholders at the company's annual general meeting. With audit firms providing more services apart from auditing, it was seen to be good business when a company gave additional work to their audit firm. This could have been seen as enticing the audit firm to provide a clean audit report, otherwise the additional work would not be forthcoming. In reality, one would expect that all parties would act ethically, but processes were introduced not only to improve corporate governance, but also to ensure that one gave the appearance of good corporate governance.

Summary

In addition to pushing for improved corporate governance, the Sarbanes-Oxley Act recognised the importance of auditor independence, and to ensure that there was no conflict of interest in any auditor's relationship with its clients. At the same time, the Ramsay Report in Australia recommended that auditor independence be recognised and enforced.

3.3.9 Higgs Report

This report is the most recent in the series coming out of the United Kingdom concerning corporate governance, being released in early 2003. This report is a review of the role and effectiveness of independent directors, concluding with recommendations that clarify the role and increase the effectiveness of independent directors. The earlier work done on corporate governance by the Cadbury, Greenbury, Hampel and Turnbull reports established the building blocks of corporate governance, with this report placing more emphasis on how boards do their job, and how this can be improved. There were many recommendations made in this report; those most relevant to the role of independent directors are in the areas of strategy, performance, risk and people (Higgs, 2003).

These recommendations are all structured to enhance the overall improvement of the board's performance. This is a logical progression. The earlier reports either reviewed untouched areas of corporate governance, or sought to improve on previous recommendations. Corporate governance concerns improving the performance of the board, and as the board is made up of its individual members, the directors, the sensible way of improving the performance of the board is to ensure that the directors are as effective as possible. If this is the case, but the board is underperforming, then it is possible that the combination of directors is not optimal.

The term of reference for the Higgs Report was to lead a short independent review of the role and effectiveness of independent directors in the United Kingdom. The final report is substantial and goes well beyond its terms of reference. It is a complete guide on how to maximise board performance in the United Kingdom. This guide can be adapted for use in any economy as it is far-reaching and thorough.

Summary

The Higgs Report pushed for an improvement in the effectiveness of independent directors as a way of improving the performance of the board of directors. This is a broad-based report and can be tailored to work in any economy. The subsequent Smith Report concentrates on issues relative to audit committees, with the only reference to independent directors following the recommendations from the Higgs Report, that is, that all members of the audit committee be independent directors.

3.3.10 Australian Stock Exchange corporate governance principles

Recently, the Australian Stock Exchange (ASX) has issued its 10 corporate governance principles (ASX, 2003). Listed public companies are not required either by law or by the ASX Listing Rules to comply with these principles. However, these companies must provide details in their annual reports of where they do not comply with the principles. The first principle is important in the corporate governance context as it recommends that a company set its framework so the board is in a position to provide strategic guidance to the company, and be able to oversee management in an effective way. Tests for independence of directors were discussed through the Cadbury Report, which has influenced the tests in the Australian context. These tests are incorporated in the ASX principles, and are discussed in greater detail in Section 2.6.1.

Summary

The ASX recommendations included how to assess the independence of directors. These recommendations were released in 2003 and were intended to be in place for several years to allow the ASX to monitor their acceptance and effects. The recommendations have recently been revised with the issue of independence of directors moving towards a test for independence of mind. This is in line with the initial propositions put forward in the Cadbury Report.

3.3.11 Corporate Law Economic Reform Program and other issues

Corporate failure has been in focus in the early 2000s following the collapse of several well-known public companies. It is not the responsibility of the company’s auditors to uncover fraudulent activity, nor to prevent this from occurring. Management should accept this responsibility in the first instance, but the primary responsibility lies with the directors. The reasons for corporate failure are many and varied, but poor governance on behalf of the directors is a major contributing factor. Issues within this are a lack of internal controls, the existence of a dominant director, and the lack of attention given to the company’s affairs by independent directors (Sexton, 2001).

While directors should have the flexibility to put the company at risk when undertaking new transactions, as legislated through the Business Judgement Rule in the Corporations Act, Section 180(2), criminal and civil penalties should be imposed on those directors who act outside the law (Gething, 1996). Directors should not be able to put the company at risk without first undertaking a thorough review of any transaction on which they are required to make a decision. But this requirement to fully investigate each transaction should not inhibit the potential improved performance of the company through new transactions.

Directors are appointed to help the company in managing its affairs so it can be as successful as possible. With potential liability issues facing directors, it may be that more managers who have the ability to be good directors are reluctant to take up these positions. Recent amendments to the Corporations Act through the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003

(CLERP) reform have attempted to make the provisions relating to directors more reasonable. This is intended to motivate more managers to become directors, who are likely to be independent directors. These provisions include the ability to delegate, and more importantly, established the Business Judgement Rule (Ravlic, 1999). The notion of the business judgement rule was discussed by Baxt (1994) a number of years before it was introduced. This discussion centres on the findings of Justice Ipp in *Vrisakis v. Australian Securities Commission*[61].

Companies may merely be appointing independent directors to give the impression of good corporate governance (Cox, 2001). It would still be possible for fraudulent activity to take place if the management were expert at hiding their transactions. While shareholders may see them to be worthy appointments, some independent directors may be poor managers, and not be capable of carrying out their duties. Alternatively, while the independent directors may have every intention of carrying out their duties, the executive directors and management may be so powerful as to make the independent directors powerless.

The decisions made by boards affect the company's performance, and making poor or incorrect decisions is detrimental to the health and longevity of the company (Cutting & Kouzmin, 2000). Every action that a company undertakes is a result of decisions made by the board, and while mistakes and poor decisions are made, the directors should not be held responsible for any losses that result from these decisions, unless the decision was made on fraudulent grounds. Companies will not grow or become more efficient unless risks are taken. But these decisions should be made only when due care is taken. Directors are now protected from litigation for poor decisions made on these grounds through the Business Judgement Rule.

The issue of delegation, as now included in the legislation, was raised in the Cadbury Report, and further developed in CLERP. The other significant issue that followed the same path is the Business Judgement Rule, which provides support for decisions made by directors that may lead to a negative result for the company (Nicoll, 1994; Finlay, 1999; McConville, 2001; Baxt, 2002a). Under this rule, directors will be protected from personal liability for breaches of duty of care and diligence in relation to honest, informed and rational business judgements. Three elements are required for this: an

[61] (1993) 11 ACSR 162

informed decision in good faith; no material interest in the subject matter; and a rational belief that the decision is in the best interest of the company (Finlay, 1999).

The CLERP proposal is important, as it will protect those directors who make business decisions in the best interests of the company. Every business decision carries a level of risk, but the level of risk should be directly relative to the potential rewards to the company. This rule is not meant to protect directors who improperly assess the business decision, or have the company undertake a venture based on fraudulent decisions.

The actions of the directors in making a business decision are important, particularly the level of inquiry undertaken by the director. They cannot simply rely on other directors considered expert in the area of the decision, but must make independent inquiry themselves. This is relevant to independent directors, who are expected to be experienced in business generally, and highly expert in one or maybe two particular business issues. An expert would be expected to recognise issues in a business decision relating to his/her area of expertise, but other independent directors couldn't be expected to do so.

This is where the importance of independent inquiry is raised, and the independent directors must be motivated to undertake independent inquiry, and to seek external expertise if necessary to gain a better understanding of the issue (Turnbull, 1999; Ham, 2002). This duty of care necessitates taking an objective view, especially considering the reference in the CLERP proposal on what decision a reasonable person in a similar position would make on a similar business decision. This may help to distinguish different responsibilities between executive and independent directors.

Directors are now able to delegate functions to other people, and are able to rely on advice and information provided by other people. However, this raises the issue of independence. If directors, and in particular independent directors, rely on advice and information provided by others, and the usual source of this information would be the company, there is the issue of them being able to maintain their independence (Turnbull, 1999).

This concept of delegation is relevant to independent directors. While they do not have direct continuous involvement with the company, Justice Santow in the HIH case did comment that the reasonableness of the reliance or delegation must be considered on a case-by-case basis, and that whether the director is executive or independent may be taken into account in this consideration. But the question arises as to how heavily should the board be involved in general issues facing the company. There is no doubt that the board should be intimately involved in the strategic decision making process, but maybe there should be limits on how much further should it go (Scherrer, 2003).

The board should oversee strategies for the business and review policies covering operational areas where risk is an issue. Members of the board should have technical knowledge of all areas of the company; some directors will know more about some areas of operation than others. Responsibility for complying with these policies can be delegated, as long as the board understands the risks involved and is sure that the policies cover these risks. In the AWA case, losses were incurred due to inappropriate use of treasury products, with poor monitoring and reporting procedures adding to the problem. The board did not fully understand these risks, nor did it seek regular reporting on this issue (Heywood, 1996). Poor policy setting, lack of reporting procedures and poor training and documentation combined to establish a frame whereby a loss was inevitable. The board should ensure that all policies are effective and well documented, and that all staff are correctly trained. This can relate particularly to independent directors, as one of the reasons for their appointment is specialisation in one or two particular areas.

Historically, there was legal precedent that the content of the duties to the company between executive directors and independent directors should be viewed as being different. This distinction comes from the contractual relationship that the two classes of director have with the company. Executive directors, as full-time employees of the company, have the same responsibilities to the company as other full-time employees. In contrast, independent directors had been seen to have a specialised role (Cassidy, 1995). However, these views are changing as the role of the independent director evolves. The reasoning for having independent directors varies between governance issues and economic issues. The extension issue of independence has been widely discussed, and several tests for this have been proposed.

Governance issues central to this theme include offsetting the power of executive directors, creating a link between stakeholders and the board and the company, creating the appearance of good corporate governance, and providing a level of independence.

The economic issues revolve around the benefits to the company, and include the expertise brought by the independent director in specific areas, the external contacts they have, specific industry or activity knowledge, and the transfer of their good reputation to the company (Boyd, 1996; Barratt & Korac-Kakabadse, 2002; Baxt, 2002a; Higgs, 2003). However, independent directors have a greater duty of care than just opining on their field of expertise (Lyons, 1995). They must make a greater overall contribution and ensure that they are aware of all that is going on in the company.

The functions and roles of independent directors are considered to be wide-ranging. They are appointed to broaden the strategic view of boards, ensure that the board is working for the best interest of the company; they should appoint, monitor and replace the chief executive if necessary, and bring awareness of the external world. (Clarke, 1998; Kakabadse et al., 2001; Barratt & Korac-Kakabadse, 2002; Higgs, 2003). The performance of senior management should also be reviewed by independent directors (Turnbull, 1999; Ham, 2002) They should also ensure that information, particularly accounting information, is accurate (Turnbull, 1999), but Ham (2002) contends that, technically, independent directors should play no role in the company's day-to-day management. Independent directors are to oversee the board, and should be monitoring those people who appoint them.

In smaller companies, where expertise rests with fewer people, the role of the independent director could include either taking on, or assisting with, operational or management and executive functions (Barrow, 2001). This view is limited only to smaller companies in the literature, but may now be gaining more credibility in larger companies. This raised the question of the ongoing independence of these directors. If they are merely acting as advisors or consultants, and showing the employees what is required or how it is done, then there should be no question of their independence. But if they are actually doing the work, then they are acting more as executive directors, and their independence can be questioned.

The role of the independent director being a link between the company and its stakeholders appears to be gaining more support (Kakabadse et al., 2001). More instances of corporate failure are being experienced by an increasing number of stakeholders. With more independent directors being represented on boards, stakeholders should have more confidence that their interests are better looked after, and that the influence of the executive directors is constrained when required.

Independent directors have been described as boundary spanners (Geletkanycz & Hambrick, 1997), whereby they act as a two-way conduit, distributing information on the company to the stakeholders and the wider environment, and passing requests for information from the stakeholders and the wider environment back to the company. This concept enters the corporate social policy debate: whether a company should be established merely to generate profits for its owners, or whether each company should contribute to the better social standing of the communities in which it operates.

In taking this position of the connection between the company and the environment in which it operates, independent directors place themselves in the unique position of holding strategic knowledge of the company, and being able to use both this knowledge and that gained from the external environment to benefit the organisation through developing better strategy, or better advising or commenting on strategies developed by others inside the organisation (Barratt & Korac-Kakabadse, 2002).

Kakabadse et al. (2001) undertook a study in the United Kingdom of the role and contribution of independent directors. They concluded that independent directors make a valuable contribution to the company, but that their motivation is not clear, as rewards are low. Traditionally, boards establish several committees, including the remuneration, audit and nomination committees. It is common that most, if not all, members of these committees are independent directors, as they are formed to check segments of the company's operations.

Kakabadse et al. (2001), in common with similar studies, also found that the uses of independent directors will vary with the activities of each company, and each particular independent director's area of expertise. Having several non-executive directors who can be relied upon to perform their required functions enables the executive directors and senior management to concentrate running the business. The different personalities and seniority of independent directors add to their usefulness, sometimes acting as a sounding board for the chief executive or challenging others in board meetings.

Summary

Poor governance practices in the past were partly responsible for some of the corporate collapses seen in Australia in the early 2000s. Directors needed to take greater responsibility without the fear of prosecution if poor decisions led to problems. The Business Judgement Rule was legislated following recommendations in the CLERP reform. This enabled directors to undertake new ventures following a thorough analysis of the decision, without danger of recourse. As independent directors had less knowledge of the organisation than executive directors, this rule allowed the independent directors to make a greater contribution and the responsibility to make deeper inquiry.

The involvement of independent directors in business decisions has led to them taking more responsibility as board members. These responsibilities were previously the domain of the executive directors, but better corporate governance has demanded that the independent directors take more responsibility. Independent directors are appointed for various reasons, and boards have started to use the independent directors for the benefit of both the board and the company.

3.3.12 Summary and conclusion

The influences set by the governance pillar on the role of the independent director have only become apparent since the early 1980s. These issues have existed for a much longer time, as seen in the review of common law earlier in this chapter. This terminology has been in use only since the early 1980s when it was realised that the behaviour of a board of directors governed and influenced the performance and structure of the company.

As these influences exerted by the board of directors became better understood, organisations established to monitor company behaviour recognised few controls to monitor and control directors. 'Corporate governance' describes how directors are monitored and controlled, and how influencing factors impact on the actions and behaviour of the members of the board. With the board made up of several groups – chairman and deputy chairman, managing director and other executive directors, non-executive directors, and independent directors – corporate governance common sense determines that the independent directors should play particular roles, as their position on the board is determined not only by their experience and skills, but by their impartiality. All stakeholders are affected by the corporate governance influences set by the company's board. Some shareholders, including shareholder groups like the Australian Investment Manager Association, view the monitoring of the return to shareholders as the main priority.

From the mid 1980s, organisations with influence over the operations of companies began imposing their authority on the structure and operation of company boards. These influences have been evident mainly in the United Kingdom and the United States, and regulators in other countries have followed suit. The OECD is well placed to have a global overview of the progression of these regulations, and it views the consistent approach to be most effective in setting an overall structure, which will then be specifically designed in each country to match the cultural and economic dynamics of each country.

Over the past 20 years, a series of successive reports and regulations have been commissioned and implemented by the respective authorities. This progression not only reflects the changing nature of corporate governance to meet modern day expectations, but provides a better understanding of how corporate governance influences the behaviour and performance of the board.

One of the main recommendations of these reports has been to increase the number of independent directors on company boards. This is seen to improve the performance of the board in two ways. First, by bringing a greater level of independence to a board, outsiders perceive that the executive directors will have less influence than in the past, and that decisions made by the board will be the best for the company, and not for the executive directors. Second, the board will benefit from the general and specific knowledge of the independent directors it appoints. As the election of directors to a company's board through a vote of the shareholders is transparent, it is assumed that only independent directors who can add value to a company's board would be elected.

The Cadbury Report released in the United Kingdom was the first report that recommended that the number and power of independent directors be strengthened.

Then in 1995 the Greenbury Report reviewed the specific issue of directors' remuneration and recommended the establishment of remuneration committees whose members were independent directors. This followed the theme established by the Treadway Commission in the United States, which recommended audit committees made up of only independent directors. The Hampel Report, released in 1998, reinforced the recommendations of the Cadbury and Greenbury reports, and expanded the sphere of corporate governance to also include the new issues of auditor independence and shareholder input on corporate governance.

In 1999, the findings of the Turnbull Report recommended a framework to improve the effectiveness of internal controls, which increased the burden on company boards by ensuring that they were setting strategies and policies to achieve this. This framework is part of the continuing progression of corporate governance as new issues seen to be affecting the performance of the company's board are brought under this concept.

In the United States, the implementation of the Sarbanes-Oxley Act in 2002 was seen as a significant progression in corporate governance in that country. This legislation concentrated on the independence of directors on all of the company's board committees and paid specific attention to audit committees and the independence of a company's auditors, which has since become a critical component of corporate governance. The most recent report released in 2003 in the United Kingdom was the Higgs Report, which reviewed the role and effectiveness of independent directors while placing more emphasis on how boards perform, and how this performance can be improved. This report considered the skills that independent directors brought to the board, how they contributed to identifying, monitoring and mitigating risks, and their contributions to setting effective strategies and overall improvement of the performance of the board.

In the Australian context, the recommendations of the United Kingdom and United States reports and legislation have been broadly followed through the ASX Corporate Governance Principles, the Ramsay Report and the CLERP legislation. These require increased independence on boards and ensure that boards act in the best interests of the company and its stakeholders. They incorporate issues such as the ability to delegate the day-to-day running of the business to management, and the Business Judgement Rule to enable the board to take their opportunities to grow the business. With the increasing representation of independent directors on boards through following the ASX guidelines, their roles have become more refined. Their functions are wide-ranging, and form a basis of their main roles, which are to monitor the executive directors and senior management, to expand the skills and knowledge of the board as a whole and to create a link between the board and the company's stakeholders. All of these roles are seen to improve the effectiveness and performance of the board.

3.4 The Commercial Pillar – the 'what'

3.4.1 Introduction

The role of the independent director has evolved over time. The commercial view of the role is determined by the nature and size of the company on which the director is appointed, among other factors such as ownership structure, complexity, personnel, culture and traditions (Bosch, 1995a). Under The Corporations Act there is no differentiation between executive and independent directors, and the act does not require the inclusion of any independent directors on a company's board (Surgeon, 2003).

Commercial thought, however, suggests that boards of directors include a majority of independent directors with an appropriate blend of experience and skills (Bosch, 1995a). Non-executive directors had, in the past, taken board positions to use the knowledge that they had gained in their working careers to improve shareholders' wealth (Arbouw, 2004). A director was proud to serve on boards, the motivation being the contribution to the business, not the remuneration. With the recent corporate collapses in Australia, including One.Tel, Harris Scarfe, Ansett, AWA and HIH, independent directors have come under greater scrutiny. Regulators and stakeholders want to know what these independent directors are doing, what contributions they are making to the company, and whether they are policing the executive directors. The role is changing, and the current commercial views on what this role is and what it should be are diverse.

When the AWA case came before Justice Rogers, before he could make his judgements he had to determine the roles and duties of each group of people involved in the case.

He reviewed numerous legal and managerial writings and concluded that the separation of duties between all the involved parties was not clear-cut (Hilmer, 1998). Rogers concluded that the board of directors has two main functions, monitoring and performance enhancement, and obviously the independent directors should play major roles in both of these functions. The findings from the AWA case indicate that independent directors are expected to provide an informed and independent opinion on those matters that the board considers. As they are non-executive and involved only part-time in the board, they should be able to rely on information provided to them by the company's management or advisors, unless they would have reason or suspicion not to rely on this information.

This section of this chapter sets out what independent directors are supposed to do, from the point of view of those working in and around company boards. Although the roles can be segregated into several categories, there is a state of confusion when the role is viewed from this aspect. The literature reviewed in this section has been written by a variety of observers experienced in this field. However, the experience comes from several different angles, each being influenced by the writers' point of view, whether this is as a fellow director, a specialist firm providing personnel recruitment or accounting services to the industry.

This lack of structure may be partly due to the lack of an authoritative basis for this literature. There is no overriding system such as the legal system in the first pillar, or the governance system in the second pillar. Those systems set the foundations that boards and directors are expected to follow, but this commercial pillar has no such system to set such a foundation. As a result, the authors of this literature are not responsible to a higher authority. They are not creating precedent or reporting guidelines, but are merely writing as observers.

The discussion includes a variety of views: those who observe the behaviour of directors from within and around the behaviour of boards; including those who interact with boards and management, such as accountants, lawyers and regulators such as ASIC, APRA and ASX; those who observe and formulate theories and priorities; and those whose work is the result of related issues such as the Independent Working Party into Corporate Governance. These views are often independent and unrelated, leading to an apparent lack of logical sequence in the literature. Common themes in these discussions include the performance of the board, effectiveness, monitoring, individual expertise and board committees.

3.4.2 Performance of the board

The Independent Working Party into Corporate Governance formed after the AWA case on the recommendation of Justice Rogers concluded that the independent directors on any board should put their emphasis on ensuring that the board's performance should be their main concern (Hilmer, 1998). Five questions should be continually asked by the independent directors. They should ensure that the performance expectations of shareholders are being attained and, if not, why not. They should monitor the recommendations of management regarding significant changes to the company, or recommend whether alternative advice be sought. They should check whether policies are in place where management has limited discretion, and whether there are processes to ensure that these policies are being followed.

Directors are elected by the company's shareholders and these shareholders thereby delegate the management of the company to these directors. Directors are responsible not only to the company's shareholders but to all of the company's stakeholders (Bosch, 1995b), which includes creditors, employees, the general public through environmental issues, competitors, suppliers, and any other individuals or groups of individuals affected by the company's operations. As a sign of confidence in their own abilities and in the company generally, independent directors are encouraged to own shares in the companies on whose boards they sit. But this can devalue some of their independence (Carter & Lorsch, 2004) and these directors may make recommendations and decisions that are not in the best interests of all stakeholders, but in their interests as a shareholder.

Directors are elected by the company's shareholders, and independent directors can fill the role of a boundary spanner by taking on the role of the communications link between the board and the shareholders (Nicholas, 2004) and between the board and all other stakeholders (Barratt & Korac-Kakabadse, 2002). This role has been called the senior independent director and some argue that it is a role that should be undertaken by the chairman. If the chairman is an executive chairman then the deputy chairman, if there is one, should take on the role. Such a role would be practicable only with large shareholders or shareholder groups. For example, as at 30 June 2004 Telstra had over 1.6 million shareholders, excluding the Commonwealth Government's 51% shareholding, of which over one million held 1,000 shares or fewer. (Telstra Annual Report 2004, page 141). It would be impossible for any one director to meet with these shareholders, even the few who would like to do so. Even then, the issues raised would represent only a minority of shareholders.

A company necessarily interacts with many different and unrelated stakeholders and the flow of information to these stakeholders and back to the board is important (Barratt & Korac-Kakabadse, 2002). Independent directors are best suited to fulfil the role of boundary spanner merely because they are independent and, unless they are dishonest, they would only gain by passing correct and full information between the board and its stakeholders. This role can expand to include the company's management as a stakeholder, with independent directors acting as an independent body between the board and management. This may help to ensure that accurate information flows to the board as it would not be edited or blocked by the executive directors. By keeping external stakeholders well informed and passing their comments and requests back to the board, independent directors are promoting a role of corporate social performance, enhancing the view of the company as being a good corporate citizen.

Research on organisational strategy and performance has shown that the boundary spanning activities of directors is the most active of all positions within a company (Geletkanycz & Hambrick, 1997). These relationships between the directors and stakeholders have increased political activity and corporate acquisitions. By using independent directors to link with the company's stakeholders, social information is passed back to the board and is used within the company to reflect the preferences of the company's stakeholders.

Independent directors, elected by shareholders, can be seen to be agents of the shareholders and they are therefore obliged to act in the interests of the shareholders by protecting the best interests of the company. Independent directors should be skilled professionals who are appointed to provide the board with knowledge, objectivity, judgement and balance that can come only from external influences (Clarke, 1998). Relying only on executive or non-executive directors may limit the breadth of knowledge, objectivity, judgement and balance and therefore limit the effectiveness of the board.

Having independent directors on the board can merely be an attempt by the company's board to prove that it has effective corporate governance practices and provides a degree of integrity (Clarke, 1998, Kakabadse et al., 2001). But having independent directors who do not add to the board's knowledge at the expense of executive or non-independent directors can be detrimental to the company's performance (Cox, 2001). Employing competent and knowledgeable independent directors can bring transparency and accountability to the board, and the business credibility and capabilities of these independent directors can be beneficial to the performance of the company.

Summary

Ensuring optimum performance by the board is a critical role of the independent director. Their responsibility is to all of the company's stakeholders. Merely giving the appearance of good corporate governance is insufficient. The independent directors should link directly with the company's stakeholders, acting as a boundary spanner and transferring information from the stakeholders to the board, and back from the board to the stakeholders. Stakeholders see the independent directors as more reliable than executive directors, as the independent directors are impartial to the context or content of the information transferred, as long as it was being done in the best interests of the company. By ensuring that the board is aware of the issues concerning stakeholders, they are working to help the board in improving its performance.

3.4.3 Effectiveness

By definition, independent directors should be independent of the executive management of the company and of the company itself. Both independent and non-executive directors are expected to monitor the company's senior management, which includes any executive directors, and assist with developing business strategies that will be used to manage the company to enable it to reach its goals (Bosch, 1995a; Surgeon, 2003).

Surgeon (2003) believes that the more independent these directors are, the more effective they will be. Their thoughts, decisions and recommendations will not be tainted by how management usually runs the company, but by their own education, experience and independent view of the company and its industry. Directors are responsible for the financial performance of the company, which reflects the strategic decisions set by the board. Directors are therefore expected to be heavily involved in setting strategy and making strategic decisions on all aspects of the company's policies, particularly independent directors who are appointed for their strategic expertise (Scherrer, 2003).

The contrary argument is that the more independent a director is, the less knowledge they will have of the company and/or its industry (Carter & Lorsch, 2004), and they will therefore be less effective than an executive director or non-executive director who has extensive industry and/or company knowledge. Each situation is different and one must consider the company's intentions in selecting independent directors. Appointees are often specifically selected for their particular expertise in certain areas, as well as their general business knowledge. A particular independent director may be an asset to one board, but little value to a board of a company in a different industry. The independent director will become familiar with a company's operations and its industry through working on the board. This, together with the independent director's expertise and general business acumen, will enable that director to add increasing value over time.

However, an independent director's value can eventually decrease. The longer an independent director serves on a board, the less independent they become. Wallis (2000 pp.17-18) has even suggested that independent or non-executive directors be provided with specific and extensive training and development processes, but the information contained in this process could be biased. If independent directors limit their time to serving on one or two boards, and are not otherwise involved in keeping up-to-date with current business practices, their usefulness will diminish over time as their ability to offer new ideas or concepts will decrease, and their thought processes will gradually tend to follow that of the company's management and executive directors.

To fulfil their role of providing guidance and strategic direction, independent directors can gain knowledge of the company and its industry by working on a board or by relying on information provided by the company's management or executive directors.

However, this information may be flawed (Carter & Lorsch, 2004) or biased, resulting in the independent director being unable to perform their role satisfactorily. Directors should be more actively involved in the decision-making processes of the company, and need substantial understanding of the company to do this effectively. They should therefore be able to understand information provided to them about the company and determine its accuracy (Scherrer, 2003).

The independent directors should ensure that the short-term goals of the company are part of the longer-term strategic direction that has been set by the board (Scherrer, 2003). The capabilities of the directors on the board, particularly of the independent directors, will have a substantial impact on the performance of the company, its integrity, and how it is viewed by investors, particularly professional investors such as investment funds. If the independent directors are not being proactive, it will become obvious to these investors, and the investment community could lose confidence in the company as an investment. Companies need additional capital to help finance their growth, and they will find it difficult to source new equity capital if investors lack confidence in the corporate governance of the company or are uncertain that their interests are being monitored and protected by the independent directors.

Compared with independent directors, executive directors will have a greater understanding of the company and will have access to more information about the company. They will know before almost anyone else when the company is in financial difficulties. If independent directors take a passive stance and wait for information to be provided to them, they may be too late to assist in turning the company around from a disaster situation. Scherrer (2003) recommends that these directors take a greater role in the management of the company, which should enable them to have earlier access to important information. They should create their own information flows within the company to ensure that they are provided with all relevant and important information. These independent directors also have access to external information and resources that may assist the company.

But directors are not involved in management (Wallis, 2000) as the directors delegate the management of the company to those employed to manage the company (Baxt, 1995). As independent directors are not full-time managers they should not be making any operational decisions, but act reasonably to delegate these decisions to others. In some cases they will be involved in appointing those to whom they delegate these responsibilities. Directors rely on information provided by others to enable them to make decisions. It would not be reasonable to accept this information, or any other information that is provided to them, without questioning the accuracy or source of the information if they felt that it was questionable (Rogers, 2002; Unkles, 2002). Directors use information provided by others to make decisions, as well as using information they source themselves. They have a duty of care when making decisions and must be diligent when doing so. There should be no limit to how deep directors can dig to ensure the validity of the information that is provided to them (McMillan, 2003).

Not being constantly involved in the company's business requires the independent directors to request information from the company's management or executive directors that is not otherwise available. If this information is necessary for the independent director to perform their duties and it is not provided, or it cannot be verified, the independent director may, in some circumstances, have to resign (Lyons, 1995). All directors are required to become familiar with the company's operations and performance. Independent directors are not expected to become involved in the day-to-day activities of the company nor audit the company's accounts, but they must continually ask for and have verified information that they request so they are confident in their knowledge of the company and are able to contribute adequately as a director (Baxt, 1995).

There are no formal distinctions between the roles of executive director and non-executive director, whether the latter is independent or not. Each should add value in their specialised area, and by contributing to the better management of the company. There is no formal job description for an independent director (Pease & McMillan, 1993). Their role will vary depending on the size of the company, the industry in which it operates, the expertise and experience of the other directors on the board, and the specific expertise and experience that the independent director brings to the board. The reasons for appointing independent directors are many and varied, and depend on the specific characteristics of each company, and the scrutiny under which that company comes from the different stakeholders, the general public and the media.

Pease and McMillan (1993) defined the role of the independent director as a separate function from executive directors. As independent directors are able to put themselves in positions that executive directors cannot, they can play specific roles while not being concerned about the repercussions of challenging the chairman, executive directors or management. Pease and McMillan view the independent directors as having three main functions: corporate monitoring, contributing to company performance and protecting shareholder funds. These three functions capture all the roles discussed in this section and emphasise two areas of concentration: the independent director as a boundary spanner, and the independent director being responsible for conformance and performance of the board. By fulfilling these functions, independent directors can make an effective contribution to the performance of the board.

Summary

Independent directors are invited to join boards for their specific expertise as well as general business knowledge. As they are not full-time employees of the company, they must rely upon others to provide them with the information they require to be effective. This information may be flawed or incomplete and, to be fully effective, independent directors may need to establish their own information sources in the company. As they are expected to monitor executive directors and senior management, who are the most likely sources of information, independent sources may be more of a necessity and a control mechanism than simply a benefit. Disclosure of the provision of information to independent directors from independent sources would also provide comfort to investors and other stakeholders.

3.4.4 Monitoring

Independent directors can bring benefits to the board that executive directors cannot bring, which can include a more knowledgeable or different view of issues, or sometimes a more professional view of the situation in which the company finds itself (Kakabadse et al., 2001). The independent directors can also act as mentor or confidante to the Chief Executive Officer, a role that executive directors or senior management cannot fulfil, as they are junior to the chief executive. Independent directors should evaluate the performance of the chief executive, and if they are professional independent directors, they will be able to judge this performance against that of chief executives on other boards. To add value, independent directors need to be effective and constructive and must participate independently.

Carter & Lorsch (2004) argue that one of a board's most fundamental responsibilities is unbiased oversight of management, which can only be constructively accomplished if the majority of the board members are independent. For independent directors to better understand the company from an unbiased perspective they must spend more time being involved in the company's operations. But this is difficult for professional independent directors as they rely on director's fees for their livelihood and therefore sit on many boards. Spending more time on fewer boards being paid higher fees may be a solution. But over time these directors will lose their independence, and therefore they should be replaced regularly. The downside is that the board and the company then lose the benefits of the knowledge and expertise developed by these directors (Nicholas, 2004), which can sometimes be critical when the company is facing a crisis.

One of the most important aspects of independent director involvement is to ensure that the executive directors and management are monitoring and guarding against risks. Risk taking is a part of business and if management does not undertake risks, the company is unlikely to grow. Managing risks, rather than just taking risks, is the key issue. The use of treasury risk management products is widespread but these products are not always well understood. Directors, especially independent directors, should have a good understanding of these products, how they are used, and the risks in using them. The financial reporting of the exposure covered by these products should also be understood by independent directors (Heywood, 1996). Policies to manage risks should be set by senior management and adherence to these policies should be regularly monitored by the board. Financial problems can arise quickly relative to treasury risks, such as occurred in the AWA case, and independent directors should be aware of exposures to which the management and executive directors have contracted the company and the policies and procedures used to monitor those risks.

Challenging the views and comments of other board members, especially of executive directors, is an important role played by independent directors. They would not be serving their employers to the fullest extent if they did not challenge others, and merely gave supporting views or comments to matters put forward by others on the board

(Moodie, 2003a, p. 18). Constructive argument and debate is more beneficial to the company, even if it means challenging the chairman or managing director. Independent directors should behave as 'devil's advocate' (Moodie, 2003b, p. 22). They should not be bound by the seniority of others on the board, as would be executive directors who may be concerned of the repercussions following a challenge to the managing director. Clarke (1998) takes this one step further and sees the independent directors as having a clear role in appointing, monitoring and, if necessary, replacing the chief executive.

The board has an objective role to oversee the company's management and ensure that they are accountable to the shareholders, as is the board (Horwath, 2002). If the independent directors hold a majority position on the board and work together, they can influence board decisions and implement strategy or policy that may even be contrary to that proposed by management or the executive directors. This also gives shareholders confidence in the board as they would view the board as being responsible and focused on making decisions that are in the best interests of the company, not of the directors.

Independent directors should not participate in the day-to-day management or operations of the company (Ham,. 2002). They should be corporate watchdogs and should challenge the board, the executive directors and the chairman. They should question anything that they view as being unethical, or not in the best interests of the stakeholders (Clarke, 1998). They should be capable of judging policies and procedures and be prepared to investigate to uncover fraud or dishonesty. They should understand accounting policies and be able to challenge the company's accounting approach from an educated stance, to ensure that International Accounting Standards are being followed. This is not the job of the company's auditors, who are employed to audit the company's accounts. The independent directors should have the necessary qualifications to do all these things. However, the independent directors are usually appointed or recommended by the chairman, the nominations committee or the board, and then have their appointment ratified by a vote of the shareholders.

Leith (2002) does not believe that independent directors should have to monitor the other board members, specifically the executive directors. Her position is that they should support the board and the company's management in building the success of the company. Much of the time spent by independent directors is linked to managing risk and its accountability, and this can dictate the expertise independent directors may have which makes them in demand. Those with experience in accounting and law can be preferable to others who may limit the usefulness or productivity of the board. Too many independent directors with similar expertise leads to a narrow reference pool and adds little value to the board, unless their general business knowledge and abilities are substantial. Depending on their experience and expertise, some directors may not be capable of providing advice or commentary on financial matters (Leith, 2002; McMillan, 2003) but may be more useful in other areas. This is the argument used for appointing independent directors with different backgrounds and experiences, so the whole board can provide a complete view on the company's operations and the issues that affect the company.

The job description of a director can be extensive and can include opining on and reviewing strategies, approving budgets, monitoring business performance, approving dividends and large investments, evaluating the chief executive, monitoring management, succession planning, approving executive compensation, identifying and mitigating risks (Nelson, 2002), ensuring accurate financial reporting and legal compliance (Garrat, 2003; Buffini,2004). Shareholders expect their directors to carry out all these roles, and it is unrealistic to expect that all roles will be performed perfectly in the few days each year that independent directors spend working on any company.

Directors owe a duty of care to the company and are expected to make proper enquiry to the state and performance of the company (Baxt, 2000b, 2001). They cannot simply allow management to run the company without oversight, or allow executive directors to control the company. They must ask questions about the performance of the company, and make further inquiry if dissatisfied with the information provided to them, usually by those people they are supposed to be monitoring. Independent directors should not become involved in the daily business of the company but they should make themselves aware of its financial condition to ensure that the company is viable and able to pay its debts.

The role of the independent director is aligned to the role of the board, with conformance and performance being the two issues upon which both must focus (Business Law Education Centre (BLEC), 1996). The independent directors should be vocal when they view a lack of conformance and must push the board members to conform to all requirements, whether legal, ethical or moral. To ensure conformance, the independent directors should ask the tough questions that executive directors will not ask their employers, be alert to possible signs of problem issues, seek professional advice or guidance should they see a requirement to assist in their monitoring of performance, monitor management from an objective point of view, and act to protect the company's or stakeholders' interests should they feel the need to do so.

Other than bringing an independent view to board discussions and contributing significant vision and experience, Bosch (1995a) raises four reasons for the majority of board members to be independent. One of the most important roles of the board is to appoint and monitor the Chief Executive Officer, and to replace them if necessary. It is difficult for executives who report to the Chief Executive Officer to take on this role. The board provides a structure that assists management in effectively managing the company. If the board members were not independent it would simply be a matter of management managing itself. A majority of independent directors can make an external view of management. As independent directors are elected by the shareholders, they are responsible to the shareholders, and they must both look after shareholders' interests and ensure that the executive directors and management are focused on the critical issues that allow the company to comply with its chosen strategy.

Summary

Not being full-time employees of the company, independent directors are in the unique position of being able to 'counsel' the managing director without being beholden to him for their livelihood. They add value by helping the managing director to be more effective. In the same vein, they can challenge the managing director or other executive directors without fear of losing their jobs. If they challenge others on the board with adequate authority and argument, independent directors may be able to influence the board to establish strategies contrary to that proposed by senior management or the executive directors. By monitoring the actions and recommendations of others on the board, independent directors can help to ensure that the board is performing to the best of its capabilities.

3.4.5 Individual expertise

Independent directors are invited onto boards for their expertise in one area in which the company operates, as well as for their general business experience (Clarke, 1998, Kakabadse et al., 2001). It could then be logical to suggest that each independent director be given a specific functional responsibility to manage (Cutting & Kouzmin, 2002). As the board works to develop the strategic direction of the company, each independent director could take responsibility for a certain aspect of this strategy, linked to their individual expertise. The background of newly appointed independent directors is slowly changing (Korn/Ferry 2000 Study). Expertise in certain areas is becoming more in demand. This reflects a shift from employing generalists to specialists. But the majority of independent or non-executive board positions are still held by retired chief executives, proving that general high-level management expertise is highly regarded, but is slowly decreasing.

The Korn/Ferry 2002 Study confirms this trend, with ex chief executives still highly valued, but other specialists in high demand, especially those with accounting or financial expertise. The overall combination within a board is particularly important, with the chairman recognising that the chemistry within the board must work, there must be differing views, respect for others and the ability to see others' points of view. The days of the 'old boys' network have passed as older independent directors who are no longer involved in any business on a day-to-day basis are outdated. More frequently, younger independent directors are being appointed, as they are seen to have a better discourse with management and stakeholders.

The size or demands of the organisation can sometimes determine the job specifications for independent directors (Clarke, 1998, Kakabadse et al, 2001). Smaller companies may not be able to employ full-time managers due to staffing or financial constraints, and therefore may take on independent directors with particular expertise not otherwise provided by the company's management (Barrow, 2001). In these cases, the independent directors are used more as consultants and can be used as sounding boards by the executive directors and management. Alternatively, a second board, or 'Corporate Governance Board' could be created to undertake corporate governance without being subject to influence by the main board or the chairman (Turnbull, 1999). This board would also have a separate source of information from within the company to ensure the independence of information it receives, otherwise it would be relying on information provided by those that it should be governing. In contrast to larger companies, control in smaller companies is less formal and smaller companies require a degree of discipline (BLEC, 1996). Directors need to monitor the risk/return issue, which in this case is translated into the control/cost question.

Summary

Independent directors with different skills bring different benefits to a company. More independent directors are employed on boards due to specific expertise they may have. This may have a greater impact on smaller companies as their senior management may not have all the necessary skills required to manage the company; these missing skills could be provided by the independent directors. This specific expertise may influence some of the board's strategies, but it should be to the advantage of the company.

3.4.6 Board committees

One major role of the board is to provide guidance to the company, and to ensure that sufficient policies and procedures are in place to prevent and detect frauds or errors in reporting or accounting (Sexton, 2001). While the board cannot delegate this responsibility to management it can delegate it to a committee appointed by the board. The board will then still remain responsible for these issues. The audit committee would usually take on this role, and should normally have independent directors as all or most of its members, with the committee's chair always being an independent director. Some decisions should not be made directly by the board but by other committees established for particular reasons. The executive directors' and senior managements' compensation is one issue that should be determined autonomously from the board. Remuneration committees are established for this purpose and should consist only or mainly of independent directors, with the Chief Executive Officer as a member. This should ensure the appearance that the decisions of this committee are made arms length from the board (Clarke, 1998)

There is ongoing debate about who should be members of a company's audit committee. It is argued that the managing director should be a member of this committee, but this may prevent the audit committee and the company's external auditors being able to have open discussions. The accepted view is that the majority of the members of the audit committee are the independent directors (Bosch, 1995a) and that the committee chair should be elected from this group. As the managing director should have significant contact with the external auditors, Bosch (1995a, p. 164) suggests that the managing director may be present for the majority of the audit committee meetings, but the committee should mainly consist of the independent directors.

Similar recommendations exist for other major board committees, such as the nomination and remuneration committees. Companies in specialised industries also have board committees that add value to the board's work. Examples of these are investment committees for insurance companies and risk committees for banks. The make up of these committees will be determined by the required skills and expertise, and the requirement for independence. Members of investment or risk committees would be those with expertise in these areas, with independence not being a major factor in the decision. However, remuneration and nomination committees should have significant levels of independence but should include the managing director, who will have positive contributions to make to both of these committees. However, the managing director should be excused when the remuneration committee discusses his or her remuneration. It is also useful for both the board chair and managing director to sit on the nomination committee as their involvement in appointing senior staff and nominating directors is important. That being said, the appearance of independence in both of these committees is critical and is seen to be good corporate governance.

Summary

Board committees are established to manage and monitor particular aspects of the board's responsibilities and the company's activities. Most of these committees should consist of independent directors as members, particularly the committee chair.

Individual expertise and being distanced from the main board should ensure acceptance of the decisions and recommendations made by these committees by all stakeholders.

3.4.7 Summary and conclusion

This section has expanded the view of the expected roles of independent directors. Some of these roles flow from the legal and governance pillars, as commercial requirements should logically follow from legal and regulatory issues. Once requirements are regulated, or become law, commercial reality takes over. Directors are expected to comply with the legal and regulatory requirements of their roles and use these requirements as a base for what they do on the job. The AWA cases have impacted on the commercial requirements of the role as first the courts, and then actual practice, have influenced how directors, particularly independent directors, perform their roles.

Recent cases such as HIH Insurance illustrate the executive directors abusing their positions. The concern from these cases is what the independent directors were doing to prevent this abuse from occurring. In general, they are expected to ensure that the executive directors and senior management comply with the law, act in a proper manner, and are challenged on any issues that the independent directors feel are not being properly managed.

There are no legal requirements to appoint non-executive directors to boards, whether they are independent or not. Commercial reality requires that they be appointed, for a number of reasons. Overall, independent directors are elected by the shareholders and are there to 'police' the board and senior management and make sure that all decisions made by the board are in the best interests of the company, the shareholders and all other stakeholders.

Independent directors provide arms-length contribution to the board. Stakeholders are more comfortable when independent directors are involved in issues that may be sensitive, and are more confident that the correct decision has been made. Being independent, these directors can provide other benefits to the board, particularly introducing ideas and concepts from the outside world.

A number of themes have been developed through the commercial aspect of the role of the independent director, all investigating what independent directors actually do in fulfilling their duties. A variety of these roles have been identified from many different angles, usually without reference to any previous literature on the subject. Many roles occur only in limited or specific circumstances, and are mostly unrelated.

The progression of contemporary issues covered through the commercial pillar appears illogical, with no definite conclusions on the role of the independent director through the Commercial pillar. However, several common themes have been identified. First, one of the determinants of the role of the independent director is the size and nature of the company. Larger companies tend to be more complex and employ more directors on their boards. The collective expertise of these directors is well spread, and may cover all of the main issues that impact on the company's operations, such as marketing, finance, manufacturing, etc. In smaller, less complex companies, the executive directors are likely to have expertise in that company's activity, and any independent directors invited to join the board fill any knowledge gaps, such as a finance specialist in a biotech company. While the theory is similar in all organisations, executive directors in larger organisations are likely to have more industry expertise, rather than particular activity or product expertise as seen in smaller companies.

Second, more stakeholders are demanding to know what the independent directors are doing. They expect more interaction with the board in general, and the most efficient way of achieving this is by using the independent directors as boundary spanners, the link between the board and the company's stakeholders. Stakeholders view information coming from sources independent of the company's senior management as more complete and reliable. However, this reliability may be flawed, as the information on which the independent directors base their knowledge is provided by the executive directors and senior management. A mitigating factor is that the executive directors and senior management are aware that the independent directors are acting as boundary spanners and would want to ensure that the information they pass to the company's stakeholders is as accurate and complete as confidentiality issues would allow, otherwise it would reflect poorly on the company's management, executive directors and board in general.

Third, the independent directors want to ensure that the information they receive is complete and reliable, and therefore they closely monitor senior management and the executive directors, particularly the Chief Executive Officer and the chairman, to ensure that this is the case. In doing this, the executive directors form a close relationship with the Chief Executive Officer and are able to appraise their performance. Being aware of this, their unique position and the fact that the independent directors report to the board chair and the board and not to the Chief Executive Officer, the Chief Executive Officer may use this relationship to form a mentor partnership with one of the more senior independent directors. However, with the Chief Executive Officer being appraised by the independent directors, they are in a good position to review the Chief Executive Officer's performance. They may decide, in extreme cases, to replace the Chief Executive Officer.

Finally, the independent directors use their own knowledge and skills to interpret the information provided to them to maximise their contribution to the board in setting strategies and improving performance. This performance improvement is twofold: by improving the performance of the board in fulfilling its objectives, and then by improving the performance of the company through guidance and setting strategies, usually delivered through the Chief Executive Officer and other senior executives.

This section has drawn together many aspects of the role of the independent director from a diverse range of sources. While the literature appears confusing, conclusions can be drawn about what independent directors are doing on company boards. The major roles – comprising many sub-roles – are acting in a monitoring capacity, enhancing performance and acting as a boundary spanner.

3.5 Chapter summary and research issues

3.5.1 Elements of the method employed

This section reviews the components falling within the boundaries set around the three pillars. A frame was constructed around each of the three pillars within which the reference data were identified. To enable the researcher to analyse the literature within each pillar in a logical manner, each piece of literature was classified into a category. In this study, these classifications have been called data sets. Connections between the data sets from within the different frames were expected, as commercial practice often follows laws and regulations that have been established to regulate those practices. This section reviews the relevance of each set of research data through time.

The map of the three pillars presented in the literature review is subjective, determined by the researcher's background. The three pillars therefore have the potential for further development by other researchers at a later stage (Hart, 1998).

Analysis of the legal frame

The data sets in the legal frame included cases cited to support both the analysis and the Corporations Act, the statute with greatest impact on directors and their duties. It is simple to establish a frame around the information incorporated into this section, as both common law and statute form the legal basis around which the duties of directors are established.

Common law has had a significant impact in defining the role of the independent director from a legal point. Common law is dynamic, not static; it is constantly changing as new cases are decided with time. Common law provides precedent for subsequent decisions. Each new case will be decided with reference to preceding cases involving similar facts.

Statute is similar to common law, as both change over time with contemporary thought and practice. Cases can be decided depending on the relevance of the facts to the governing statute. But if the relevant statute cannot be used to determine the case, the judge can make his determination by using either previous cases or their interpretation of the relevant statute. If the statute is then considered not to be relevant to contemporary actions, or new issues arise that are not fully covered by statute, then legislation can amend the statute to make it more relevant. This action, as in common law, occurs in a gradual and logical manner over time.

Analysis of the governance frame

The data sets in the governance frame were more widespread, but still fell into two categories: industry reports commissioned by governments, government bodies or industry bodies, such as the Cadbury Report; and principles established by regulatory bodies, such as the ASX Corporate Governance Principles. The information caught within this frame is easily identified. While the majority of the principles established by regulatory bodies are expected to be followed, and non-compliance can be punishable under law, they are merely principles and not statute. The reports included in this section cover governance from a practical perspective, and were not written as a commentary on governance, but from an expert's perspective, the intended result being better regulation through the principles.

The industry reports followed two streams. One was a logical succession of reports in one country. An example of this is in the United Kingdom where the Cadbury Report was followed by the Greenbury Report, followed by the Hampel Report. The other stream is where a report in one country is followed by a similar report in another country, such as Cadbury Report in the United Kingdom leading to reports in South Africa (the King Report), France (the Vienot Report), and the Netherlands (the Peters Report). Both of these streams are instances of a progression of concepts through time.

The series of principles followed a similar path to the industry reports. The authors of these principles acknowledge that they are evolutionary, being revised and updated over time. Examples of this are the OECD principles published in 1999, then reviewed in 2004, and the ASX principles that were published in 2003 and which have recently been reviewed. There are also examples of principles established in one country leading to similar events in other countries. In the United States, the updating of the SEC listing requirements was followed by the UK listing rules being amended, then the AIMA in Australia updating its revised practices. It is noted that the path of these principle reviews also follows that of the industry reports.

Analysis of the commercial frame

The literature in the commercial frame was widespread and fragmented, and not easily classified into data sets. In some cases it was concentrated around issues relevant at the time the data were published. In other cases it was in response to a new report, policy, case or regulations that had recently been released. The information analysed in this area can be framed as ‘any other literature that cannot be defined to be included in the other two pillars’. They are papers and articles written by observers, usually in reaction to reports or regulations that had recently been released.

The Independent Working Party into Corporate Governance (Strictly Boardroom, Hilmer, 1998) was formed after the AWA cases, and is an example of the reactive nature of the research components in this frame. Similarly, the article by Baxt et al. (“CLERP” Explained, 2000) was written following the release of the policy proposals, but before the finalisation of the program. Similarly, Greenhow (1999) reviewed the effects of the Business Judgement Rule before it was enacted.

An example on both cases is the practice of Professor Baxt in writing articles on issues raised by the courts relative to directors’ duties and other similar issues. A number of such articles were used in the literature review in the commercial pillar. Also, there was substantial public discussion after the release of the exposure draft of the Corporate Law Reform Act 1992 (Australian Government Solicitor, 1997).

Summary of the frame analyses

In all three cases, the literature review for each pillar was structured to allow documentation of a logical path illustrating change over time. This worked well for the legal and governance pillars, where the paths were easy to follow. Even though the review in the legal pillar was discussed in terms of the five individual topics, the common law and statute in each topic followed paths that evolved over time.

There was no such pattern in the literature review of the commercial pillar. While this was structured in topics, using the same format as the legal pillar, the literature did not form a path through time, as there was little evidence of any articles following from others.

The combinations of the two categories of literature in the legal and governance pillars are also similar. In the legal pillar, common law and statute are related, as new statutes are often the result of common law decisions. Similarly in the governance pillar, new principles established by the regulatory bodies often followed from the findings detailed in the industry reports. No such relationship exists in the commercial pillar.

The introduction to this section discussed the concept of creating a map for each pillar. Mapping the issues in each of the three pillars established what had been done, when it had been done, what methods were used, and who contributed what. The next level involved identifying the links between what has been done (Hart, 1998). Links were identified in the legal and governance pillars, as issues followed logical paths, but the links in the commercial pillar were weak at best.

The following section discusses the materials used and the approach taken in analysing each of the three pillars. The strength of the literature in the legal and governance pillars is highlighted, as is the weakness in the literature in the commercial pillar. The research methodology used in this study is described in Chapter 4, and shows how a well-structured and robust study such as this is able to fill the gaps identified earlier in the literature review.

3.5.2 Analysing the three pillars

Analysing the materials and approach used in the literature review of each of the three pillars shows how the literature can be considered as an up-to-date compilation of the issues that constitute these pillars. The approach used in the literature review illustrates the logical progression of the issues in the legal and governance pillars, and underlines the lack of a logical progression in the commercial pillar.

Analysis of the legal pillar

The common law used to detail the path through contemporary thought follows a logical progression. For example, in section 3.2.2, The Duty of Care and Diligence cases cited were from *Land Credit Co of Ireland v Fermoy*[62] in 1870 to *Australian Securities Commission v Adler*[63] in 2002. The decisions in the cases cited in this section mirror the perceptions of duties of independent directors at the time the cases were held. A brief summary of the issues in these cases over time demonstrates this point, and is used as an example of the logical path followed by common law decisions. Note that these comments are reflective of the particular cases:

- 1870. Directors were liable if they were at a board meeting but claimed that their thoughts were elsewhere[64]
- 1875. Directors were liable if they were at a board meeting but were sleeping or did not hear what was discussed[65]
- 1892. Directors were not liable if they were not present at a meeting[66]
- 1925. Directors have a fiduciary duty to the company and are expected to exercise reasonable care, skill and diligence in discharging these duties that an ordinary man might be expected to take in the circumstances on his own behalf, but are not liable for mere errors of judgement[67]
- 1988. A director was not liable for debts incurred by the company if the director did nothing, was not involved in the day-to-day running of the company, and did not participate in the company incurring those debts[68]
- 1989. Directors are responsible if they make a decision, even if they do not benefit from having all the relevant information[69]

---

[62] LR 5 Ch App 763
[63] 41 ACSR 72
[64] Land Credit Co of Ireland v Lord Fermoy (1870) L 5 Ch App 763
[65] Ashurst v Mason (1875) LR 20 Eq 225
[66] Re Cardiff Savings Bank [1892] 2 Ch 100
[67] Re City Equitable Fire Insurance Co Ltd [1925] Ch 407
[68] Metal Manufacturers Ltd v Lewis (1988) 6 ACLC 725
[69] North Sydney Brick and Tile Company v Darvall (1989) 15 ACLC 230

- 1990. Directors are liable for a company's debts even if the director was not involved in running the business and had no input whatsoever[70]

- 1990. Directors are liable for a company's debts, but are not liable if the debts were incurred without their express or implied authority, or was not reasonably aware that the company could not repay the debt[71]

- 1991. Directors are liable as they should question management on the state of the company[72]

- 1992. Independent directors are not liable as they are not expected to give constant attention to the company's affairs, they did not have an awareness of an issue and there was no dereliction in their duty in the fact that they did not come across the relevant information[73]

- 1993. Independent directors are not liable as they should limit their duties to board meetings and special committees[74]

- 1994. Independent directors are liable if they do not disclose all information to the board[75]

- 1995. Independent directors are liable as there are no differences in the obligations between executive and independent directors[76]

- 1998. Independent directors are liable as they should exercise the degree of skill and care which could reasonably be expected[77]

- 2002. Directors are liable as they are expected to act with reasonable skill and care[78].

The decisions prior to 1992 do not specifically refer to executive or independent directors, but the facts of the cases indicate that they do relate to independent directors.

---

[70] Statewde Tobacco Services Ltd v Morley (1990) 8 ACLC 827
[71] Group Four Industries Ltd v Brosnan and Anor (1990) ACLC 137
[72] Commonwealth Bank of Australia v Friedrich and Ors (1991) 9 ACLC 946
[73] AWA Ltd v Daniels (1992) 10 ACLC 933
[74] Vrisakis v ASC (1993) 11 ACLC 63
[75] Permanent Building Society v Wheeler (1994) 11 WAR 109
[76] Daniels v Anderson (1995) 13 ACLC 614
[77] Circle Petroleum (Queensland) Pty Ltd v Greenslade (1998) 16 ACLC 1577
[78] Australian Securities Commission v Adler (2002) 41 ACSR 72

For a period in the 1990s, the decisions were specific to independent directors, as was highlighted in the 1992 case of AWA Ltd v Daniels. The courts took a different view in this case on appeal in 1995, which was reinforced in the Adler case in 2002 (Cassidy, 2006), even though it had been argued that executive directors have more information on the company than independent directors due to their day-to-day involvement in the company's affairs.

That being said, the decisions highlight two issues over time:

1. If a director is present at a board meeting, they are responsible for the result of any actions that were discussed at the meeting.

2. While earlier independent directors were not liable for debts if they were not aware of them, they are now considered to be as liable as the executive directors.

The evolution of the law relating to corporations follows a similar path. In the period 1961−1963, uniform companies legislation was passed throughout Australia. Following attempts to create national legislation and commissions, an agreement was made in 1978 whereby Commonwealth legislation would be applied to all states and territories. A cooperative scheme was established in the 1980s, but was found to be flawed. National scheme legislation was then formulated and, following several problems between 1988 and 1990, commenced operation on 1 January 1991.

The laws that made up the national scheme included the Corporations Act 1989 and the corporations acts and corporations laws of each state and territory. The Corporations Law of the Australian Capital Territory became the Corporations Act of each state (Australian Corporations Legislation, 1997).

Amendments were subsequently made through the Corporate Law Reform Acts of 1992 and 1994. These included introducing an objective duty of care and other issues (the 1992 Act) and a regime of continuous disclosure (the 1994 Act) (Australian Government Solicitor, 1997).

In December 1994 the First Corporate Law Simplification Bill was read in the House of Representatives (McDonald, 1995). While there were no issues in this bill relating to directors' duties, there were amendments to the administration of corporations that reflected current practice. In 1996, the Second Corporate Law Simplification Bill was issued. As with the first bill, there were a number of amendments to the administration of corporations, in this case particularly in relation to meetings of members. Later in 1996 the Third Corporate Law Simplification Bill was issued, related to fundraising and takeover provisions for corporations.

The Corporate Law Economic Reform Program was established in March 1997. Work on this led to a number of papers leading to changes to the existing Corporations Law (Black et al., 2000). Those that impacted on the duties of directors included, among several minor amendments:

- clarification of the standard of care and diligence
- reformulation of the duty to act honestly
- introduction of the statutory business judgement rule
- introduction of protection for directors relying on information or advice from others
- recognition of a directors' ability to delegate.

The Corporations Act 2001 commenced on 15 July 2001. This act replaced the Corporations Law of each state and territory and is administered by the Australian Securities and Investments Commission.

While the paths through common law and statute in the legal pillar are by no means straight, the deviations from their respective paths are only minor. The common law path changed tone from general comments relating to directors to comments specific to independent directors. Subtle differences in some of the cases influence the court's decision. In addition, the sitting Justice's interpretation of facts, precedent cases and governing legislation may influence the outcome.

The process of establishing a national Corporations Act was eventually successful, despite problems encountered by the regulators over a 40-year period. This reflects the strategy of creating consistent legislation throughout Australia that has been influenced by both statute and common law decisions from all states and territories.

Analysis of the governance pillar

As with the legal pillar, the materials used in the governance pillar in the literature review follow a logical progression. Section 3.5.1 discussed the two types of information analysed, industry reports and regulatory principles. A brief review of the industry reports from the UK demonstrates the logical progression of the literature in the governance pillar:

- 1992. Cadbury Report looked at best practice and recommended more independent directors on boards, and for all directors to act with independence of mind.

- 1995. Greenbury Proposal recommended wider powers be given to independent directors, particularly on remuneration issues of senior management.

- 1998. Hampel Report reviewed recommendations of Cadbury and Greenbury reports, and promoted even higher standards of corporate governance.

- 1999. Turnbull Guidance used recommendations of Cadbury, Greenbury and Hampel reports to establish framework of good corporate governance.

- 2003. Higgs Report, following the establishment of the framework from the Turnbull guidance, pushed for an improvement in the effectiveness of independent directors to improve board performance.

Evidence of the relationship between the industry reports and regulatory principles is the UK Stock Exchange's amending its listing rules in 1993 for companies to comply with the Cadbury Report recommendations. These listing rules were further amended in 1995 for companies to comply with the recommendation following the release of the Greenbury Report.

Similarly, in Australia the ASX released its Corporate Governance Principles in 2003 in response to the growing importance of corporate governance and the need to establish guidance for the public companies that it supervises. Following two years of operation and a further two years of monitoring, these principles are currently under revision. This revision is in response to current market and global practices, and reflects the contemporary position of the market. The OECD followed a similar path to the ASX with its Principles of Corporate Governance released in 1999, with the revised principles released in 2004. This revision was in response to recent developments and experiences in OECD member and other countries (OECD, 2004b).

The paths followed by the regulators and industry bodies are more straightforward than those followed through common law and legislation. The logical sequences established by either distinct regulatory or industry bodies allow a researcher to easily follow the evolution of corporate governance through these means.

Reflecting the structure of the legal pillar, the literature reviewed through this governance pillar continues to be proactively updated in line with contemporary practice.

Analysis of the commercial pillar

The review of the literature in the commercial pillar highlights several relevant points. First, the literature can be categorised into five separate topics. Second, while easily categorised, the literature in each topic does not follow any obvious path. Third, this section of the literature provides evidence of the two important issues of company position and information (as discussed in Chapter 5). The lack of any obvious path in any one of the categories can be illustrated by a review of the important issue of performance of the board, discussed and analysed in greater detail in Section 3.4.2.

This section analyses three sub-topics:

- performance responsibility
- responsibility of independent directors to shareholders and other stakeholders
- the boundary-spanning role of independent directors.

The articles reviewed under each of these sub-topics, even when considered over time, do not flow from one to another.

Performance responsibility

- 1998. The board's performance responsibility should be their main concern (Hilmer, 1998)
- 1998. Independent directors bring external expertise to the company's board (Clarke, 1998)
- 2001. Having independent directors on a board may merely be a sign of good corporate governance (Kakabadse et al., 2001)
- 2001. Having independent directors on a board who do not add value may be detrimental to a company's performance (Cox, 2001)

Responsibility to shareholders and stakeholders

- 1995. Responsibility is to all stakeholders, not just shareholders (Bosch, 1995a)
- 2004. Owning shares in the company may devalue independence and decisions may not be in the best interest of stakeholders (Carter & Lorsch, 2004)

Boundary spanner

- 1997. The boundary-spanning activities of independent directors is one of the most active positions (Geletkanycz & Hambrick, 1997)
- 2002. Independent directors take on the role of communications link between the board and the stakeholders (Barratt & Korac-Kakabadse, 2002)
- 2004. Independent directors take on the role of communications link between the board and the shareholders (Nicholas, 2004)

Many observers writing on these issues, each with their individual point of view, produce numerous articles on each topic and sub-topic. This has resulted in many unstructured and unrelated articles on the role of the independent directors from the commercial pillar, in contrast to the structured flow of information evidenced in the legal and governance pillars. Thus a deeper study into the role of independent directors from a commercial view is required.

The lack of structure in the literature relating to the role of independent directors through the commercial pillar requires subsequent research to be structured, in-depth and robust. The current study fulfils these requirements. It was designed to combine all the elements identified in the literature review. No robust academic studies have previously been conducted through interviews with relevant parties on the role of the independent director in Australia. These interviewees in the current study were working in the role of an independent director, and the interviews were both broad and deep in order to cover the issues identified in the literature review. The methodology used for data collection and analysis is described in the next chapter.

3.5.3 Identification of the research topic

This chapter has reviewed and analysed the literature relating to the three pillars of legal, governance and commercial. While the results of each analysis are comparable, the evolution of issues concerning the independent director differs between the legal and governance pillars on one hand, and the commercial pillar on the other.

Both the legal and governance analyses identify a logical evolution of concepts affecting independent directors over time. While the literature in the legal pillar covers a period of over 110 years, the literature in the governance pillar has been recognised for only the past 25 or so years. However, the evolution of both pillars follows a similar pattern. This systematic pattern shows a line being drawn in the sand at a point in time, then the progression forward of the line in the sand as new information and contemporary practice and thought come into play. This progression continues to this day. Examples are additional legislation in the Corporations Act following the CLERP recommendations, and the review of the ASX Principles that has taken place in 2006/07.

The literature reviewed in the commercial pillar is even more recent than that in the governance pillar. While this does not create an issue in the analysis, this literature does not follow any logical sequence. It comprises a multitude of seemingly independent articles on issues concerning independent directors that follow no discernible pattern. The authors are many and varied, with minimal or no reference to other articles in this area. They can loosely be matched to new legal or governance issues, and are reactive in nature, written by various authors from a myriad of positions. This in itself indicates a gap in the knowledge of the role of the independent director from a commercial aspect, and indicates to the researcher where this study should be targeted.

Roles of independent directors are easily identified through the analysis in the legal pillar. The systematic process of common law and new legislation provides evidence of the progression from independent directors having no real responsibilities to the current position where independent directors have significant expectations to perform, as well as taking responsibility for their own actions, and the actions of others.

The effect of larger company failures impacting on more stakeholders has resulted in a greater focus on independent directors. Common law and legislation have been structured to create a set of rules, or framework, within which independent directors are now expected to perform. Boundaries have been set, and independent directors are expected to work within those boundaries.

Independent directors are appointed to company boards as they can make contributions that no other board members can make. In bringing these unique contributions to the board, independent directors are expected to assist in improving the performance of the board and the company. As they are independent of the executive directors and senior management, independent directors are also expected to monitor others in the company. This monitoring has two distinct foci. One is to monitor the performance of others to ensure that they are contributing. The second is to monitor others to ensure that they are doing no wrong.

Similar to the legal pillar, the literature reviewed through the governance pillar shows a logical progression over time, albeit a period significantly shorter than that of the legal pillar. Global oversight bodies including the OECD and the World Bank have taken a similar strategy to legislators. They have established frameworks on best practice and corporate governance that can be used by local regulators to create country-specific structures within which companies are expected to operate.

These oversight bodies and the more important investigations such as the Cadbury Report recommend that public company boards have a majority of independent directors. As shareholder numbers of public companies have increased through privatisation and investments of superannuation contributions, there is a wider investor audience that has taken an interest in the performance of public companies, and those issues that can be easily identified as affecting this performance. Independent directors fall within this category as they are easily identified, and shareholders can use them as a proxy for the board in general. The shareholders elect the directors and therefore expect that the directors will perform to the best of their abilities for the benefit of the shareholders. As the independent directors are by definition independent of both other board members and the company, their performance is under considerable scrutiny as they act as agents of the shareholders.

As the performance of public companies has affected a wider range of investors and other stakeholders in this time period, regulators have initially been slow to react in using their position to influence and monitor company boards. While regulators can set expectations and regulations through the statutory performance of organisations, they cannot force company boards to perform to the best of their abilities. They see the independent directors as taking this responsibility, and while these regulators recommend that boards employ more independent directors, they cannot enforce this, or choose not to do so.

With the scrutiny of independent directors increasing, their perceived responsibilities are also increasing. They are expected to perform and take responsibility for their own performance. The governance requirements of independent directors are expectations that the independent directors will improve the performance of the board and the company, and monitor other board members and senior management to ensure that they are contributing to performance, and acting honestly and ethically. With the breadth of shareholders of public companies expanding, and shareholders taking more interest in company performance due to the impact on their superannuation savings, shareholders are looking to the independent directors as their agents, and expect the independent directors to act as boundary spanners by bringing them information, and taking it back to the board.

Unlike the legal and governance pillars, the analysis of the literature in the commercial pillar does not follow any logical pattern other than a loose connection to new issues as they arise in the other pillars. It appears that as a new issue becomes a requirement either through regulation or legislation, an observer analyses that issue in the commercial environment, and produces an article from their particular point of view. In the review of the commercial aspect of the role of the independent director, a complex and mismatched assortment of interested parties have made contributions to what has influenced this role and to what independent directors should be doing. There are no specific requirements to appoint any independent directors to a company's board of directors, but their position has come under greater scrutiny over the past 20 years as what they do affects other stakeholders in ways that have only become apparent in this time period.

These authors are observers, and are connected to public company performance in some way, either by providing a service to industry such as law, investment banking or accounting, or observing from a professional point of view, such as economists. Nevertheless, they see the role of the independent director as having evolved to the same three roles as identified in the governance pillar: to improve the performance of the company's board and the company; to monitor the other board members and the company's senior management; and to act as a boundary spanner between the company's board and the company's stakeholders. This is not surprising, as the writings of these authors usually follow issues as they arose through the governance pillar.

These three main roles have been identified in reviewing the why, what and how of the role of the independent director in Australia. In summary, through the three pillars of legal, governance and commercial, these roles are:

LEGAL	GOVERNANCE	COMMERCIAL
•Performance Improvement	•Performance Improvement	•Performance Improvement
•Monitoring	•Monitoring	•Monitoring
	•Boundary Spanner	•Boundary Spanner

While the results for each of the three pillars are comparable, the ways that they have evolved are not. The evolution through both the legal and governance pillars follow a similar pattern, which is logical and reflects contemporary practice and thought. There is no logical pattern through the commercial pillar, and this evidences a lack of thorough research. This represents the gap in the research, and raises the question of the role of the independent non-executive director from a commercial perspective. To answer this question, this study has used interviews with a number of independent directors to provide information on contemporary practices, with grounded theory used as the methodology to analyse the resulting data. This methodology is described in detail in the following chapter.

CHAPTER 4 METHODOLOGY

4.1 Introduction

In the previous chapter, the literature relating to the role of the independent director was reviewed and analysed in the three pillars of legal, governance and commercial. The process in the legal and governance pillars showed evidence of evolution through a logical path over time, but the literature reviewed and analysed in the commercial pillar revealed no such logical path.

In that chapter, the three pillar structure was reviewed, including the materials and approach used in each pillar. The rationalisation for the research carried out during this study was justified, and now this chapter describes the methodology used to analyse the data.

The first section discusses the research problem and the research design, providing depth to the study structure and design. The techniques for data collection are then identified and analysed.

Interviews were the selected data collection method, and issues arising from this choice are reviewed in detail. The chapter discusses why interviews were chosen to collect the data and the specific type of interviews used, and provides information relating to the particular population interviewed.

Grounded theory has been used as the research methodology to sort and analyse the data collected through the interview process. With grounded theory, the researcher does not establish a hypothesis to be tested. Instead, the researcher enters a field of interest with a topic in mind, conducts and analyses the research, then uses the data to formulate the theory.

The verification, validation and reliability issues of the research methodology are then discussed, as are the ethical issues relating to this type of research process. Finally, in the conclusion to the chapter, a meta-analysis has enabled the researcher to bring the three pillars together.

4.2 Research problem and research design

4.2.1 The research problem

In the previous chapter, three main roles of independent directors were identified from the literature, but it was obvious that there is significant confusion on what this role really entails. Both the legal and corporate governance pillars show a logical progression of the role of independent directors through time. This progression follows the gradual movement from early recognition of the roles and responsibilities of independent directors, to the sensible recognition of their responsibilities today. The progression through the commercial pillar is not logical; it follows the path of the other pillars to some extent, but shows no logical pattern.

This study aims to clarify the commercial pillar. The commercial aspect of this role is targeted directly at the point where independent directors practise their role. It aims at the heart of the matter and is intended to identify the main issues of how they do their job. This research identifies the core factors that influence how the role is filled, and a grounded theory can then be established. This theory will be used as the basis for proposed amendments to existing professional practice and policies.

The objectives of this study are to define these roles and associated issues, bring these to the attention of those working within this field and setting the policies and procedures (such as the Australian Stock Exchange) and identify how and where the participants should be educated. A procedure should be established by the regulators to enable those institutions to continually monitor what is happening in this industry so the policies and procedures can be continually updated to ensure they are in tune with contemporary practices. These objectives guided the research methodology selected for this study.

The theory proposed at the end of this study will result from a combination of analysing the data collected through interviews with independent directors, a review of the literature, and participant observation. As the theory is generated by the research process, the most appropriate methodology to use is grounded theory (Denzin, 1977). Strauss and Corbin (1997) consider this one of the most widely used and influential methodologies now used in qualitative research, where the researcher's main aim is to generate theory.

4.2.2 Research design

The history of corporate governance spans only around 20 years but significant recent advances have been made (see Section 3.3.1). These include the involvement of statutory bodies and other industry organisations stamping their policies and requirements on the adherence by member organisations to their stated guidelines on corporate governance.

The proactive involvement of the independent director is critical to ensuring that organisations follow good corporate governance guidelines. The definition of this role, which is seen to be clouded, is the most important aspect of this issue. Much has been written on this role but there is no one definition that can be applied to all participants in all organisations. Perceptions of the role have continued to change over time as business advances into current practices and a general set of roles need to be defined for each set of circumstances. Robust research through a well-designed study is required to enable these definitions to be made.

The choice of the research design is determined by its aim, its goal, the specific research question and appropriate mode of engagement or paradigm (Crabtree and Miller, 1999). Creswell (1998) sees that the format of the design follows the traditional research approach of presenting a problem; asking a question, collecting and analysing data, and then answering the question. The research question should always determine the method (Crabtree and Miller, 1999).

Qualitative analytical methods are used to convert data into findings. There is no one formula, just guidance in the various forms (Patton, 2002). The grounded theory methodology is qualitative as the researcher continues to visit the field to gather additional data which is used in formulating the theory. Creswell (1998) describes this as a "zigzag" process. Participants are chosen who can contribute to the process, a strategy defined as "theoretical sampling" by Creswell.

The qualitative research methodology of grounded theory has its roots in phenomenology and strives to define the basic social psychological and/or social structural process in a specified scenario (Crabtree and Miller, 1999). Creswell (1998) lists four basic forms of information that can be used in formulating grounded theory: interviews, observations, documents and audio-visual materials. The main data collection technique in this study was a series of interviews, supported by participant observation. After collection, the data are analysed using a systematic coding process, following which a theory is developed. As the theory is developed from the data gathered in the field and then analysed, it is said to be 'grounded'; there is no a priori theoretical basis to this form of qualitative analysis (Creswell, 1998). Hussey and Hussey (1997) describe this methodology in simple terms:

> *The theory is generated by the observations rather than being decided before the study. This contrasts with positivist research where speculation and reflection lead to the development of hypotheses (p. 70).*

Following the issues identified in the Chapter 2 that highlighted the importance of the independent director's role, the literature review then identified several roles of the independent director through the three-pillar analysis structure. This literature review was the first stage in the basic research design as it identified the three roles that formed the initial theory and therefore set the basis for the interview questions. The second stage is the formulation of the grounded theory that establishes a theoretical foundation for developing rules and boundaries for independent directors. The final stage is the formulation of research conclusions and the impact these have on policy creation or revision.

The research design is logical as the research starts with a general investigative question; its relevance is then determined in the context of the socio-economic situation in which this phenomenon exists. The issue is then investigated through a review of the relevant literature and once the researcher sees the data starting to develop into a theory, further investigation is undertaken through appropriate means to develop a theory that has been grounded in the data. In this study, this stage of further research began with the interviews.

4.3 Data collection techniques

In a qualitative study, the researcher should use a data collection technique in which the process involves determining a strategy for the purposeful sampling of individuals or sites (Creswell, 1998). The researcher should use a technique that emphasises meanings and experiences related to the phenomena (Hussey & Hussey, 1997). In the past quarter of a century, investigations into the social sciences through qualitative methodologies have led to a substantial amount of research in addition to advice on which methodology to use in undertaking this type of inquiry (Prasad, 2005). This then poses the question of which data collection method is best suited to any one qualitative research study. Creswell (1998) encourages the researcher to establish or define the situation or group that will be investigated to provide the data to answer the research question.

The main data collection techniques for a qualitative study as identified by Hussey and Hussey (1997) are:

- critical incident technique
- diaries
- focus groups
- interviews
- observation
- protocol analysis
- questionnaires.

This study used a group of independent directors as the base of the data. Several methods could potentially elicit the data in the most useable format from this group. In this case, the researcher wanted to know what people think, and Miller (1991) recommends that the best method for obtaining the information is to use questionnaires or interviews, with the latter through either focus groups or individual interviews.

4.3.1 Interviews

Interviews can be conducted either with an individual or with a focus group, and each method has its advantages and disadvantages.

Advantages of individual interviews include (Miller, 1991; Hussey & Hussey, 1997; Creswell, 1998; Pole & Lampard, 2002; Northcutt & McCoy, 2004):

- Interviews provide a high percentage of returns.
- They can be structured to provide an almost perfect sample.
- Compared with other methods, the information is more likely to be correct.
- Other information on the respondent can be collected.
- Return visits can be made for clarification or additional data.
- Spontaneous responses may be given if the respondent is caught off guard.
- Responses can add richness and depth to the data.
- The order of questions can be pre-determined.
- The respondent can be observed by the interviewer.
- Responses can be recorded.

Disadvantages of individual interviews include (Miller, 1991; Pole & Lampard, 2002; Northcutt & McCoy, 2004):

- The process may be costly.
- A large number of potential participants may decline to be interviewed.
- Data may be inaccurate and/or incomplete if the interviewer is inexperienced.
- The interviewer may fail to ask for examples.
- There may be personality conflicts between the interviewer and the respondent.
- There may be language issues between the parties.

Advantages of focus groups include (Hussey & Hussey, 1997; Pole & Lampard, 2002; Northcutt & McCoy, 2004):

- Participants can relax in a group setting.

- Observation of the group dynamics may reveal additional data.
- The overall time taken may be less than for individual interviews.
- Group interaction may provide richness of data not obtained in a one-on-one interview.
- The process should ensure that all issues are covered.

Disadvantages of focus groups include (Hussey & Hussey, 1997; Pole & Lampard, 2002):

- The interviewer may have less control than in a one-on-one situation.
- Some members may dominate the session.
- Data are more difficult to record and analyse.
- There may be problems with the composition of the group.

4.3.2 Questionnaires

The discussion in this section also incorporates surveys, as these are carried out using questionnaires which are usually sent via mail or email.

Advantages of questionnaires include (Miller, 1991; Hussey & Hussey, 1997; Pole & Lampard, 2002; Weinberg, 2002):

- They allow wide coverage for minimal cost.
- They can reach people who are difficult to locate.
- Greater coverage may yield greater validity.
- The questions can be posed uniformly.
- The respondent has privacy.
- Interviewer effects are reduced.

- Responses can be scaled.

Disadvantages of questionnaires include (Miller, 1991; Hussey & Hussey, 1997; Pole & Lampard, 2002; Weinberg, 2002):

- The issue of non-returns must be addressed.
- Respondents may differ significantly from non-respondents.
- The person requested to respond may not be the actual respondent.
- The researcher has no opportunity to observe the respondent.
- Probing questions cannot be asked.
- The respondent cannot clarify the question.
- The selected sample may be biased.

4.4 Interviews

The interview method was selected for data collection as it is considered to provide the most accurate and informative data, it should ensure a high response rate (Bailey, 1982), and it should raise different related issues as more interviews are completed (Hussey & Hussey, 1997). In semi-structured interviews the interviewee's responses may well be more expressive (Flick, 2002). Indeed, both quantitative and qualitative researchers rely on interviews as the basic method for collecting data, as the results are both trustworthy and accurate (Fontana & Frey, 2000).

It was expected that some interviewees might be uncomfortable with issues raised in the questions, as they may have little historical knowledge on the subject. The non-verbal behaviour of these interviewees could also be important and was noted during all interviews, particularly when interviewees were responding to the more searching questions (Bailey, 1982). Most of those interviewed had several years' experience as public company directors, with only two taking on independent directorships within the last three years. Both of these respondents have had considerable senior management experience in large companies. As with all the other respondents, they were confident in their responses and did not appear to be uncomfortable with any questions or issues raised during the interviews. The non-verbal behaviour of these two respondents reflected their confidence and comfort; they hesitated only occasionally to ensure that their responses were sensible, logical and complete. These characteristics were the same for all respondents. This confidence was expected considering the nature of those interviewed.

The interviewees' responses were their own as they had no opportunity to collaborate with others, or to do any research prior to or during the interview (Bailey, 1982). The interviews were arranged so the interviewees were unaware of the questions prior to the interview. Also, the results from the literature review were gradually broached during the interview, with the questions structured and ordered in a specific manner. This was done so as not to influence the responses to the initial questions, which allowed the respondents to develop their own view of what their role was, as opposed to stating what the literature review had revealed. Had this been the case, the respondents might have just agreed to these conclusions without first providing their own thoughts.

4.4.1 Interview type

To ensure that all responses were comparable, the questions were asked in the same order, and usually in the same way (Bailey, 1982; Hussey & Hussey, 1997). *Stimulus equivalence* is the issue of asking the same questions in the same manner, ensuring that each interviewee should understand the questions the same way (Hussey & Hussey, 1997). This was the case during the interviews. However, sometimes words having the same meaning were substituted to put the question in the same terminology that the current respondent was using. Preparation for the interviews included setting out each question on a different page with space below each question for taking notes. At the start of the interview, each respondent was advised that a number of set questions would be asked, and if the respondent's comments diverged from the question so as not to add any pertinent information to the study, then they would be brought back to the topic through a comment or new question from the interviewer. There was only one instance where a response to a subsequent question was given as part of a response to an earlier question, but this did not alter the structure of the interview, nor was the response considered to be different from what it would have been had that question been asked in order. On a few occasions, the questions were slightly rephrased so they flowed better from previous comments made by the respondent or to use the same terminology as the respondent. For example, some respondents referred to independent directors as ‘outside directors’ or ‘external directors’, so this phrase was used in the question instead of ‘independent director’. However, this was only on the basis that the distinction had been clarified and confirmed.

Glesne and Peshkin (1999) stresses that the make-up and content of each question should be carefully considered, so the interviewee understands what is being asked, and time is not taken up explaining the question. On a few occasions a question was misunderstood. In these cases, the respondents were given time to respond to what they thought the questions to be ,as the responses may have provided some additional information that otherwise would not have been obtained. In three cases where the responses were obviously outside the scope of the study, a redirecting question was asked to bring the response back to the initial question.

The interviewees were assured of confidentiality (Hussey & Hussey, 1997) and that they could decline to answer any of the questions. Ethical considerations were met (Fontana & Frey, 2000) by obtaining consent from the interviewees and ensuring confidentiality and privacy. All respondents readily signed the consent form and two queried the use of the recording equipment relative to their responses being confidential. The requirements of the Ethics Committee regarding use and storing of recordings and transcripts was explained to the respondents’ satisfaction. All respondents willingly answered all questions.

4.4.2 Interview method

To achieve the best results, both structured and unstructured questions were used (Hussey & Hussey, 1997), and were supported by prompts and silences to motivate the interviewees to fully and honestly respond to the questions. These interview methods can provide flexibility, which Bailey (1982) suggests can lead to more detailed responses. It was also likely that the interviewees would discuss issues that were not directly relevant to the subject (Hussey & Hussey, 1997), but were relevant to directors’ responsibilities in general. Bailey (1982) calls this spontaneity, whereby the first answer given by the interviewee is recorded and cannot be withdrawn, with these answers being very informative. This did provide some important information, and gave a deeper insight into other problems and issues encountered in board meetings. It was assumed that the interviewees have knowledge on the topic, and that well structured interview questions elicited highly informative responses (Flick, 2002). Most responses directly answered the questions, but some comments made by the respondents as they 'thought aloud' while gathering their thoughts did provide some unsolicited information. As Flick (2002) had proposed, this unsolicited information provided additional depth to the information gathered during the interviews. While not directly in response to the questions, this information did add credibility to some responses as it provided evidence of the experience of the respondents or specific examples that supported their responses.

For example, when one respondent was asked if any of the three roles identified through the literature review were evident in her role as an independent director, she first discussed the example of an under-performing Chief Executive Officer of a company of which she is an independent director, and described how the board acted to remove and then replace this member of the company's senior management.

Taking these factors into account, the interviews were classified as being semi-structured, with open- and closed-ended questions. The questions were well organised to get the best responses, while still providing flexibility for diversification in the responses. While the same questions were asked in the same order, different probes and follow-up questions were used to maximise the information gained from each interview (Rubin & Rubin, 1995). As expected with respondents' different personalities, experiences and backgrounds, each question was answered differently, and therefore different probing questions were used to ensure that all responses provided the required information.

4.4.3 The interview questions

The questions and their ordering were designed to generate responses to further develop the theory resulting from the literature review, and to delve deeper into this topic. Annexure AAA provides the list of questions in the order they were asked. The initial three questions related to the respondents' particular skills and experience and were phrased so that the respondents would provide their views on why they became independent directors, and what specific responsibilities they may have had as individual members on the board. The fourth question specifically targeted the three roles identified through the literature review, to ascertain if the respondents undertook the roles of boundary spanner, improving board and company performance, and/or monitoring the other directors and senior management.

With the increased legal and regulatory requirements impacting on boards, as shown by the literature review, the respondents were questioned on how this impacted on their roles, as this may have defined the nature of their roles, or how they were performed. One of the more significant issues that arose in the research through the legal pillar was whether the independent directors saw themselves or other non-executive directors being involved in the day-to-day running of the firm. Two questions were designed to explore this issue, one directly targeting the role undertaken by the respondent, and the other targeting their observations of other independent directors. The last few questions required the respondents to define how they saw their role, and what they envisaged it to be in the future. The final question asked if the respondents wanted to comment on, or add anything to what had been discussed, or to raise any issues on the topic that hadn't been covered.

As Glesne and Peshkin (1999) noted, the questions should provide the interviewer with information that the interviewer was unaware of, offer insight and break apart the ignorant views held by others.

4.4.4 Pilot interview studies

During the research undertaken for this paper, no detailed interview-based studies were found in the Australian context on the role of the independent non-executive director. This raises two questions. First, if no such research has been done, is it an issue that needs researching? Second, is the issue such a relatively new concept in the Australian context that no interview-based research has been done in the short time frame – just over 20 years – that this topic has been an issue?

In response to the first question, the volume of literature reviewed in the previous chapter written in the Australian context indicates substantial interest in the issue. Further research overseas has resulted in a number of similar studies having been undertaken in the United Kingdom. This is on the back of the Cadbury (1992), Greenbury (1995) and Hampel (1998) reports undertaken there, which suggests that corporate governance as the wider topic has been an issue of interest for a longer period of time in the United Kingdom than in Australia. This argument indicates that the issue deserves researching and the lack of Australian research of this type is probably because of the relatively recent interest in the topic in Australia.

In the study in the United Kingdom by Deloitte Haskin and Sells (Tricker, 1978), one of their senior partners undertook a study of the duties and responsibilities of directors in British companies, with special reference to the role of the non-executive director and the audit committee. The style of the report, while published as a book, was intended for businessmen, practitioners and politicians, but not academics. The research for this publication was carried out through a series of 75 interviews with chairmen, managing directors, finance directors and non-executive directors in the United Kingdom and in the United States. A survey was also undertaken of the partners of Deloitte Haskins and Sells, and substantial written material was reviewed. The results included a chapter discussing the roles of independent directors on 8 of the 15 boards studied. While none of the companies were named, the brief history and corporate structure of each was disclosed, as was the make-up of each board of directors. The roles of the independent directors on each of these boards were discussed by the chairman and at least one other director.

There were several themes that were common to the roles of the independent directors across these eight boards. The independent directors were appointed to bring an outside view through broader experience, and many noted their responsibilities towards the companies' shareholders and employees. Each independent director had a field of specialisation, and occasionally undertook special assignments. The independent directors did not have specific tasks, but were to act as a check on management, including the executive directors, as the executive directors may act with bias as their careers have evolved through their full time employment in the company.

4.5 Data collection

4.5.1 Information on companies represented in the research

The 12 independent directors interviewed were on a total of 31 public company boards at the time of the interviews. Two directors were on two of these boards. Most of the respondents had previously been on a number of other public company boards. The interviews were broken into three stages. The first stage consisted of four interviews, the second stage, five, and the third and final stage had three.

At the time of the interviews, the first four respondents were members of eight different public company boards, in addition to a number of private company and state-owned enterprise boards. Apart from one, all had previous experience on numerous other public company boards. The one respondent with no previous public company board experience had been a director on one of his boards for over 20 years. The four respondents had over 50 years' combined experience on their current board positions. The combined experience is significant and the point to note is that having served on public company boards for many years, the respondents had experienced the changing nature of expectations of public company directors since corporate governance issues became important in the early 1980s.

The second stage interviews involved a further five respondents, representing 14 public company boards. Again, they were also on a number of private company and state-owned enterprise boards, and also had combined public company board experience in excess of 50 years.

The third stage interviews involved the final three respondents who were on 11 public company boards at the time. Similar to the first two groups, these respondents were also on a number of private company and state-owned enterprise boards. Two of these respondents could be termed professional directors, as this has been their main profession for many years. Their combined public company board experience was greater than the 50 or so years of the two previous groups.

Table 4.1 summarises the details of companies represented by the interviewees.

Table 4.1 Statistical information on companies represented by independent directors interviewed during the research

Number of public company board positions	33
Number of companies represented	31
Number represented twice	2
Lowest turnover at last balance date	$2.2 million
Highest turnover at last balance date	$13.9 billion
Average turnover at last balance date	$2.557 billion
Median turnover at last balance date	$ 954.8 million
Number with turnover under $100 million	4
Number with turnover between $100 million and $499 million	5
Number with turnover between $500 million and $999 million	7
Number with turnover between $1 billion and $4.99 billion	10
Number with turnover over $5 billion	5

This information in tables 4.1, 4.2 and 4.3 was finalised on 10 December 2005, and represented companies with their last balance dates of 31 December 2004, 31 March 2005, 31 May 2005, 30 June 2005, 31 July 2005 or 30 September 2005. Turnover was used to rank the companies represented by the respondents, as it is an accurate representation of size. This is important in the context of some of the comments made by the respondents, as in some cases the size of the company on whose board they sat determined in part their role relative to that particular company. Table 4.1 shows the distribution of represented companies by turnover.

It became apparent during the interviews that most of the respondents were invited to join their boards due to specialist skills or industry knowledge they had. Table 4.2 lists the industry sectors[79] represented by the respondents at the time of the interviews, and the number of companies in the seven sectors represented. The three sectors not represented are Energy, Telecommunications and Information Technology. A further dissection into Industry Group, Industry and Sub Industry is detailed in Appendix 4.

[79] Sector categories are defined using the Global Industry Classification Standard per the S&P/ASX classifications.

Table 4.2 Sectors containing companies represented by independent directors interviewed during the research, and number represented in each sector

Sector	Number represented
15. Materials	3
20. Industrials	7
25. Consumer Discretionary	6
30. Consumer Staples	1
35. Health Care	1
40. Financials	11
55. Utilities	2

Another factor that influenced the role of the independent director was the size of the company. Table 4.3 lists the sectors represented in the research by turnover. Five of the seven sectors had are multiple representations, and by analysing the representation by turnover, there are nine instances where there is more than one representation in each category. Nineteen out of a possible 35 categories were represented by the respondents.

Table 4.3 Sectors containing companies represented by independent directors interviewed during the research and number represented in each sector by turnover

Industry	Turnover under $100M	Turnover $100M–$499M	Turnover $500M–$999M	Turnover $1Bil–$4.99Bil	Turnover over $5Bil	Total
15. Materials			1	1	1	3
20. Industrials		2	2	2	1	7
25. Consumer Discretionary	1		2	3		6
30. Consumer Staples					1	1
35. Health Care				1		1
40. Financials	3	3	1	2	2	11
55. Utilities			1	1		2
Totals	**4**	**5**	**7**	**10**	**5**	**31**

Interviewing equipment included a tape recorder and a digital recorder. While the interviewer made notes, transcriptions of the interview recordings were the most important component of the data. All interviews were recorded on a digital recorder and transcribed using voice recognition software. As the interviewees' voices were not recognised by the software, the researcher listened to the recordings through headphones, then dictated the complete interviews through the software, Dragon Naturally Speaking 8 Preferred. Transcriptions were edited and corrected to ensure their accuracy. Written notes made during the interviews assisted in recording non-verbal responses.

Seidman (1998) considers that all in-depth interviews should be recorded, as using written text as a source is the most reliable method for data analysis. If the transcript is unclear the researcher can review the recording to ensure accuracy. This also eliminates any potential biases or deficiencies in researchers' note-taking if this were the only method of data collection.

Each interview took an average of four hours to transcribe, correct and edit. Interviewers become more familiar with the interview content by transcribing their own recordings (Seidman, 1998), and this assists in coding and analysing the responses. Furthermore, recording and then transcribing interviews gives more scope for the interviewer to note nonverbal responses, which must also be taken into account. Using the interview transcriptions assisted in making the coding and analysis of the responses straightforward.

4.5.2 Participant observation

A common method of confirming findings when using interviews as the principal data collection method is triangulation (Denzin, 1977; Miles & Huberman, 1994), facilitated in this study by participant observation, the third form of data collection used.

The participation observation method is important as researchers want to collect data from their research subjects while interacting with them (Denzin & Lincoln, 1998). Denzin (1977, 1978) describes four variations of participant observation. First is the complete participant, where the researcher does not directly participate in the events being researched, but observes covertly as part of the research group; second, the participant is an observer who is seen to be part of the research team; third, the observer is a participant, where the participant is seen by the subject as the primary researcher; and fourth is the complete observer, where the participant takes only an open observer role in the research process. Creswell (1998) describes these four variations more simply: conducting an observation as a participant, conducting an observation as an observer, spending more time as a participant than as an observer, or spending more time as an observer than as a participant.

Qualitative researchers differentiate between interviews and participant observation, although Fontana and Frey (2000) describe Lofland's (1971) view of the two going hand in hand, as many of the data gathered in participant observation came from the interview process. The observation of ongoing events is typically less concerned with recording the frequency and distribution of events than it is with linking interaction patterns with the symbols and meanings believed to underlie that behaviour (Denzin, 1978).

In this study, participant observation was mostly used with the researcher being fully involved with the participants, during the interview process. That is, the researcher spent more time as a participant than as an observer. This was intended to provide a better understanding of the values, motives and practices of those being observed. However, observation techniques can have problems (Hussey & Hussey, 1997). The researcher may be unable to control the variables in the setting, and may either miss part of the subject's response to a question, or miss observing an important non-verbal sign.

Field notes should be taken during the observation process, and not entrusted to memory as the richness and detail of an experience may be overridden by a new experience (Crabtree & Miller, 1999). Two of the strengths of participant observation as a data collection method are gaining information that cannot be derived from surveys or experiments, and gaining information about the environmental context (Emory & Cooper, 1991). For example, in this study the notes made on subjects' non-verbal responses while they answered interview questions provided the researcher with information relative to the respondents' confidence and comfort or discomfort when responding to some questions.

4.5.3 Interviews with respondents

Ideally, a sample is representative of the target population (Singleton & Straits, 2005), in this case all independent directors of all public listed Australian companies. However, the time and expense required to interview the whole population make it prohibitive. However, as it is difficult to evaluate a population to understand its overall representativeness, it is unlikely that a perfectly representative sample can be determined in practice (Singleton & Straits, 2005).

For this study, non-probability sampling was used, as the population was not defined. The sampling frame defined by Singleton and Straits (2005) as the operational definition of the population provided the basis for the sample. The sampling frame can be determined by either listing all of the cases, or providing a rule that defines the membership of the frame. This research could have listed all public companies to represent all cases, or could have specified that public companies covering a range of sizes would be used.

The use of theoretical sampling in non-probability sampling is debated by Wengraf (2002) using arguments from Burgess (1982) and Denzin (1970). Burgess' assertion is that the researcher continues to collect and analyse the data, then decides what data to collect next to develop the theory as it emerges. This study adopted Denzin's argument that theoretical sampling ends when no new concepts appear.

Once it had been decided that interviews would be used to investigate the role of independent non-executive directors, the next decision was how to best approach the prospective interviewee population. The most complete database of all directors in Australia is managed by ASIC, but it would be time-consuming and expensive to request a search on each individual public company, and then individually contact each independent director to ascertain their willingness to be interviewed. The New South Wales General Manager of the Australian Institute of Company Directors was approached to request the support of the institute and their members in undertaking this project. The initial response was positive, but authorisation had to be given by the national executive. Ultimately, the national president declined to assist as they felt that they already requested their members to participate in a tolerable number of surveys. The researcher then contacted the Australian Managing Director of Korn/Ferry

International Pty Limited in Sydney, on the basis of this company producing an annual Study of Boards of Directors in Australia and New Zealand. Korn/Ferry has been operating in Australia since 1972 and specialises in board and senior management appointments. The managing director agreed to assist, following which the researcher agreed to give presentations to Korn/Ferry's management and clients on the findings of this research once the examination of this thesis had been completed.

Discussions were then held with the client partner at Korn/Ferry to determine how the potential interviewee population would be approached and it was agreed that a letter would be sent to the potential respondents. Following approval from the University's Ethics Committee, a letter was sent to 38 clients of Korn/Ferry (refer attachment XX) outlining the research project and asking any recipients interested in participating to contact the researcher directly. Twelve responses were received, and all were interviewed. During the interview process, several respondents discussed the issue of whether interviewing 12 respondents from an unknown population was an adequate sample. The respondents were advised that when no new data were obtained by the researcher then a sufficient number of respondents had been interviewed.

Seidman (1998) comments on adequate numbers of participants. He reviews the strategy of Lincoln and Guba (1985) and Rubin and Rubin (1995), who did not define the number of participants at the start of the research, but added more during the research as the path being researched expanded. This is similar to the views of Bertaux (1981) and his snowballing technique, whereby participants introduce new participants to take part in the research. However, the researcher must know when an adequate number of participants have been interviewed; Seidman (1998) specifies two criteria for determining this number.

The first is sufficiency. Has the researcher interviewed a sufficient number of participants to ensure that the range of the possible population has been covered? In this study, relevant information is given in tables 4.1, 4.2 and 4.3. Twelve independent directors were interviewed, and at the time of the interviews they were on the boards of 31 different public companies, with a range of the sizes and spread of industries that would indicate that sufficient number of companies were represented. But to make sure of this, many more independent directors representing many more companies would need to be interviewed.

Seidman's second criterion – saturation of information – overcomes this problem. This is the point whereby respondents are providing only the same information as given by earlier interviewees, and no new information is being collected. This point was reached after the tenth interview in this research. No new information was received in the last two interviews. Patton (2002) defines this as interviewing to the point of redundancy.

The interviews were held in quiet, undisturbed locations, such as the interviewees' office, a meeting room at Korn/Ferry, and in one case, in the lobby of a major hotel in Melbourne. For all interviews, both parties were comfortable with the location (Bailey, 1982). The only disturbances were three instances of mobile phones ringing, but these were immediately switched off and the flow of the interview was unaffected.

Coding the responses resulted in some irrelevant background information being discarded. The number of codes used was optimised – ideally five or six codes (Creswell, 1998) – as too few codes may result in groupings where the contents are not closely enough related, whereas too many codes may make it difficult to accurately analyse the data. Coding followed the number and pattern of questions asked, with the responses of a few being grouped together as they asked for the respondents' views on their own experiences and what they observed of others.

A potential problem with using interviews to gather research data is that this method can be very time consuming and costly (Hussey and Hussey, 1997). The twelve interviews took between 28 minutes and 55 minutes, averaging just under 45 minutes. Each interview session included time for the respondents to review and sign the Information and Consent Form as approved by the Ethics Review Committee (Human Research) and ask questions about the purpose of the research. Costs were well controlled, the highest being a return airfare from Sydney to Melbourne and purchase of the digital recording equipment.

Several authorities suggest practical ways of ensuring the data are collected efficiently, accurately, and in the form most suitable for subsequent coding and analysis. Accuracy can be achieved by using high quality recording equipment (Glesne & Peshkin, 1999) or a professional transcriber could be employed (Creswell 1998; Glesne & Peshkin, 1999), allowing the interviewer to record the non-verbal responses (Hussey and Hussey, 1997). The interview location should be selected so the interviewee is comfortable and there will be no distractions or external noise to disturb the interview or interfere with the recordings (Creswell, 1998; Glesne & Peshkin, 1999).

As recording equipment can sometimes malfunction, it was tested at the start of each interview. Creswell (1998) suggests the interviewer should take notes in case of equipment failure, although this has the disadvantage that the interviewer may miss out on important verbal and/or non-verbal information if they are taking detailed notes. Also, Glesne and Peshkin (1999) advises that interviewers should be aware that if they stop taking notes, the interviewee may think that what they are saying is unimportant or uninteresting. Since these notes may not be a full recollection of the interviewees' responses (Creswell, 1998), the interviewer made post-interview reflective notes as soon as possible after each interview.

During the first interview, the last seven minutes of the interview were not captured by the recording equipment. The incomplete interview was shown to the respondent, who confirmed that the final unrecorded portion of the interview merely reiterated what had been said earlier. To prevent a similar mishap occurring again, both a tape recorder and the digital recorder were used in all subsequent interviews. The digital recorder worked perfectly in the remaining interviews.

Apart from the loss of a few minutes of the first interview, which did not impact on the quality of the data collected, all interviews were accurately recorded. The researcher did all the transcriptions, thereby thoroughly comprehending the responses, which thus assisted in the data coding procedures as the researcher had in-depth knowledge by the time the coding commenced.

Because additional issues may arise as the interview process progresses, and the interviewer may want to revisit earlier interviewees, it is advisable to close each interview at the pre-arranged time (Creswell 1998) and ask permission to contact the interviewee for further questions or clarifications at a later date (Hussey and Hussey 1997). This was done in all interviews. Aside from the issue encountered with the equipment in the first interview, the researcher had no cause to re-contact the interviewees. This aided in reducing the administrative burden of the interview process and helped keep the costs to a well-controlled level.

A potential problem with the selection method was that, while the interviewees were selected at random, they would probably be based in Sydney because of constraints on travel by the interviewer. This issue was mitigated by the likelihood that the interviewees would be on several boards of Australia-wide companies. Such details formed part of the research into and questioning of each interviewee. As it happened, the final two interviews were held in Melbourne on the same day, and the companies represented by the respondents were based in Sydney, Melbourne, Perth and Adelaide, with all represented companies operating nationally, and most operating internationally.

Finally, authorities warn that the interviewer should be aware that the interviewees may not take the research seriously if they perceive the two parties are of unequal status (Glesne & Peshkin, 1999). The interviewer must show that he/she is knowledgeable on the topic. The informal conversations between the researcher and the interviewees prior to the interviews starting helped put the respondents at ease. These conversations gave the researcher the opportunity to show his in-depth knowledge of the topic. Also, the interviewers' position and title at the time of the interviews was a divisional director of a major international bank. None of the respondents seemed to have any issues with the seniority or knowledge of the interviewer, and saw the interviewer as being knowledgeable on the subject.

4.5.4 Limitations of research by interview and how they were handled

There are limitations to any qualitative research methodology. In interviews, either the respondents or the interviewer can potentially introduce errors or bias. Respondents may deliberately lie, for example to cover their lack of knowledge or other shortcomings; they can introduce unconscious or accidental errors, such as by making a mistake or misunderstanding the question; or they may suffer from memory failures (Bailey, 1982). The interviewer may also make errors through their questioning (Hyman, 1954 as quoted in Bailey, 1982), leading to inaccurate responses. Examples of such errors include altering or omitting part of a question (asking errors), or undertaking biased, irrelevant or unnecessary probing (probing errors). In addition, recording errors due to equipment failure or malfunction, poor note taking or the interviewer's lack of concentration, or the interviewer cheating by making up or changing responses, can jeopardise the validity of the interviewing process. None of the possible errors discussed here occurred, apart from a minor mishap with the recording equipment in the first interview, as discussed earlier. Furthermore, the researcher is an experienced interviewer, having worked in a senior professional position in the finance industry for nearly 20 years, during which time he has conducted hundreds of interviews with clients, including CEOs of public listed companies, asking questions to gather information for credit assessment or to plan marketing strategies.

4.6 Grounded theory

Theory, consisting of grounded explanations of phenomena, sets the foundations for the research act (Denzin, 1977, p. 51)

Since the development of grounded theory in 1967 by Glaser and Strauss, many sociologists and researchers have used this qualitative method to derive theories from research in social settings. In the investigation of a social scene, the goal of grounded theory is to develop classifications and theory grounded in that scene (Crabtree & Miller, 1999). This methodology has gained significant support and is widely used (see, for example, *Grounded Theory in Practice*, Strauss & Corbin, 1997).

4.6.1 Defining grounded theory

The basis of grounded theory is the development of theory without any specific commitment to types of data, avenues of research or theoretical interest (Strauss, 1987). One of many different methodologies for undertaking qualitative research, it comprises several critical steps. These include theoretical sampling constantly comparing issues and a three-step coding paradigm, all used to ensure conceptual development and density.

Strauss (1987) describes how grounded theory emphasises theory generation and the use of the data in which the theory is grounded:

> *Grounded theory is a detailed grounding by systematically and intensively analysing data, often sentence by sentence, or phrase by phrase of the field note, interview, or other document; by constant comparison, data are extensively collected and coded…thus producing a well-constructed theory. The focus of the analysis is not merely on collecting or ordering a mass of data, but on organising many ideas which have emerged from analysis of the data (pp22-23).*

A simple definition is used by Kathy Charmaz (in Denzin & Lincoln, 2000) whereby grounded theory consists of systematic inductive guidelines for collecting and analysing data to build theory generated by the data. Grounded theory should be extracted from the data by a theoretically sensitive researcher who guides the data collection process; the theory is not just lying around in the data waiting to be discovered (Locke et al., 2004).

Grounded theory is an interpretive method using the philosophy of phenomenology, which is the science of phenomena (Hussey and Hussey, 1997). It is the observation and analysis of actions and reactions around a certain event or situation. The researcher will enter the event or situation of interest and will allow the data collected and analysed within that event or situation to develop the theory.

Strauss and Corbin (1997) base grounded theory methodology on eight assumptions:

- To discover what is really going on, the researcher needs to get out into the field and experience the environment themselves.
- Generating a theory that has been grounded in data that can be used as a basis for social action.
- Both human action and the accompanying phenomena are complex and variable, and understanding and being able to analyse this enables the theory to be generated.
- In any situation the researcher must understand that where there is an issue, people will react to the issue, and the researcher needs to be able to understand this and work with it.

- The researcher needs to understand that human action comes from the researcher's understanding of meaning, being how they interpret actions, reactions and other phenomena.

- The researcher should realise that through interaction, meaning is continually defined and redefined.

- The researcher should develop an understanding of and sensitivity to the nature of events and reactions as they evolve over time.

- The researcher should be able to connect the interrelationships between the underlying conditions, actions and consequences of the subjects, the subject of the theory and the research environment.

Data analysis in grounded theory is an essential procedure and is critical to the development of the theory (Strauss, 1987). A multi-level coding process means that researchers can develop codes only after some initial exploration of the data has been done. Usually, an editing, organising or immersion style is used (Crabtree & Miller, 1999) (see Section 4.6.4). The data analysis, using the coding procedures, is undertaken to achieve five results:

- The theory should be constructed and not tested. This is the basis of grounded theory.

- When the researcher immerses themself in the research environment they will generate an enormous volume of data; this procedure was developed to handle and organise this data.

- The initial codes can be refined and modified as the researcher considers the different meanings of the phenomena.

- The coding procedure is a logical system enabling the researcher to be systematic in their analysis of the data, but still allows the researcher to be creative as the relationships in the data develop over time.

- The structure allows the researcher to connect themes and concepts, and develop these progressively towards constructing the theory.

4.6.2 Short history of grounded theory

Grounded theory was developed by Glaser and Strauss in 1967 during a field observational study in hospitals (Strauss, 1987; Creswell, 1998). This was detailed in their book, *The Discovery of Grounded Theory: strategies for qualitative research.* Glaser and Strauss worked together for many years using grounded theory in their research (see *Awareness of Dying*, 1965; *Time for Dying*, 1968) but differed about grounded theory in more recent times with Glaser being highly critical of Strauss (Creswell, 1998). Both Glaser and Strauss have continued to write about grounded theory, with this methodology achieving increased popularity, especially in the areas of education, nursing, sociology and other social science fields (Creswell, 1998).

In the first part of the twentieth century researchers viewed quantitative analysis as being traditional, with any fieldwork or other qualitative research seen as preliminary to a quantitative study. Denzin and Lincoln (2000) consider the discovery of grounded theory revolutionary because it challenged:

- arbitrary divisions between theory and research
- views of qualitative research as primarily a precursor to more rigorous quantitative methods
- claims that the quest for rigour made qualitative research illegitimate
- beliefs that qualitative methods are impressionistic and unsystematic
- separation of data collection and analysis
- assumptions that qualitative research could produce only descriptive cases rather than theory development.

Grounded theory established a qualitative research methodology that was systematic in its process, and further development of this concept and refinement by Strauss and Corbin has incorporated internal verification and validation.

4.6.3 Criticisms of grounded theory

Creswell (1998, p. 58) sees grounded theory being challenging to researchers in four different ways:

- The investigator needs to set aside, as much as possible, theoretical ideas or notions so that the analytic, substantive theory can emerge.
- Despite the evolving, inductive nature of this form of qualitative inquiry, the researcher must recognise that this is a systematic approach to research, with specific steps in data analysis.
- The researcher faces the difficulty of determining when categories are saturated or when the theory is sufficiently detailed.
- The researcher needs to recognise that the primary outcome of this study is a theory with specific components: a central phenomenon, causal conditions, strategies, conditions and context, and consequences. These are prescribed categories of information in the theory.

Some researchers consider that grounded theory is regularly used in a too technical and nonhermeneutic way, without regard to the assumptions and practices of researchers to adequately include reflexivity (Crabtree & Miller, 1999). Similarly, Silverman (2005) considers that grounded theory is more about generating a theory than testing a theory, and that it fails to acknowledge implicit theories that sometimes guide early stages of research.

The grounded theory process itself can lead to weaknesses in theory development. Through the overemphasis of theoretical deductions, the researcher may not be prepared to review theories when new data are found, or as there is an overemphasis on inductive theory that has been grounded in data, the researcher may fail to be candid about the initial theoretical sources of ideas (Ezzy, 2002).

There is the suggestion that grounded theory fractures the data as the researcher creates codes and categories as the themes are defined within the data. This may lead to the separation of the experience from the experiencing subject, the meaning from the story and the viewer from the viewed (Denzin & Lincoln, 2000). These authors recognise the interactive nature of both data collection and analysis, and see that grounded theory fosters the development of qualitative traditions through the study of experience from the standpoint of those who live it.

4.6.4 Generating grounded theory

Methodical and logical grounded theory techniques have been proposed by Glaser and Strauss (1967), Strauss and Corbin (1990) and Glaser (1992). These techniques follow a similar process as defined by the underlying process of generating theory that has been grounded in the data. Strauss and Corbin (1997) take any one research project back to its point of inception. As the theory emerges during the research process, the researcher must have had a prior interest in the wider research area. Otherwise the researcher would not know how to structure the research design or have any pre-established concepts about the research issue.

In this study, the researcher has considerable interest in the wider area of public company boards, and has been affected by decisions made in the boardroom. How some of these decisions were made was not obvious at the time, and therefore the researcher wanted to investigate what role the independent directors played in the decision-making process. This topic then expanded to an attempt to create a theory of what role independent directors play in Australian companies.

Glaser and Strauss (1967) emphasise one very important aspect of generating grounded theory:

> *Joint collection, coding, and analysis of data is the underlying operation. The generation of theory coupled with the notion of theory as process, requires that all three operations be done together as much as possible. They should blur and intertwine continually, from the beginning of an investigation to its end (p. 43).*

Denzin (1977) suggests that to generate theory, the best approach is an initial systematic discovery of the theory from the data generated by the research. This should ensure that the theory will fit and work, and since the categories arise from the data, those involved in the area should be able to understand the theory.

Parker and Roffey (1997) set out a sequence of key considerations for researchers to use in conducting a grounded theory study. This sequence has been developed for researchers whose primary training has been in economic or behavioural research paradigms, and this fits with this researcher's experiences:

1. The grounded theory researcher will decide on a research area where they have some degree of familiarity.

2. While the researcher will not enter the site with any particular theory, even though the decision to select this study is reflective of the researcher's research perspective, they will consider pre-existing theory developed through a review of the relevant literature.

3. An initial research question (or questions) should be formulated. This will be quite broad and will become more focused as the research progresses. As the question is formed, the researcher should construct the research design to ensure that the sensitivities contained within the study will be covered by the design.

4. Data collection should then commence. The data will come from several sources including interviews, documentation and observations recorded at relevant events.

5. The researcher should now start to analyse the data, looking for relationships between the main elements. This may require the researcher to review some of the data or to include new data for verification and to highlight the key relationships.

6. The initial research question can now be restructured into initial theory development, supported by the emergence of the key relationships. These key relationships will emerge through the coding process.

7. As the theory is developed, the researcher may search for more data by continuing with data collection through interviews with modified or new interview questions.

8. The researcher will continue with sampling in different areas in order to develop new categories and new analysis of new or existing data, which will provide either positive or negative confirmation of the working theory.

9. As the researcher reaches saturation point, with the data no longer revealing any new insights, they may consider a review of the literature with the research theory in mind.

10. The researcher will then look to compare the themes generated in the literature review with the theory developed through the research process.

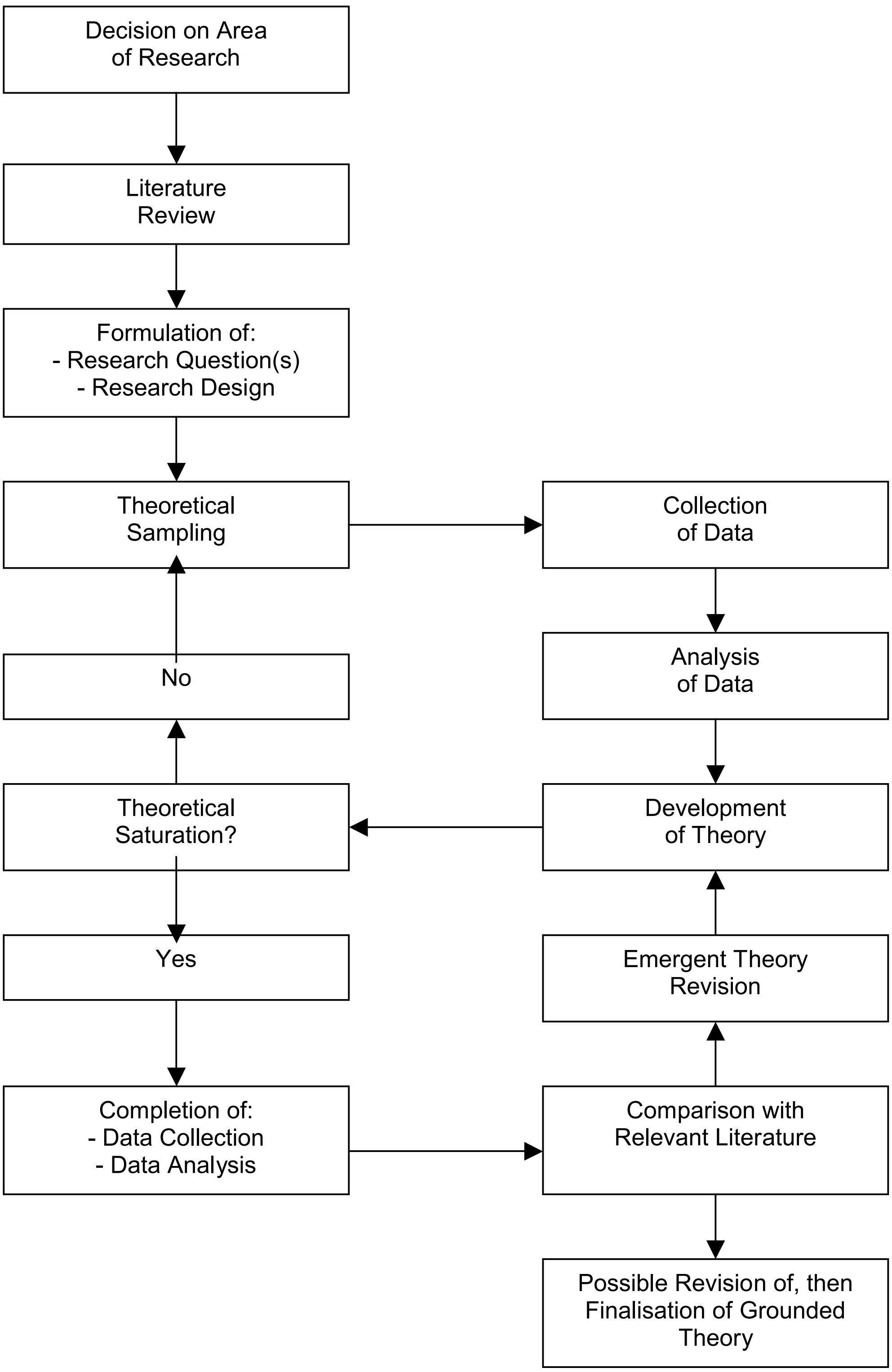
11. The developed concepts will be tested for confirmation or disconfirmation, with the researcher seeking alternative explanations. The tests are undertaken until no new or relevant data appear, all elements of the theoretical paradigm are covered and relationships between categories have been covered.

12. It is only at this stage that the final part of the sequence is reached. The theory that has emerged during the research can be revised so that it can now be verified by analysing the research data and thus can demonstrate that it results in valid and reliable practical and theoretical results. This process is detailed in Figure 4.1.

At the conclusion of Section 5.7, which is the final stage of data collection, this process will be shown to have been completed.

Bryman (2004) sets out a similar process but notes that it is difficult to portray the process exactly, because with grounded theory, the existence of different forms of the approach does not allow a permanent procedure. The process is iterative: the researcher collects and analyses data, steps back from this process occasionally to write notes and memos on data that have been collected and analysed (Charmaz, 2006), then returns to the field to collect additional data until all categories are saturated and no new data are found. Figure 4.1 is a representation of grounded theory studies. Charmaz notes that the research process is not linear, and noting the iterative process of data collection, the format of any one grounded theory study may differ from the others. Section 4.8 details the specific process undertaken in this study.

Figure 4.1 The grounded theory process



Grounded theory involves a systematic process of data collection and analysis that is repeated until the researcher learns nothing new. This iterative process aids the researcher in developing the theory from the data, at the point of reaching theoretical saturation. At this stage, no new information is found. The researcher should continue to analyse the data; once the point of saturation is reached, the procedure is repeated for each category (Glaser & Strauss, 1967). Negative contributions to the categories are also noted and explained.

Strauss and Corbin (1997) advise four considerations when collecting data: the researcher must choose (i) a site or group to study, (ii) which types of data to use, and (iii) the timeframe within which to study the area; and (iv) the researcher must realise that access, resources, research goals and time availability will initially determine the number of sites and observations or interviews that will be used. While most types of documents can be used for qualitative research data, these are not used as much as interviews and observations in generating theory (Glaser & Strauss, 1967). But Creswell (1998) considers interviews play a central role in data collection in a grounded theory study, with participant observation, researcher reflection and other methods less important. Data collection is discussed in more detail in Section 4.5.

The researcher will end up with a significant volume of data to analyse and must decide how to do this. Silverman (2005) considers data analysis should start from the beginning of the research, with the researcher always thinking about data already collected, questioning and comparing the data and looking to see where they could collect more data (Strauss & Corbin, 1997). The researcher should use their own insight and sensitivity in analysing the data.

Three different styles can be used for organising the data for analysis: template, editing or immersion style. The template style uses a template or code manual as an organising system for collating text and identifying categories. With the editing style, the researcher interprets the text and segments it relative to the research question, and then categorises the data during the continuing interaction with the data. The immersion style is when the researcher uses their intuition to organise the data after an extended period of immersion within the data. Ethnography, hermeneutics and grounded theory often use the editing style in their interpretive process (Crabtree & Miller, 1999).

Analysing multiple forms of data, including interview text and documentation, can be daunting. The researcher must also decide how the data should be represented. Personal experience will also impact data analysis as the experiences and knowledge that we hold may influence or inform our research (Creswell, 1998). The researcher should have sensitivity to provide insight and give meanings to the events and happenings in the data (Strauss & Corbin, 1997).

The volume and complexity of the data to be analysed can be challenging (Parker & Roffey, 1997). First, the researcher must look at the connections between the data and the research question to discover what really is happening. Second, initial hypotheses may over time become less relevant as additional data are analysed and the researcher must be able to discard them, rather than trying to justify them. Third, within the iterative data collection process, the researcher should attempt to validate or confirm the emerging theories and categories via the use of additional data. Fourth, if concepts or categories cannot be substantiated by the data, then the researcher must be able to discard them, no matter how attractive they may seem.

Data are analysed through a three phase coding process: open coding, axial coding and selective coding. Strauss and Corbin, (1997, p. 3) define coding as “the analytical process through which data are fractured, conceptualised, and integrated to form theory.” Coding involves the discovery and naming of categories and the researcher needs to code the associated subcategories (Strauss, 1987).

Parker and Roffey (1997) recognise six steps of data analysis when undertaking a grounded theory study:

- At the outset and then during the data analysis, generative questions should be developed.
- As concepts are coded, the researcher should look for linkages between them.
- The theory should be verified as the researcher tests the validity of the concepts and their linkages.
- The coding should be relevant and this is tested by ensuring that the new data confirm any links.
- Categories, dimensions and linkages are integrated into forming theory.

- Theoretical memos, created during the research process, are continually restructured and modified according to the integration of new data.

Silverman (2005) agrees with the concept proposed earlier by Glaser and Strauss (1967), in that in research, data collection, hypothesis construction and theory building are interwoven with one another. He sees data analysis consisting of three stages: an initial attempt to develop categories representing the data; a process of saturating the categories with evidence to highlight their relevance; and developing the categories into more analytic frameworks with relevance outside the area of research.

Developing theory is a complex activity. The process can be lengthy and entails not only conceiving or intuiting ideas, but also formulating them into a logical, systematic research process. It is also important to follow through with the implications derived from a theory. Central to theory development are the joint endeavours of making inductions and deductions. Over the process, the researcher should have systematically developed the analytical results into a theory (Strauss & Corbin, 1998). In the case of this research, the implications for policy and practice recommendations are detailed in the concluding chapter.

During the research process, the researcher undertakes theoretical sampling, which is a process of data collection for generating theory during which the researcher jointly collects, codes and analyses the data, then returns to the area of research to collect, code and analyse data until the categories developed during this process have been saturated. This method contrasts to statistical (random) sampling, which is used for accurate evidence on distributions among categories that are used for verification or description (Glaser & Strauss, 1967).

In this study of independent directors, theoretical sampling was performed through a series of interviews that was undertaken with 12 subjects, all of whom were independent directors of at least one public company at the time of the interviews. Strauss (1987) discusses the wide variety of sources that can be used in data collection, including any source that provides useful information to the researcher. Participant observation was also used as a minor but still useful source. Initially, four interviews were conducted, with the transcripts then coded. Memos were created using the interview questions as categories. Next, five more interviews were conducted with the coding and memo writing processes extended to include the data sourced from these interviews. As new codes were found, the first four interview transcripts were reviewed to search for additional information to add to these categories. The final three interviews produced only minimal new information from the third last interview and no new data from the last two interviews.

Theoretical sampling is purposeful as it is based on concepts that emerge during the research, and evolves during the process. It allows the researcher to choose avenues of sampling that result in the greatest theoretical return and, while it should be worked out carefully, it should not be too rigid in its approach as this could stifle creativity (Strauss & Corbin, 1998).

Creativity is required through the processes that force the researcher to break through prior assumptions and to create new order form the old (Parker & Roffey, 1997). Glaser, Strauss and Corbin all acknowledge that creativity is important in developing grounded theory, as this is not the generation of new ideas, but the ability through the research paradigm to identify new connections between conceptual ideas through the use of theoretical codes, which Glaser believes to be the connectors.

Silverman (2005) recommends that grounded theory be used with imagination rather than as a mechanical research methodology. Without this, the grounded theory study may result in no significant findings, as no creative thought has gone into what the data are really saying apart from existing or trivial phenomena. The researcher may have preconceived ideas about what is happening, and the risk is taking these for granted and missing the inductive grounding that is needed (Miles & Huberman, 1994).

The process of theory development begins with the data coding. This coding process starts as data collection continues, and as the theory develops, the researcher continues to return to collect more data until the concepts are saturated and no new data are found. This process of returning to collect more data is iterative in which both inductive and deductive analyses are mixed (Denzin & Lincoln, 1998, 2000; Crabtree & Miller, 1999). Theoretical sampling is used to develop the emerging categories and concepts, and it is only when the researcher discovers no new or relevant data, and all relationships between the concepts and categories have been defined and validated, that the process is completed (Glaser & Strauss, 1967; Strauss & Corbin, 1998).

When this stage is reached, the researcher is then able to create and express the grounded theory that has been formulated through the data collection and analysis process.

4.6.5 How good is the theory?

For the theory to be useful, it should be developed for application in the chosen field. Glaser and Strauss (1967) consider that the theory should be developed using four highly interrelated properties:

> The first requisite property is that the theory must closely fit the substantive area in which it will be used.
>
> Second, it must be readily understandable by laymen concerned with this area.
>
> Third, it must be sufficiently general to be applicable to a multitude of diverse daily situations within the substantive area, and not to just a specific type of situation.
>
> Fourth, it must allow the user partial control over the structure and process of daily situations as they change through time.

Research credibility may also be an issue. There are two problems in getting readers to understand the discovered theory (Glaser & Strauss, 1967). The first is enabling the reader to understand the theoretical framework. This problem can be overcome by the researcher providing a detailed summary presentation of the overall framework and of the main theoretical statements.

The second problem is how to describe the data so the readers can imagine themselves almost being involved in the research activity with the subjects, relative to the theory. This can be overcome by providing as much easily understood data as possible in the forms of quotations and basic tables and diagrams, but the volume should be limited to only what is necessary to get the message across.

4.6.6 Application of grounded theory in business ethics

Why was grounded theory chosen as the research methodology for forming a theory on the role of the independent director? Grounded theory is one of the most common and influential methods used when the researcher's aim is to form a theory (Strauss & Corbin, 1997). Its use has grown since it was introduced by Glaser and Strauss in 1967, with its applicability becoming increasingly widespread.

Since its conception by Glaser and Strauss, grounded theory has been developed in many disciplines (Hussey & Hussey, 1997). The reasoning for using grounded theory is to develop recommendations for policies and procedures that can be understood and used by those involved in the area under study, and can be commented on and corrected by them.

Denzin and Lincoln (1998) consider that grounded theory is the most widely used qualitative framework, especially in the areas of education, health sciences, communication and sociology. This is because the methodology provides specific steps that any researcher can follow, and therefore grounded theory appeals to a broad range of researchers and situations. Strauss and Corbin (1997) have a similar view, and have seen examples in fields of research including accounting and business management in addition to those areas listed above.

In this study, the research question is intentionally narrow, but the research process undertaken through a grounded theory study has enabled the researcher to not only develop a theory to respond to the research question, but also to determine what factors influence the theory in any given situation. Different situations are defined as the different forms of public listed companies, as determined by the size of the company, where it is in its lifecycle and how long it has been listed on the stock exchange.

4.7 Data analysis

The analysis should correspond with the objectives of the study so that each analysis will provide evidence relating to a corresponding hypothesis (Locke et al., 1993). Some categories developed through data coding may come from the existing theory while others are developed by the researcher during the analysis. The data analysis and coding are heavily influenced by the researcher's interaction with the data (Maxwell, 1996).

Data analysis necessitates analytical induction. Within this is the theory that there are patterns to be found in the social and physical worlds. Theories or constructs generated through grounded theory attempt to describe these patterns in as detailed manner as possible. To discover these constructs, an iterative procedure of question-and-answer cycles is used (Denzin & Lincoln, 1998).

Glaser and Strauss' development of grounded theory incorporated a method of analytic coding that emphasised theoretical sensitivity, while Strauss and Corbin utilised a coding paradigm involving open, axial and selective coding (Morse & Richards, 2002). In this paradigm, the data are sorted and rearranged into categories that allow the data to be compared within and between these categories, following which the theoretical concepts are developed (Maxwell, 1996).

The chain of theory development commences with open coding. Open coding involves the close examination of all collected data, including line-by-line examination of text and interview transcripts to define event and actions. The next step, axial coding, makes connections between categories and their subcategories, which include conditions leading to the category, its context, the relevant social interactions, and its consequences. Finally, selective coding, being more directed, uses the initial codes to sort the data, and categorises them more precisely (Charmaz, 2000).

The model used in the analysis and coding of the data in this study is the conditional matrix as developed by Strauss and Corbin. This model assists in representing the interconnections of the conditions and consequences and the resulting chain of events as defined by the data. It utilises the actions and interactions between different events to create conditional contexts.

4.7.1 Open coding

Open coding aims to open up the data and identify concepts that may fit the data (Morse & Richards, 2002). Initially, the data are sorted into many different initial codes as the researcher reviews the data line by line. Many of the initial codes will become irrelevant as the coding process progresses.

By breaking down and labelling the individual parts of the information, the data become easier to recognise and manage. The process continues with the codes subsequently organised into a pattern of categories and concepts. The labels arise either from the data as provided by the interviewees (*in vivo* coding) or from the researcher's own experience (Hussey & Hussey, 1997).

Several properties or subcategories are discovered within each category as the researcher identifies the patterns within the data, with these patterns outlined to show their extreme possibilities (Creswell, 1998). At the end of this process, each category should be saturated, as any new information no longer adds to the existing information. The data are eventually reduced to a small number of categories that reflect the area under investigation in the grounded theory study.

This first step in the analytical phase is essential (Seale, 2004). Strauss and Corbin (1998) named this process 'open coding' as the text is opened to expose the thoughts, ideas and meanings contained within, enabling the researcher to develop the concepts. Over the course of the process, many concepts are derived, with similar concepts categorised and categories amalgamated so that as the researcher groups the many concepts they form a fewer number of predictive and explanatory categories that are easier to analyse.

The categories reflect the different phenomena derived from the data. These phenomena have the ability to answer the question "What is going on here?" All issues and concerns that are of interest are reflected in the phenomena, with category names being both distinctive and indicative of their content.

Following the identification of a category, the researcher will develop it in terms of its specific properties and dimensions. This will assist in fully defining each category and the position of each property in the continuum of that category. By studying various properties in a category, patterns can be observed. Strauss and Corbin (1998) recognise that each property may not completely fit a pattern, but dimensions can be useful as long as the lack of fit is within certain limits.

When open coding is undertaken in line-by-line analysis, the researcher can generate categories quickly and develop these categories through additional sampling. This process is known as theoretical sampling. As each identified incident is compared, the comparison is always according to the properties and dimensions contained within that incident, enabling the researcher to group similar incidents in each category.

The next stage in the data analysis process is the identification of a single category as the central phenomenon, and the associated exploration of the interrelationship of categories. This stage is known as axial coding.

4.7.2 Axial coding

Axial coding moves the focus around a concept (Morse & Richards, 2002). It identifies the relationships between the open codes, from which it develops core codes (Parker & Roffey, 1997). Axial coding involves restructuring and rebuilding the data into patterns to identify links and relationships. Part of the process is developing the properties and categories of the concepts with a view of linking them at the dimensional level (Hussey & Hussey, 1997).

The links can be presented in a coding paradigm or logic diagram through the following procedure (Creswell, 1998. p. 57). The researcher:

- identifies a central phenomenon
- explores causal conditions
- specifies strategies
- identifies the context and intervening conditions
- delineates the consequences for this phenomenon.

At this stage, the researcher can create a conditional matrix which assists in visualising the conditions and consequences related to a phenomenon. The matrix is a formation of concentric circles with each spiral representing the different conditions that influence the phenomenon. As the circles spiral outwards, their representation evolves from micro effects to macro effects. The centre of the circle represents actions and interactions, the inner circles represent the small group and individual influences, while the outer circles represent national and international influences (Charmaz, 2000).

Ezzy (2002) does not consider axial coding useful in grounded theory. He argues that, while Strauss and Corbin see the value in axial coding, Glaser does not as it is a process that restricts the inductive nature of theory building. Strauss and Corbin believe that axial coding should focus on the four dimensions of context, strategy, processes and consequences, which suggests a particular way of constructing the data analysis.

Flick (2002) sees the process as one of refinement. From the initial categories developed in open coding, those that should be further elaborated upon are selected and saturated with as much data as possible. These categories are then compared and finally the relationships between these categories are identified and elaborated. The important aspect of axial coding is for the relationships between the categories to be clarified and established.

In 1990, Strauss and Corbin developed new procedures for analysing data, including axial coding and the creation of a conditional matrix (Charmaz, 2000). They advocate the use of an organisational scheme to highlight the linkages among categories that can sort and organise the emerging categories. The scheme they use is called the paradigm. The components of the paradigm are conditions, actions/interactions, and consequences, all of which relate to the emerging phenomenon (Strauss & Corbin, 1998).

By using the *conditions*, which is a description of answers to the questions *why*, *where*, *how come* and *when*, the responses can be grouped. Together they form the structure or set of circumstances or situations in which phenomena are entrenched. Conditions can either be causal or somehow affecting or impacting on the cause.

The *actions/interactions* are the result of the conditions, and can be summarised by responses to the questions *by whom* and *how*. The conditions will lead to issues, problems, happenings, occurrences or events.

The results of the actions/interactions are the *consequences*. These are represented by responses to the questions *what happens* as a result of the actions/interactions, or the failure to act as a result of the actions/interactions.

Figure 4.2 gives a diagrammatic representation of the paradigm used during the axial coding process.

Figure 4.2 Strauss and Corbin's conditions/actions/consequences coding paradigm

	Impacting Conditions What impacts on it? What affects it?	
Causal Conditions What causes it?	**PHENOMENA**	**Actions/Interactions** What results from the conditions?
	Consequences What are the results of the actions/interactions?	

4.7.3 Selective coding

Selective coding provides deep analysis focusing on one category at a time (Morse & Richards, 2002). It requires the selection of the main core code, the central phenomenon that resulted from the axial coding process (Parker & Roffey, 1997). Selective coding can be seen as taking axial coding to the next level, as the categories that have been developed in axial coding are then grouped to form the core category (Flick, 2002). From the selection of the core category, the researcher continues the iterative process and searches for additional data to support the core category. Once no additional data are found, the category is saturated, and the researcher should then examine the relationships between the core code and other codes.

Coding is completed when the researcher is satisfied that the theory is saturated (Ezzy, 2002), after finalising the core category or story around which the analysis is focused. Bryman (2004) sees the core category as the central issue or focus around which all other categories are integrated, and refers to what Strauss and Corbin call the storyline that frames the account.

The core category brings all other categories together to form a unit that explains all other categories. It may be phrased as one of the main categories identified in the axial coding process, or may be phrased otherwise to ensure that the title captures all categories. Strauss (1987, p. 36) details criteria for determining the core category:

- The category must be central so all other major categories can relate to it.
- It must appear frequently in the data.
- Data should not be forced to fit in the core category, and all other categories should relate in a logical manner.
- The name of the core category should be able to be used for further research in other substantive areas.
- As the core category is filled with data, the process should flow easily.
- The main issues in the data, as well as variations, should be easily explained by the concept underlying core category.

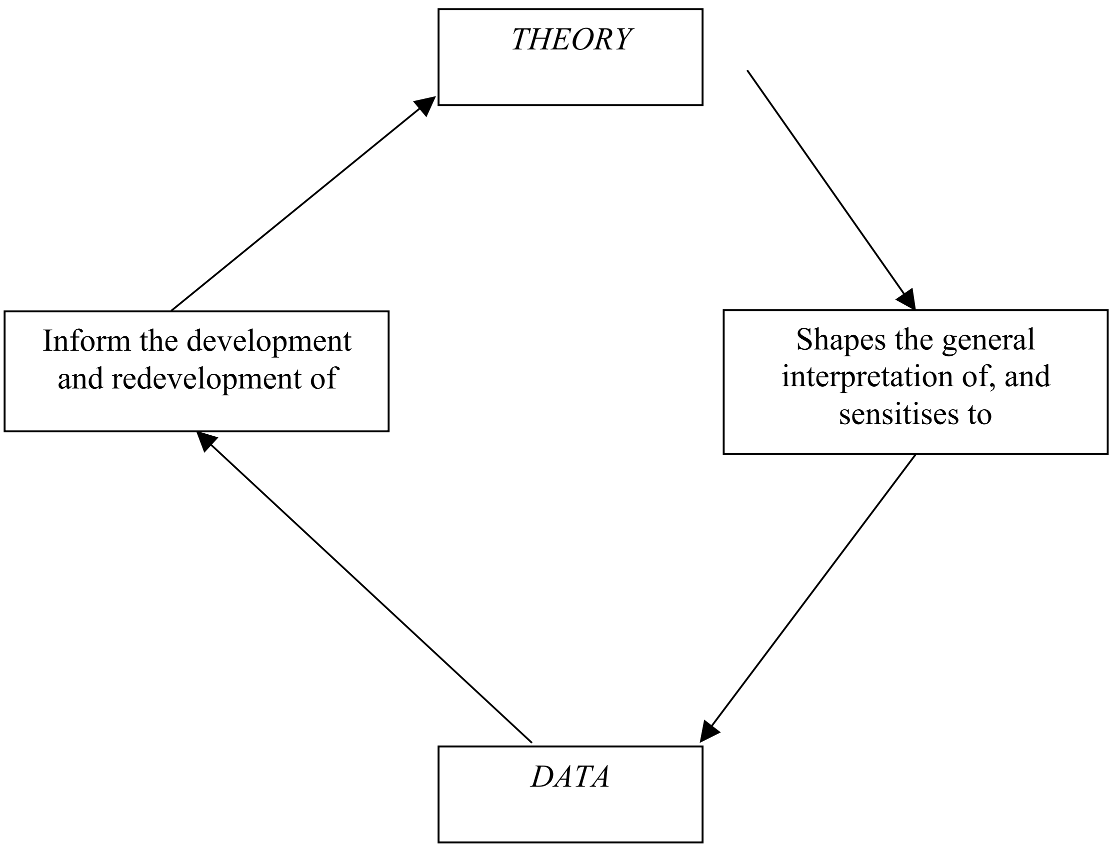
Glaser uses the term ‘theoretical coding’ as opposed to ‘selective coding’, and suggests that theoretical codes are used at this point in the data analysis to see how the codes established in the previous coding process relate to each other so that a theory may be formed. In line with other approaches described above, Glaser uses this practice to move the analytic story in a theoretical direction (Charmaz, 2006).

4.8 Developing the grounded theory

Grounded theory is grounded in data and observation. The process should not be influenced by pre-existing experiences or theories, nor is it a model of setting a hypothesis then testing that hypothesis with reference to selected data. Ezzy (2002) promotes the symbolic interactionist theoretical perspective first proposed by Glaser and Strauss in their early works, in which the researcher personally becomes deeply involved in the research process, especially in the physical setting in which the research takes place.

The grounded theory model is sophisticated (Ezzy, 2002) as it draws on both inductive and deductive methods of theory generation. Instead of starting with a hypothesis to be tested, grounded theory starts with the selection of an interesting issue that will then guide the collection of data. Pre-existing theory in the selected issue can help to guide the research questions and the research design, but the grounded theory process itself will result in the generation of the theory. This is a circular process that uses data to inform the theory, which impacts upon the interpretation of data (Figure 4.3)

Figure 4.3 Grounded theory: a sophisticated model (Ezzy, 2002)



While there are guidelines to undertaking a grounded theory study that include a number of specific processes, because each study is individual and unique it will have its own sequence of events. There is no predetermined number of visits to the research setting that will result in saturation of the concepts and categories. But the processes first identified by Glaser and Strauss, and then revised by others should be followed (Bryman, 2004; Charmaz, 2006; Ezzy, 2002).

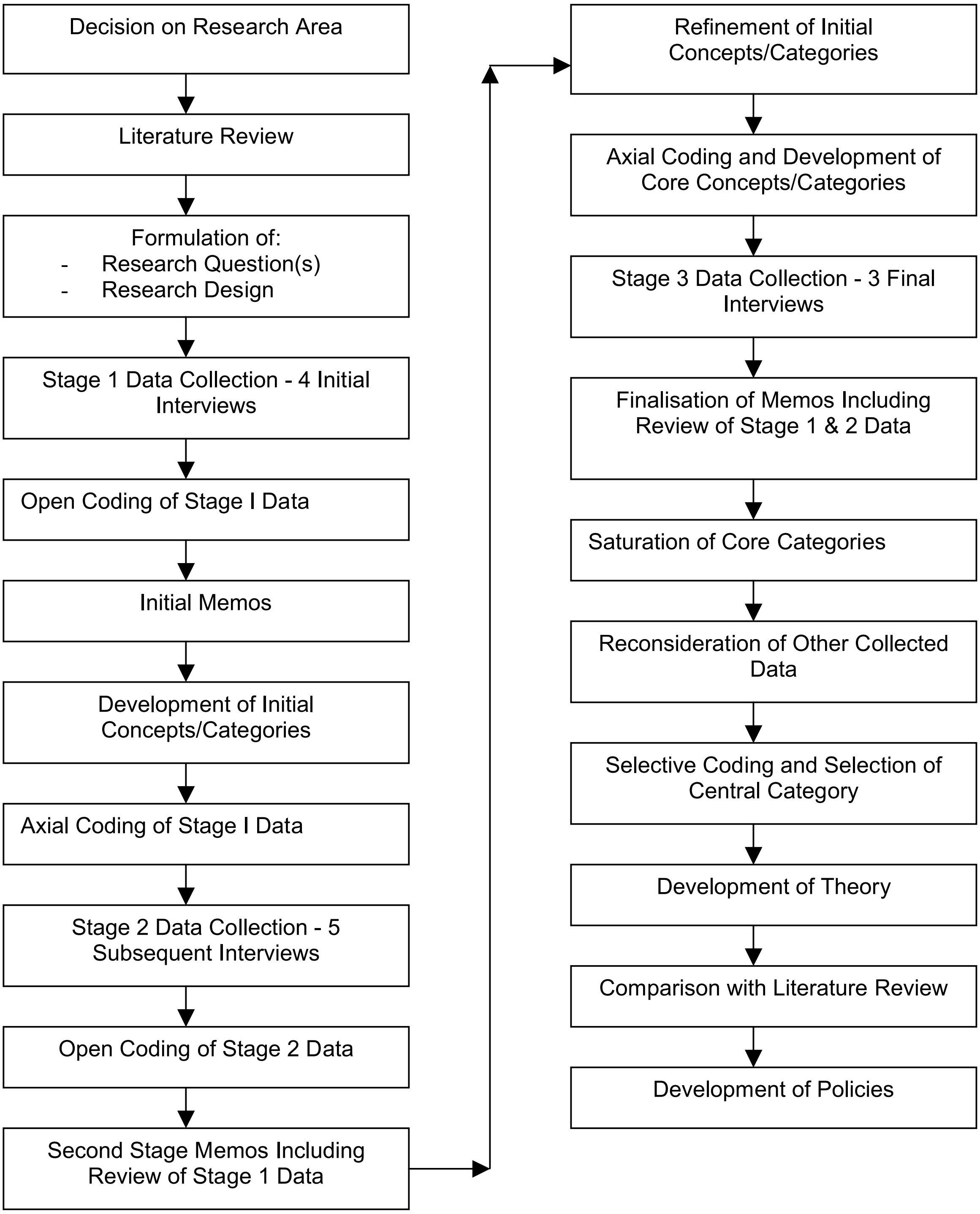
There are 19 stages in this study culminating in the development of the theory. In addition, two subsequent steps have been included – the comparison of the theory with the relevant literature, and the development of policies relevant to the area under investigation. The diagrammatic interpretation of this study is shown in Figure 4.4.

The 12 interviews were split into three stages. The first stage involved four interviews, after which the interviews were transcribed by the researcher and the transcripts were analysed and coded. For this first open coding process, memos facilitated data analysis and the development of initial categories and concepts. This process also allowed the researcher to refine the interview process. Axial coding of the Stage 1 interviews was then completed.

The second stage of five interviews was then undertaken. Again, these interviews were transcribed and coded. The memos written after the first stage interviews were further saturated with data from the second stage interviews. The discovery of new concepts led to new memos being written, and the transcripts from the first stage interviews were reviewed to add data to these new memos. Data from the first stage interviews that were initially thought unimportant became relevant as more instances of the same concepts appeared in the second stage interviews.

As the concepts became saturated with the data from the first two stages of interviews, axial coding was again undertaken to develop the core categories and concepts. The third and final stage of three interviews was then held; only the first of these revealed some new data. The final two interviews contributed only additional instances of concepts that had been developed during the first two interview stages.

Figure 4.4 Diagrammatic representation of the grounded theory process



The memos were then finalised using the data from the last three interviews, and the interview transcripts from the first two stages were again reviewed to ensure that nothing had been missed, and to search for additional instances of the new concepts discovered in the third last interview. The core categories were found to be saturated as no new data had been discovered, and the other data such as that identified through participant observation was then considered prior to the central category then being finalised. Finally, the theory was developed, and then compared with the relevant literature, with the resulting policies being developed.

4.9 Verification, validity and reliability

Lincoln and Guba (1985) believe that reliability and validity have no place in qualitative inquiry, while others such as Leninger (1994) argue that qualitative and quantitative inquiry should have different criteria for reliability and validity. Reliability requires that the same results would be obtained if the research was replicated, and validity requires that the results accurately reflect the phenomenon studied (Morse & Richards, 2002). Verification involves the checking of common or misleading biases that can become part of drawing conclusions (Huberman & Miles, 2002).

4.9.1 Verification

Grounded theorists believe that the researcher should be responsible for establishing verification as it is an active part of the research (Creswell, 1998). The procedures for determining verification are contained in the various stages of the research. Creswell uses the example of the coding process as part of verification. Once the open code categories have been developed, the researcher interrelates these in the axial coding process. The relating of the data using events and evidence in the research data is part of the verification process and is known as discriminant sampling.

Creswell and Miller (1997), as discussed by Creswell (1998), have defined eight verification procedures that are often described in the literature:

- The researcher should spend a prolonged amount of time in the field. This enables the researcher to collect and compare data from different subjects and allows checking for any misinformation.

- The researcher collects data from varying sources to enable corroboration of the evidence, a system called 'triangulation'.

- A peer of the researcher can review the research to provide an external check of the research process.

- If there are negative indications in the data the researcher can review the initial hypotheses so that all cases then comply.

- The researcher may be biased due to their involvement in the research area and this must be discussed so any bias can be clarified and the researcher's position is understood.

- The research participants can review the findings and interpretations to establish credibility of the hypotheses

- The researcher should use rich, thick descriptions so the reader can transfer the ideas to other settings.

- An external consultant can perform an audit to assess the accuracy of the research by examining the process and the product.

Creswell (1998) recommends that at least two of these procedures be utilised in any given study. Triangulation, writing with rich, thick descriptions and reviewing the product with the participants are all easy to undertake, while others such as an external audit or peer review may be time consuming or expensive.

In this study, there is no researcher bias as the researcher's involvement in this topic has arisen only through the study. The researcher had undertaken no formal or informal research prior to the commencement of the study, and therefore had formulated no initial thoughts on the results of the study.

The research included reviewing transcripts of interviews, participant observation and information derived from the review of the Principles of good Corporate Governance undertaken by the ASX Corporate Governance Council in late 2006 and early 2007. This structure forms the basis of corroborating the evidence through triangulation as proposed by Denzin (1977) and Miles and Huberman (1994).

Other than review of this study by the researcher's supervisor, no other form of peer review or external audit has been carried out on this study.

4.9.2 Validity

A number of issues can undermine validity: faulty research procedures, poor samples or inaccurate or misleading measurement. Validity shows how well the findings accurately represent what is happening in the research situation (Hussey & Hussey, 1997). As the grounded theory paradigm should capture the essence of the phenomena and use the data to explain and analyse the situation, the researcher endeavours to delve deeply into the research data to develop the theory, allowing them to use and analyse data thick in knowledge and meaning. Consequently the validity in this paradigm is high.

The validity of any research can be assesses in a number of ways (Hussey & Hussey, 1997; Bryman, 2004):

- Face validity is the most common, whereby the tests or measures used by the researcher do, in fact, represent or measure what they should represent or measure.

- Construct validity relates to the concern that there are issues that are not outwardly observable, such as motivation, anxiety, ambition or satisfaction.

- Concurrent validity is where the researcher uses a criterion on which cases are known to differ and that is relevant to the concept under study.

- Predictive validity can be used by the researcher as a future measure of criteria.

- Convergent validity is where the validity of a measure can be determined by comparing with measures of the same concept using different methods.

In this study, the process of collecting, analysing and coding the data through open, axial and selective coding ensures the validity of the data. As the interview transcripts were coded through these processes, the iterative nature of the process that results in the saturation of the concepts ensures the validation of the study. As all concepts are related through the process, including the use of negative cases to confirm or rescind concepts, the process is self-validating.

4.9.3 Reliability

Credibility of the research findings is important, and the reliability of the research is an important factor. A research finding can be reliable if it can be replicated or reproduced (Hussey & Hussey, 1997), but it can be difficult to perform the same qualitative research study as other outside factors may influence the observations, or the responses made by the interviewees. Reliability may be more important in quantitative studies than in qualitative studies. Hussey and Hussey (1997, p.57) contend:

> *"It is not important whether qualitative measures are reliable in the positivists sense, but whether similar observations and interpretations can be made on different occasions and/or by different observers."*

Qualitative research is sometimes criticised for lacking reliability as there is no statistical analysis to confirm the significance of the findings (Denzin & Lincoln, 1998). Researchers can use measures to increase the reliability of their results. Observations that recur through systematic research are credible, such as those determined through the grounded theory process. In the coding procedure, concepts become more important as more examples are identified, thus ensuring reliability of the research. The verification process described in Section 4.9.1 also supports the reliability of the study.

4.10 Ethical issues

Researchers should ensure their interview respondents' rights to informed consent, privacy and protection from harm (Fontana & Frey, 2000).

An Information and Consent Form was read by each respondent and discussed with the interviewer prior to commencement of each interview, and all respondents provided informed consent for the interviews to take place. The transcripts did not contain the name of the respondent, and the only documents that can relate any respondent to a particular transcript have been stored by the interviewer in a locked room, separately from the transcripts. The calendar that was kept by the researcher in organising the interviews has since been destroyed. To avoid the possibility that staff at Korn/Ferry might link the respondents to responses, respondents contacted the researcher directly if they wanted to participate in the research, and of the 38 potential respondents, nobody at Korn/Ferry was aware of who participated. Only one of the 12 respondents did not want the interview to be recorded. Once the Ethics Committee's requirements to anonymity were explained, and this respondent had requested a copy of the transcript, they were satisfied and agreed to the interview being recorded. Several respondents raised the possibility of reputation risk, but the discussions of the respondents' responses are anonymous, so any controversial comments cannot be traced back to any respondent.

4.11 Conclusion – bringing the pillars together

Creswell (1998) discusses the rationale of a literature review for a grounded theory study. The literature review is used to identify the gaps in the current literature. In this case, the review of the literature identified gaps in the commercial pillar, and showed the divergence in the logical progression of the literature between this pillar and the legal and governance pillars. The literature review identified the concepts that required further investigation and thus that featured in the interviews.

In the legal pillar, the analysis of the literature showed the logical progression of both common law and statute over time, allowing the researcher to easily identify the role of the independent director from a legal perspective. These are:

- to guide the company's board and senior management to improve the performance of the board and of the company
- to monitor the company's management to ensure they are performing to the maximum of their capabilities and are acting honestly and diligently.

Similarly, the analysis of the literature in the governance pillar led to identifying the roles of the independent director from this aspect. These are:

- to monitor the executive directors and senior management

- to expand the knowledge of the board as a whole
- to create a link between the board and the company's stakeholders.

While several roles were identified through the analysis of the literature in the commercial pillar, the process involved noting which issues appeared most frequently in the literature, rather than identifying roles through any rigorous method. Thus it became clear that a well-structured, robust study needed to be undertaken to correctly define the roles identified through this process. This study has been designed to do just this. The roles identified through the literature review are:

- acting in a monitoring capacity
- enhancing performance
- acting as a boundary spanner.

The methodology selected to undertake this research has been described in detail in this chapter. Applying this methodology to a population of independent directors provided the researcher with well researched and justified conclusions regarding the role of the independent director through the commercial pillar. The conclusions from the following chapter are then easily reconcilable with the results of the literature review through the legal and commercial pillars.

This chapter has discussed and justified the use of semi-structured interviews as the data collection method for use in grounded theory as the appropriate methodology to research the role of the independent director. It has shown that the responses are reliable and provide a significant amount of information, and that this information can be compared with the theory developed through the literature review to enable the researcher to come to a conclusion about the role.

While the research was limited to 12 interviews, it has been shown that this is sufficient as the last two interviews did not reveal any new information; these two respondents either repeated what earlier respondents had said, or phrased the same information in a different way. The statistical analysis of the companies represented by the respondents shows that a broad spread of companies have been represented, and while the respondents were on a total of 31 different public listed company boards at the time of the interviews, they had previously served on a number of other boards and used these experiences in responding to the interview questions.

How the respondents were approached has been discussed, as were the issues that the researcher faced in doing this. Respondents' concerns regarding ethical considerations and anonymity of responses have been described; once respondents were informed of the protocol regarding recording of interviews, the storage of the recordings and the transcripts, and the way the responses are discussed in the thesis, these issues were overcome.

Recording and transcribing the semi-structured interviews provided the researcher with a substantial and informative database. This information was easily coded so the responses could be compared with the gaps identified in the previous chapter through the literature review. The discussion and analysis of the data collected through the interview process are provided in the next chapter through the grounded theory methodology described above.

Chapter 5 RESULTS AND ANALYSIS

5.1 Introduction

The data discussed and analysed in this section were collected through 12 in-depth interviews, carried out in three stages. This data collection process was described in detail in Section 4.5. The analysis process follows stages 4 to 19 of the grounded theory process as illustrated in Figure 4.3.

The first part of this chapter describes the open coding of Stage 1 data, in which the concepts identified in the line-by-line analysis of the first four interview transcripts were listed and sorted into initial categories. The first four interviewees collectively represented eight public company boards at the time of the interviews.

Next was the axial coding of the Stage 1 data, as described in Section 5.3. Here the coding paradigm discussed in Section 4.7.2 was used to identify the relationships between the concepts within each category. Figure 4.2 shows a diagrammatic representation of this paradigm.

The next stage of interviews was then held; the open coding of these interview transcripts is outlined in Section 5.4. The second stage interviews involved a further five respondents who represented 14 public company boards. The concepts derived from these interview transcripts were then used to refine the initial categories, as discussed in Section 5.5. The Stage 1 interview transcripts were also reviewed as part of this process.

With nine interviews completed, and the transcriptions analysed and coded, the axial coding process was repeated to allow development of the core categories. Section 5.6 discusses the core categories in greater detail.

With the core categories nearing saturation, the final three interviews were completed, with these respondents representing 11 public company boards. The new concept identified in this stage was discussed in the context of its relevant category, and is included in Section 5.7.

The other data collected to complete the triangulation process are reviewed in Section 5.8, with these data adding nothing other than supporting the previous findings. Participant observation was a secondary form of data collection, as were interviews with industry experts.

Selective coding of the data and the selection of the core category (Section 5.9) followed completion of the data analysis and reviews. This is the central phenomenon resulting from the axial coding process. The relationships between the central category and the sub-categories are reviewed, as are the relationships between the sub-categories.

Finally, with the analysis of the data completed, the development of the theory is outlined in Section 5.10, with a Grounded Theory proposed in Section 5.11.

5.2 Open coding of Stage 1 data

5.2.1 Initial concepts

The data analysis was discussed in detail in sections 4.7 (Data analysis) and 4.8 (Developing the Grounded Theory) using the diagrammatic representation of the Grounded Theory process described in Figure 4.3. The initial part of the analysis was the open and axial coding of the Stage 1 data, which involved the first four interviews.

The first step was the open coding of the interview transcripts, the foundation for the rest of the analysis (Seale, 2004). Open coding is used to open up the data so concepts can be identified (Morse & Richards, 2002). The data are sorted into many different initial codes as the data are reviewed line by line. The process continues with the codes subsequently organised into categories comprising similar concepts. The labels arise either from the data as provided by the interviewees (*in vivo* coding) or from the researcher's own experience (Hussey & Hussey, 1997).

Several properties or subcategories are discovered within each category as the researcher identifies patterns within the data, with these patterns outlined to show their extreme possibilities (Creswell, 1998). At the end of this process, each category should be saturated, as further information adds nothing new.

Many concepts are derived during this process. As the researcher recognises links between concepts, they are categorised by grouping together under a higher order concept. The grouping of concepts results in fewer categories, which are predictive and explanatory and thus easier for the researcher to analyse.

Forty-one initial concepts were identified through line-by-line analysis of the first four interview transcripts. This number was reduced to 35 as several were the same concept phrased differently by different respondents. Also, some were grouped together as the same concept was identified in relation to similar groups. For example, concept 15 was initially identified as four separate concepts through the line-by-line analysis, but for the purposes of this analysis is considered to be one concept. The identification and naming of the 35 concepts is detailed in Table 5.1.

The initial line-by-line analysis revealed over 100 descriptive comments, which either provided supporting evidence to the importance of the concepts then discussed by the respondents, or allowed the researcher to determine how the respondent approached the analysis of their role. One issue repeated by several respondents was the different expectations of roles when serving on the boards of different sized companies. This issue drove their responses to some questions. This theme has appeared in the literature review as well as the interview responses. Independent directors sometimes consider that their role is determined by the size of the company.

Table 5.1 Concepts identified in open coding of Stage 1 interviews

1)	Acting as a specialist consultant or advisor
2)	Providing specific knowledge and experience
3)	Providing specific skills and expertise
4)	Providing generalist or broad management skills
5)	Bringing a unique perspective to the position
6)	Adequacy of information
7)	Monitoring other board members
8)	Monitoring senior management
9)	Monitoring compliance and conformance
10)	Monitor separation between board and management
11)	Monitor performance against expectations
12)	Board and company performance
13)	Mentoring senior management
14)	Performance of the CEO and other senior management
15)	Understanding market, customers, suppliers and competitors
16)	Understanding industry issues
17)	Time constraints
18)	Understanding drivers of company performance
19)	Succession planning
20)	Selection of senior management
21)	Provide level of independence
22)	Effective board and senior management structure
23)	Policies and procedures
24)	Clear separation between board and management
25)	Represent shareholders
26)	Represent other stakeholders
27)	Represent moral and ethical leadership
28)	Accepting responsibility for others in the company
29)	Ambassador for company
30)	Interaction with customers and suppliers
31)	Sounding board for suppliers, customers and staff
32)	Understand relationships around board table
33)	Networking, facilitator on business development
34)	Understanding of others, judging people
35)	Ensuring that the board operates on consensus

5.2.2 Initial categories

The next stage in the open coding of the interview data was the grouping of similar concepts into provisional categories that reflect the different phenomena derived from the data. Identified categories are then developed in terms of specific properties and dimensions. By studying various properties in a category, patterns can be observed. Properties that do not completely fit a pattern, with some dimensions slightly off, can still be useful as long as the lack of fit is within certain limits (Strauss & Corbin, 1998).

Charmaz (2006) proposes that the categories account for the researcher's interpretation of the data, and that some concepts may fit into different categories. By analysing the discussion in which these concepts were raised, the researcher could decide into which category these concepts best fitted, but some respondents used the same terminology to describe either different concepts, or different aspects of the came concept. For example, the concept of 'separation between the board and management' falls into two different categories. One is the structure of establishing the separation, and the other is the monitoring of this separation.

This process resulted in the grouping of the 35 initial concepts into six provisional categories, presented in Table 5.2.

The six categories developed through the grouping of the 35 initial concepts were not pre-determined. This is merely a representation of the natural categories into which the concepts fell (Strauss, 1987). This number of categories was considered manageable in the context of the research, but it is also noted that additional interviews were to be conducted, and following the line-by-line analysis of those transcripts, new or additional concepts could be discovered and new categories could be developed.

Each of the provisional categories has been named with a label that best describes the image that the concepts convey. Again, these names were provisional and could change during the course of the research study. The six provisional categories are described in detail below.

Table 5.2 Grouping of initial concepts into provisional categories

Category 1: Personal Attributes
1) Acting as a specialist consultant or advisor 2) Providing specific knowledge and experience 3) Providing specific skills and expertise 4) Providing generalist or broad management skills 5) Bringing a unique perspective to the position
Category 2: Monitoring
1) Monitoring adequacy of information 2) Monitoring other board members 3) Monitoring senior management 4) Monitoring compliance and conformance 5) Monitoring separation between board and management 6) Monitoring performance against expectations
Category 3: Performance Enhancement
1) Enhancing board and company performance 2) Mentoring senior management 3) Enhancing performance of the CEO and other senior management 4) Understanding market, customers, suppliers and competitors 5) Understanding industry issues 6) Time constraints 7) Understanding drivers of company performance
Category 4: Structure
1) Succession planning 2) Selecting senior management 3) Providing level of independence 4) Providing effective board and senior management structure 5) Implementing policies and procedures 6) Providing clear separation between board and management
Category 5: Representative
1) Representing shareholders 2) Representing other stakeholders 3) Representing moral and ethical leadership 4) Accepting responsibility for others in the company 5) Acting as ambassador for company
Category 6: Relationships
1) Interacting with customers and suppliers 2) Being sounding board for suppliers, customers and staff 3) Understanding relationships around the board table 4) Networking and being facilitator on business development 5) Understanding others, judging people 6) Ensuring that the board operates on consensus

Category 1: Personal Attributes

One of the first themes discussed in each of the interviews was the reason that person was selected to join the board. Most board chairs try to create a balanced board. Each board member should have two main attributes: general business experience and specific skills or knowledge not held by any other board member. By getting the mix of directors right, the board chair can build a balanced board.

The concepts grouped into this category are listed in Table 5.2. Each concept represents a personal attribute that the individual has gained through their years of working. From the discussions in the interviews, the respondents consider that the independent directors should take the lead on discussions in their areas of expertise, and use their experience and other skills to provide useful input on other issues discussed in the boardroom. By being able to draw from their years of experience, each independent director acts as a consultant or advisor to the board.

Category 2: Monitoring

The information provided to the independent directors for their board meetings was raised by many of the respondents. Independent directors should be able to use their years of experience to determine whether the information is both sufficient and valid. By validity the respondents are looking at the quality of the information as well as being provided with the right kind of information. By definition, the independent directors see less information than the other directors. They therefore monitor the information, in addition to monitoring everything else that goes on in the boardroom. The concepts included in this category are listed in Table 5.2.

As the independent directors answer only to the board and the board chair, they have the ability to monitor all that goes on around the board table. They are not reliant on the CEO for their livelihood, and can therefore use their independence to monitor what is happening around them so they are satisfied that everyone else is performing correctly and to expectations.

Category 3: Performance Enhancement

The respondents spend a considerable amount of their time outside of the boardroom ensuring that they perform to the best of their abilities. This translates to improving the performance of the board, and therefore of the company. One aspect of this is improving their own performance by 'doing their homework' on the company and the issues that influence the company's performance. The other aspect is determining what they can personally do to improve the performance of others. Table 5.2 lists the concepts in this category.

Independent directors' ability to improve performance is affected by time, which impacts in a number of ways. The number of board positions and other responsibilities within and outside the company will determine how much time each independent director can allocate to each board position. Board requirements in smaller companies are less than in larger companies, but independent directors spend more time working with senior management in smaller companies.

Category 4: Structure

Working to ensure that the board and senior management are structured correctly is a large part of an independent director's role. Not only do they work towards having the right people in place, but they also make sure that the best structure is in place to make their contributions as efficient and as effective as possible. Table 5.2 lists the concepts grouped within the Structure category.

The line between the board and senior management must be defined, as the directors should not be running the company. Some respondents commented that ex-CEOs sometimes have a problem when changing from their position as CEO to that of an independent director, as these roles are substantially different. The directors are not responsible for setting policies and procedures within the company, but must make sure that the correct policies and procedures are in place.

Category 5: Representative

A director's fiduciary duty is to the company, but they are elected by the shareholders and represent the shareholders. Similarly, directors should also be representing the company's other stakeholders, as there is no other group that is in a position to do this. While this applies to all directors, it applies more so to the independent directors due to their independence. They are not beholden to the company for their livelihood and can therefore take a stronger position when representing others, if they consider it to be in the best interests of the company. The concepts in this category are listed in Table 5.2.

All employees and directors of a company should represent their company, but independent directors can highlight their contribution in doing this, as it is their choice to take a position on the board. They are also expected to be beyond reproach and should be acting in an ethical manner, looking only at the best interests of the company.

Category 6: Relationships

Independent directors bring an unbiased view and can be trusted by others both within and outside the company. They can form relationships with those outside the company to strengthen the relationships between those groups and the company. Other groups can discuss issues with the independent directors and expect that something will be done to correct any problems that may have been raised. The concepts in the Relationships category are listed in Table 5.2.

Independent directors' Contacts were a positive point that was raised in all the interviews. Some independent directors were appointed because of their contacts and networks and the potential benefit to the company. This may either bring new business to the company, or help to solve a problem that was affecting the company's performance in some way.

5.3 Axial coding of Stage 1 data

Axial coding moves the focus around a concept (Morse & Richards, 2002). It identifies the relationships between the open codes from which it develops core codes (Parker & Roffey, 1997). Axial coding involves restructuring and rebuilding the data into patterns to identify the links and relationships. Part of the process is developing the properties of the concepts and their categories with a view to linking them at the dimensional level (Hussey & Hussey, 1997).

The links can be presented in a coding paradigm or logic diagram (Creswell, 1998), whereby the researcher:

- identifies a central phenomenon
- explores causal conditions
- specifies strategies
- identifies the context and intervening conditions
- delineates the consequences for this phenomenon.

Flick (2002) sees the process as one of refinement. From the initial categories developed in open coding, those to be further elaborated are selected. These categories are then saturated with as much data as possible, the categories are compared and finally the relationships between these categories are identified and elaborated. The important aspect of axial coding is for the relationships between the categories to be clarified and established.

Strauss and Corbin (1990) developed new procedures for analysing data, including axial coding and the creation of a conditional matrix (Charmaz, 2000). They advocate the use of an organisational scheme to highlight the linkages among categories that can sort and organise the emerging categories. The scheme they use is called the paradigm. The components of the paradigm are conditions, actions/interactions and consequences, all of which relate to the emerging phenomenon (Strauss & Corbin, 1998).

The diagrammatic form of the paradigm, as detailed in the previous chapter, is repeated here as Figure 5.1.

Figure 5.1 Strauss and Corbin's conditions/actions/consequences coding paradigm

	Impacting Conditions What impacts on it? What affects it?	
Causal Conditions What causes it?	**PHENOMENA**	**Actions/Interactions** What results from the conditions?
	Consequences What are the results of the actions/interactions?	

By using the *conditions*, which is a description of answers to the questions why, where, how come and when, the responses can be grouped. Together they form the structure or set of circumstances or situations in which phenomena are entrenched. Conditions can either be causal or somehow affecting or impacting on the cause.

The *actions/interactions* are the result of the conditions, and can be summarised by responses to the questions by whom and how. The conditions will lead to issues, problems, happenings, occurrences or events.

The results of the actions/interactions are the *consequences*. These are represented by responses to the questions, what happens as a result of the actions/interactions, or the failure to act as a result of the actions/interactions.

Category 1: Personal Attributes

The general or broad management skills held by an independent director are considered to be important in grounding the abilities of the individual. Without these skills, individuals would be unable to further their careers and develop to a high level in their chosen specialisation or industry. Within the coding paradigm, these general or broad skills are seen as the causal condition underlying the personal attributes paradigm (Figure 5.2).

Higher development in the individual's chosen specialisation or industry results in greater knowledge and experience, and the development of specific skills and expertise in that area. Together, these attributes can differentiate the individual from others and make them a valued part of the board. Consequently, the individual can bring a unique perspective to their position on a board, and they are chosen to join that board because nobody else can provide those particular attributes.

Figure 5.2 Coding paradigm for Category 1: Personal Attributes

	Specific skills and expertise **Specific knowledge and experience** Impacting conditions	
Generalist or broad management skills Causal Condition	**PERSONAL ATTRIBUTES**	**Bringing a unique perspective to the position** Actions/Interactions
	Acting as a specialist consultant or advisor Consequences	

The unique perspective brought by each independent director assists the board chair to build a balanced board, whereby the combination of all independent directors contributes all the attributes needed to cover all issues that the company faces. The result of what the individuals bring to their board is that they act as a specialist consultant or advisor to the board, and sometimes to the company's senior management. In boardroom situations, they are expected to take the lead in discussions on their area of expertise, and are expected to use their knowledge and experience to contribute to all other discussions. In some cases, independent directors' different perspectives can lead to wider discussions and broader debate, resulting in a better outcome or solution.

Category 2: Monitoring

The independent directors are expected to monitor the other directors to ensure that they understand the issues discussed around the board table, and that they are contributing positively to board discussions. No director is expected to have all the skills and expertise inherent in the company, so each independent director should ensure that the other directors understand issues pertinent to their particular skill base when they are being discussed. The independent directors should also monitor senior management's capability at doing their jobs, and more importantly, to ensure against excesses or fraud by the CEO or senior management.

To achieve this, the independent directors must look closely at the information provided to them. The board chair usually sets the agenda for board meetings, and this will determine what information is provided to the directors. It is the independent directors' responsibility to ensure that the information is sufficient, correct and complete. The knowledge to determine this comes from experience.

The independent directors should also ensure that the board members are not running the business, as this is the role of the company's senior management. It is the directors' role to question senior management on budgets and strategies.

The consequences of these actions are that the independent directors are monitoring the performance of the board and of the company, against their expectations. It is not simply a matter of reviewing financial performance regarding budgets or forecasts, but also reviewing financial performance, other directors' contributions and senior management's running of the business (Figure 5.3).

Since the importance of corporate governance has increased over the past twenty or so years, boards are spending more time looking at compliance and conformance in their companies. It is the responsibility of senior management to establish the compliance and conformance requirements in the company, but the board now has the added responsibility of ensuring that this is being undertaken. Again, it is more the responsibility of the independent directors, as there have been instances in the past, such as FAI, whereby executive directors have shown poor compliance, which has resulted in disaster.

Figure 5.3 Coding paradigm for Category 2: Monitoring

	Adequacy of information Impacting conditions	
Monitoring other board members **Monitoring senior management** Causal Condition	**MONITORING**	**Monitoring separation between board and management** Actions/Interactions
	Monitoring performance against expectations **Monitoring compliance and conformance** Consequences	

Category 3: Performance Enhancement

To be able to add value to the board or the company, independent directors must understand the issues that affect the industry in which the company competes. These issues may be political, environmental, or historical and may be unique to this industry. They must also understand issues that directly affect the company, especially its market, customers, suppliers and competitors. These two causal conditions form the knowledge base from which the independent director can then understand how their skills and knowledge can benefit the company (Figure 5.4).

There will always be constraints on how much time an independent director can dedicate to each board. They are expected to prepare for board meetings by reviewing the board papers prior to the meetings, but each individual will have different amounts of time available to spend on the other issues concerning the company, such as the causal conditions identified in this category. Part of what they bring to the table is their ability to improve the performance of the CEO and other senior management, by providing the benefit of their knowledge and expertise.

Independent directors can mentor senior management. The executive directors cannot do this, as it would be considered as a usual boss/subordinate situation. Also, the independent directors aren't being seen as undermining the CEO's authority. To be able to contribute positively, the independent directors must understand what drives the company's performance. This may be unique to the company, possibly due to its market position, or may be common to all companies in the industry. But without this understanding, nothing that the independent directors bring to the board or the company may be of any value.

Figure 5.4 Coding paradigm for Category 3: Performance Enhancement

Performance of CEO and other senior management

Time constraints

Impacting conditions

Understanding market, customers, suppliers and competitors
Understanding industry issues
Causal Condition

PERFORMANCE ENHANCEMENT

Understanding drivers of company performance
Mentoring senior management
Actions/Interactions

Board and company performance
Consequences

Overall, the independent director's contribution should improve the performance of the board, and therefore of the company. This point was emphasised by all the respondents. They all had different ideas of what they do or what they may bring to each board position, but they all recognise that they should be adding value to both the board and the company.

Category 4: Structure

The clear separation of board and management is an important condition of good corporate governance. Without this, the trust and respect between the board and senior management may be below what is required. The board should not be running the company and it must provide senior management with the room and the support to do this.

The board, however, must be satisfied that the correct policies and procedures are in place to ensure the company complies with its legal requirements, and that the risks inherent in the business are carefully considered and mitigated where possible. It is a role of the independent directors to make sure this happens. The executive directors are also part of senior management, and should be involved in setting policies and procedures. This results in the independent directors having a significant contribution on the selection of senior management, ensuring that the best people are employed in the right positions, and making provisions for successors if any of the senior management need to be replaced (Figure 5.5).

Figure 5.5 Coding paradigm for Category 4: Structure

	Provide level of independence **Policies and procedures** Impacting conditions	
Clear separation between board and management Causal Condition	**STRUCTURE**	**Selection of senior management** **Succession planning** Actions/Interactions
	Effective board and senior management structure Consequences	

The consequence of this approach is having the right board and senior management structure. The more effective the board's structure, the better the board will be able to operate for the benefit of the company. Similarly, the more effective the senior management's structure, the better the company should perform.

Category 5: Representative

Directors are usually nominated by the board or one of its committees, and are elected to their positions by the shareholders. The shareholders would have several motives for electing certain directors, one of which is leadership. Unlike executive directors, independent directors are not employees of the company. The shareholders expect that the independent directors will provide a high level of moral leadership, and will behave ethically.

Shareholders expect that the independent directors will represent them in discussions in the boardroom. The company's other stakeholders hold the same position. No other group of people take this position on behalf of the shareholders and stakeholders, who can be expected to also provide direction and benefits to the company.

As the directors have a fiduciary duty to the company, they are expected to take responsibility for the actions of others in the company. The independent directors in particular should take this responsibility as their unique attributes should enable them to determine how others in the company are behaving.

Directors are considered to be senior representatives of the company. The independent directors are considered by many to be more beyond reproach than the executive directors, or even the company's senior management. They have nothing to gain by not acting in the best interests of the company, and some consider themselves as ambassadors for the company. They can represent the company in different situations and are expected to do only what is best for the company. Figure 5.6 summarises the coding paradigm for this category.

Figure 5.6 Coding paradigm for Category 5: Representative

	Representing shareholders **Representing other stakeholders** Impacting conditions	
Representing moral and ethical leadership Causal Condition	**REPRESENTATIVE**	**Accepting responsibility for others in the company** Actions/Interactions
	Ambassador for company Consequences	

Category 6: Relationships

The final phenomenon described is relationships. Several of the respondents commented that the company's major suppliers and customers found it beneficial to form a relationship with the independent directors. They feel that this raises their level of importance to the company and may have an impact on the strength of their future relationship. Similarly, the suppliers, customers and staff felt that being able to raise issues with the independent directors could make a difference to how these issues were handled.

Independent directors are in a unique situation. They have significant authority as a result of their position. Their ability to understand the relationships around the board table enables them to deliver what is expected of them. They are judged by those with whom they work, and must also have the ability to understand the company's customers and suppliers, and be able to judge them to determine their motivations.

All four of the respondents in the first stage of interviews commented that their network of contacts influenced their invitation to join their boards. This network can benefit the company by either solving issues that prevent the company operating at its peak, or being able to facilitate new business for the company.

Figure 5.7 Coding paradigm for Category 6: Relationships

	Understanding relationships around the board table **Understanding others and being able to judge people** Impacting conditions	
Interaction with customers and suppliers **Sounding board for customers, suppliers and staff** Causal Condition	**RELATIONSHIPS**	**Networking and facilitating business development** Actions/Interactions
	Ensuring that the board operates on consensus Consequences	

The relationships that the independent directors generate through their position, or bring with them can have a major impact on the overall benefits that they bring to the company. But they must use these relationships to build their relationships in the boardroom, to ensure that all of the board members are working in the same direction, and that all members are in agreement on each issue debated in the boardroom (Figure 5.7).

5.4 Open coding of Stage 2 data

Once the axial coding of the first stage of interviews had been concluded, the second stage of interviews was conducted. This involved asking the same interview questions of five additional respondents. In addition, more probing questions were asked, designed to more fully investigate the relevance of the six initial categories that had been established.

The results of these interviews confirmed the relevance of the six initial categories. Two other issues were also raised, and when the first stage interview transcripts were reviewed to identify the importance of these two new issues, the researcher noted some instances where these issues had been mentioned. These issues were:

- the critical importance of the right amount and content of information provided to the independent directors
- that the role of the independent director may vary depending on the size of the company, and its stage in it business cycle.

The reference to information in this context is that provided to the independent directors to enable them to fulfil their duties as company directors. All directors will have the same information provided to them for each board meeting. However, by nature of their positions, executive directors will always have more information that is specific to the company due to their full-time position. The non-executive directors that are not considered to be independent will also possess more information than the independent directors due to their particular relationship with the company. As one of the more experienced respondents put it:

> *"One can only be effective I think as an independent director if one gets sufficient information about the business and about the issues so one is dependent on transparency from management in the boardroom. And if management tends to hog information or feed one inadequate or incorrect information then it is very hard to do one's role."*

Several respondents commented that their level of involvement differed depending on the role relative to the size of the company or its stage in its business cycle. Specialised expertise is utilised more in smaller companies and in companies that have recently become listed on the stock exchange. One of the respondents is on the board of several smaller public companies, and being very experienced as a director, had expectations that his services would be utilised more in one of his companies that was to list on the stock exchange:

> *"My expectations of the role at (Company) Limited was to be able to be a bit more involved than you would have been in a large company because there*

needed to be some things set up as it was a brand new float and therefore there were issues of corporate governance that needed to be done…I'd get involved in reporting, even financial reporting and management reporting in a monthly basis…the directors would be heavily involved in setting up a lot of the systems that a public company needs."

When asked if his expectations were met, he answered positively:

> *"Pretty well met. And because they were all recent floats my expectation was that there would be a lot more commitment than just a day a month at a board meeting."*

These two issues of information and company position were highlighted in the commercial dimension of Chapter 3.

Independent directors need to ensure that the information they receive is complete and reliable. They should closely monitor senior management and the executive directors to ensure that this is the case. Independent directors should use their own skills and knowledge to appraise the thoroughness and accuracy of the information provided to them. They should be experienced enough to gauge if the company's management is filtering the information flow or concealing issues that should come to the attention of the board. On review of the initial codes, the 'adequacy of information' concept included in the Monitoring category was removed to a new category, Information.

Analysis of the role of the independent director in companies of different sizes and stages in their life cycle indicated differences in larger and more mature companies. In smaller companies independent directors are more likely to be selected for their specific knowledge and expertise, using this knowledge and experience to fill gaps in the company's management in those specific areas. This issue of company size and stage of its life cycle was termed Company Position and was included as the eighth category.

5.5 Refinement of initial categories

With the identification of Information and Company Position as two categories that should be included, the six initial categories were reviewed. This review occurred in two parts. First the initial concepts included in the initial categories were reviewed and any identified as having a better fit in the new categories were removed to the additional categories. Second, all categories were then reviewed for their continuing relevance with reference to the combined transcripts of stage 1 and stage 2 interviews. This second phase is discussed in the next section, which includes a review of all categories through a recurrence of the axial coding procedure, resulting in the development of the core categories.

This process underlines the iterative nature of grounded theory research whereby the researcher returns to the field to gather additional data then reviews the initial data already analysed (Charmaz, 2006). It also follows the practice of reviewing the data line by line as espoused by Morse and Richards (2002) to open up the data to allow all categories to be identified.

Table 5.3 identifies the two new categories of Information and Company Position.

Table 5.3 Grouping of revised concepts into core categories

Category 7: Information
1) General relative information
2) Information due to position
3) Reviewing, analysing and discussing provided information
4) Adequacy of information
5) Allotted time determines information required
6) Effectiveness determined by information provided
Category 8: Company Position
1) Compliance capabilities determined by staff numbers & experience
2) Size determines ability to attract best staff & directors
3) Use of independent directors outside boardroom
4) Stage in cycle determines time requirement of independent directors

Category 7: Information

In the initial phase of developing the categories, monitoring of the amount and validity of information was included in the second category, Monitoring. However, after analysing the Stage 2 interview transcripts and reviewing the Stage 1 transcripts, it became apparent that the category of Information was a wider and more important issue than first thought. The information provided to the independent directors has a direct impact on several aspects of their roles and therefore the adequacy of information concept was removed from the Monitoring category and included here. Table 5.3 lists the six concepts included in the Information category.

Respondents felt that the level of responsibility held should be partly determined by the information of which they are, or should be, aware. This information is determined by the particular position held by each individual director on each board. The board chair will hold more information than other directors, and the executive and non-executive directors will hold different information, but more than the independent directors. In addition, the contribution of the independent directors will be determined by the information that they have obtained from various sources.

Category 8: Company Position

The size of the company and its position in its life cycle will determine the number and experience of its staff and the ability of the company to compensate its staff and directors. Smaller companies have lower revenues and therefore employ fewer, less experienced staff. Companies at different stages of their life cycle have different requirements of their directors, especially during a time of change. The concepts included in the Company Position category are listed in Table 5.3.

Compliance and reporting requirements of public companies are increasing. Companies must have adequate staff numbers to allow them to take time away from their normal duties to comply with the compliance and reporting requirements. Several of the respondents commented that in their positions on smaller company boards, they regularly get involved in the compliance and reporting requirements, either in the form of helping to complete these requirements, or educating others on how to comply with these requirements.

Category 2 (revised): Monitoring

With the concept of monitoring the amount and validity of information provided to the independent directors removed, the Monitoring category now takes the form of monitoring others in the organisation and what they do. This could be seen to be taking the monitoring role to a higher level, as it is now concerned with the actions and behaviours of others and how this impacts on the performance of the board and of the company.

5.6 Axial coding and development of core categories

Following the development of the two new categories of Information and Company Position, and the amending of the Monitoring category, this section reviews all concepts in all categories to determine their continuing relevance.

In Section 4.6.4 the researcher discussed Parker and Roffey's sequence for a grounded theory study. The fifth key consideration in this sequence relates to the analysis of the data by the researcher, which may require reviewing some of the data or including new data to highlight the key relationships. During this review process, some concepts in the Representative and Relationships categories were found not to be ideally described or categorised. These amendments are included in sections 5.6.5 and 5.6.6, respectively.

5.6.1 Personal Attributes

All respondents recognised that they were invited to join their boards for two main reasons. First, they brought knowledge and experience to the board that no other independent director brought. Second, with each independent director bringing different knowledge and experience to the board, the board chair was able to build a balanced board whereby between all of the independent directors, all of the issues that the company faced were covered.

The respondents also recognised the importance of a balanced board, and each was aware of their expected role on their boards. Having a specialisation in one or two areas did not mean that they were expected to contribute to board discussions only on those particular topics. They accepted that they should lead the discussions on these topics, but also contribute on all other areas where they felt that they could add value. As one respondent commented:

> *"I think the chairman of (Company) Limited is trying to establish a balanced board and looking for people with particular expertise, expertise specific to their business or somehow related to the business in which the company operates."*

Respondents' particular skills included industry-specific skills or more general skills such as corporate governance and general business management experience. One respondent, for example, had considerable success in owning and operating a business before entering politics. He served in federal parliament for over a decade, spending a significant portion of this time in two ministries, and he served on a board for a number of years after leaving politics in the same industry as one of his ministries. While this board position was offered on the basis of the knowledge and expertise gained by this respondent during his time in serving as a federal minister, this experience helped the board chair to build a balanced board as he saw this experience as being either advantageous or a necessary requirement for that board:

> *"I think I was invited to join (Company) Limited on the basis of my knowledge and understanding of government issues, management and difficult politics."*

Working for a regulator provided another respondent with specific experience, and she was subsequently approached to join two different boards:

> *"I think people are looking for a range of different experiences from directors to contribute to boards and I have particular experience in having being at a regulator…"*

Another respondent has worked in companies in heavily regulated industries, which provided her with a cautious and conservative approach to business. These attributes were seen as being a necessary requirement for her being asked to join two of her four boards, due to the nature of the industries in which these companies operate.

Building new boards was a common experience for several of the respondents. In each of these cases, as the boards were being built from scratch by the board chairs, each director was specifically selected for their particular skills and expertise, to create a balanced board and so members of board sub-committees had the required knowledge and experience. One of the respondents joined the boards of two additional companies in preparation for their listing on the Australian Stock Exchange. This respondent has extensive experience as an executive finance director in two previous roles in large public companies, and brought that experience in addition to particular industry experience to these two new boards:

> *"I think that a good board brings a blend of experience and expertise but each (director) has to contribute in a full range. ……in all three cases they are small boards so I will clearly be seen to bring finance skills."*

The nature and structure of the company are significant factors that determine the skills and experiences board members need to possess. Two major companies based in Australia but with significant operations overseas have each taken on one of the respondents as an independent director as he has worked overseas for many years. Another company with more than half of its revenues being generated outside of Australia, mostly in one country with a foreign language, has taken on an independent director who has lived and worked overseas and is fluent in that foreign language. Having independent directors experienced in working with different systems and cultures is an important asset for a board.

Specific skills in the form of industry expertise of a new board member are part of the balanced board argument. Respondents did not consider this a sufficient reason to warrant an invitation to join a board; the capability to contribute in other areas was also viewed as necessary. General experience in managing companies, or previous board experience were an advantage for one respondent, who had worked in a number of different industries at senior levels. One respondent who has had a very broad professional career in academia and a variety of industries is now a professional director, with all of her board appointments supported by her having previously worked in the industries represented by the companies of which she is an independent director. As some of these companies operate in industries with few participants, her services as an independent director are in constant demand:

> *"In the case of (Company) Limited they were looking for someone who understood risk management and particularly in reference to that industry which I had prior experience of…in the case of (Company) Limited it was because I had an understanding of corporate governance…with (Company) Limited I was because I had industry experience…with (Company) Limited it was because of my background in financial services. So in each case I think there is a logical explanation where they thought I could add value."*

Overall, respondents were aware that the board chair wanted to ensure that all issues faced by the company were covered by the skills, expertise and experience of the independent directors. Each of the respondents was aware of what particular skill they were bringing to their boards. The board chairs, aiming to form balanced boards, were looking for independent directors who could fill specific committee positions, contribute to discussions in their area of expertise and add value to other discussions, complemented other board members' skills, or could contribute from a particular perspective, such as gender. In particular, they looked for specific skills and experiences including working overseas, having related industry experience, working for a regulator connected to the business or having expertise in corporate governance.

At this stage of the analysis, the category of Personal Attributes remained unchanged; the concepts are as listed in Table 5.2 (page 174) and the coding paradigm remains as depicted in Figure 5.2 (page 180).

5.6.2 Monitoring

This category was revised to exclude the monitoring of information and now related to monitoring others on the board and in the organisation, and the impact of their performance on that of the board and the organisation as a whole.

In reviewing the respondent's comments on this issue it became evident that while there was much agreement, there were also differences of opinion on their roles. Not all respondents agreed that they should monitor their fellow board members, considering this a role of the board chair. Monitoring senior management, including the CEO, was seen to be very important, as was monitoring the performance of the board and the company. One very experienced respondent sees his role this way:

> *"You start with the critical issue of monitoring the performance of the company…I actually think that performance of the board per se is important…you monitor the performance of the chief executive and his reports…"*

Many of the respondents did not see it as their responsibility to monitor other directors, again considering this as the board chair's responsibility. The above comment pertains to the performance of the other directors as some of the respondents do monitor their colleagues to make sure that they understand the issues discussed around the board table. Monitoring of the senior management is seen to be a role that most respondents thought was important but again the responses were influenced by the size and nature of the companies represented by the respondents.

One respondent saw the board as a whole taking responsibility for monitoring the performance of the company's directors and senior management as there is increasing focus on their performance and remuneration. He sees that these monitoring roles have become more important in recent years due to the increased focus on corporate governance. The formal system of monitoring through an external evaluation was viewed as boards increasingly trying to give the appearance of good corporate governance. They can be an expensive exercise and may not necessarily add any value. However, if conducted correctly, this respondent thought that directors would be more willing to talk openly about their fellow directors to an outsider than to the board chair or someone else related to the company.

Another respondent saw the monitoring of the company's performance as critical, with everything else flowing from there. He links the company's performance to that of the board and sees the monitoring of the communication flow between the company's management and the board as important and sensitive. But monitoring by directors of other directors is informal and therefore quite subtle. One respondent does this and looks for instances where directors are not comfortable with issues discussed at the board table. She feels that one of her duties is to improve the board's performance and by making sure that all directors understand the important issues, she is helping to achieve this. She sees the monitoring of senior management being more of a formal role but overall sees it as the board chair's responsibility to be aware of what is happening around the board table and to make sure that the chemistry between the board and the CEO, and between the CEO and management, is right. That being said, she also feels that as the independent directors bring different experiences to the board, the monitoring role should more likely rest on the independent directors than on the executive directors.

Again it appears that the role can be determined by the nature and size of the company and where the company is in its lifecycle. The respondent who is an independent director of the board of three smaller public listed companies sees the monitoring role of both the board and the senior management as essential, and a critical corporate governance issue, particularly when members of the board or the senior management are from the family that has recently floated the company on the stock exchange.

> *"I see the monitoring of the other members of the board and the senior management, that is essentially the role, very much so."*

Another respondent has difficulty with the fine distinction of being supportive and constructive with management while at the same time sitting in judgement of them and having some input into their remuneration. She wonders whether by making sure that management is performing to the best of their ability, it would lead to added value for the company's shareholders. If she has any issues with the other directors, the CEO or senior management, she would either discuss it with them or bring the board chair into the discussion. She sees the role of the independent director as collegiate, working closely with the other directors to reach the best result for the company and therefore the shareholders, so her role is not to judge or monitor the other directors. Similar to another respondent, if she does any monitoring of the other directors, it is only to see if any of them have problems with any issues raised by the board, and then she will try to work with them outside the board so she is satisfied that they are eventually comfortable with what has been discussed and decided. Again, this respondent considers it the responsibility of the independent directors to monitor what is happening at the board, rather than monitoring the other directors or senior management.

> *"Your role varies depending I guess on who you are. The core role is the oversight of the company's management and the operations and its direction, and to be honest that is 90% of the role…"*

Another respondent considers one of the board chair's roles is to monitor the directors. He does not see it as his role to monitor the other directors, nor to comment on their performance. However, he does see part of his role as monitoring the CEO and other members of management, to test the management to make sure that they are still heavily involved in the company and to make sure that they have thoroughly thought through what they are presenting to the board. One of the reasons for this is to make sure that the directors are comfortable with management and that the company is heading in the right direction.

The next respondent agrees that her role is to monitor the CEO and senior management but not the other directors. She sees this as an indirect effect but it is not the focus of her role. The focus is on the business and the management. Managing itself is how another respondent described the board, in that all directors should ensure that the board does what it is supposed to do, including from an administrative point of view. He sees the monitoring role as a corporate governance role, ensuring that all legal and other requirements are met:

> *"I would agree that monitoring the executives or particularly the managing director, not so much monitoring other board members, I suppose ultimately that is an indirect effect but I don't see that as a focus."*

Issues concerning the CEO are a major role undertaken by independent directors according to the next respondent. This includes appointing, monitoring, mentoring and making sure that the CEO is focused on the strategies for the business. He sees this as the directors' most important role, in addition to keeping his colleagues honest.

The amended concepts in this category, therefore, are:

- monitoring other board members

- monitoring senior management
- monitoring compliance and conformance
- monitoring separation between board and management
- monitoring performance against expectations.

Three main monitoring roles were identified from the responses to this question. The first is that it is the role of the board chair to monitor the performance of the directors. Second, some of the respondents see it as their role to monitor both the other directors and senior management, with other directors usually monitored to ensure they understand the issues discussed around the board table. Monitoring what happens in board meetings has become increasingly important due to the increasing focus on performance, remuneration and corporate governance. Finally, other respondents do not consider their role includes monitoring other directors, but only senior management. Several respondents commented that the independent directors should undertake any monitoring as they are removed from any day-to-day activities of the company. The size and nature of the company can influence the monitoring role undertaken by the independent directors, with the role undertaken in a smaller or recently listed company more likely to include monitoring of other directors.

With the removal of the adequacy of information concept, the new coding paradigm for Monitoring is shown in Figure 5.8.

Figure 5.8 Revised coding paradigm for Category 2: Monitoring

	Monitoring separation between board and management Impacting conditions	
Monitoring other board members **Monitoring senior management** Causal Condition	**MONITORING**	**Monitoring compliance and conformance** Actions/Interactions
	Monitoring performance against expectations Consequences	

5.6.3 Performance Enhancement

The skills, expertise and experience that a board collectively has through its directors should impact on how well the directors enhance the performance of the board. Each of the respondents considers that by bringing unique skills and expertise to a board, they will improve its performance. Each board is different, but how well it performs depends ultimately on how the board chair runs the board and how he gets the best out of the independent directors. The role of the board chair in this situation is critical to the level of contribution that the independent directors make.

Most of the respondents confirmed that their boards have a formal 360° review process. This component is seen to be where the monitoring role links with the role of improving board performance, as each board member has the opportunity to comment on the performance of all the other board members, and this cannot be done constructively unless each board member has been monitoring the others. The independent directors have a more important role in this regard as they are not full-time employees, unlike the executive directors, nor do they have a close relationship, as do the non-executive directors. As one respondent commented, *"the independent directors are not beholden* *to the other board members for their livelihood so they can afford to be more open and critical in their comments".* They are there to represent the shareholders and should ensure that the board is performing as well as possible. Another respondent could not separate the two issues of monitoring and performance enhancement. He sees it as being all about performance and is constantly monitoring all board members to make sure that they are contributing, and that their contributions are positive and productive, thereby improving board performance.

Several respondents linked monitoring and performance:

> *"You start with the critical issue of monitoring the performance of the company…I actually think that performance of the board per se is important…you monitor the performance of the chief executive and his reports…"*

This quote was used in the previous section as evidence of the monitoring function and strongly supports the close relationship between monitoring and performance. In a setting such as a boardroom, the board members can only monitor how others perform to judge their performance; there are no formal written methods for this, other than possibly an annual performance evaluation, so active ongoing monitoring of all areas is critical for measuring performance.

The next respondent saw independent directors' special skills as a primary way of improving board performance. In his view, boards these days are trying to develop a range of specialist skills among their directors and he sees more specialist directors being appointed. Previously, he saw generalists, one lawyer and one accountant being appointed. In his opinion the change has been quite noticeable, and has been positive.

In the words of another respondent, the aim of appointing different independent directors with different skills and experience is to ensure that the board members work well together as a whole, rather than as individuals:

> *"I think that the board has to complement each other, some boards don't work because the members don't complement each other. And to know whether you're complementing each other you've got to study how each of*

you interact and I do think it is the role of the independent director to observe how that's going…"

He sees it as the independent directors' role to monitor the board members, observing how they are working together and making suggestions to the board chair if it is not working properly, such as if someone is not contributing or because the skills are skewed. He suggests that all board members have a responsibility to observe this, otherwise there is the danger of the board under-performing.

One respondent sees the interaction around the board table as critical to improving board performance, through the observations and comments from the independent directors that follow from their experiences. He considers that, while most directors contribute to most discussions, it is a domino effect in that independent directors' contributions motivate other directors to contribute.

Improving board performance is seen as a collective role, best achieved if all board members contribute positively in all discussions, particularly where they have the skills and experience. Improving the performance of the company and not just the board is how another respondent sees her role. She considers that the independent directors, in particular, have a duty to be focused on management so they can help improve the way the business is run by the management:

"I don't think it's the overall performance of the board, it's the overall performance of the company…one has to be focused on the business so as to help improve the way the business is run by management, and that's a difference between management and independent directors."

She notes that management has greater information on the business and that the independent directors are not expected to achieve the same level of detail. She believes that the independent directors are running the business in the interests of the shareholders and other stakeholders and should be monitoring the health of the organisation through profit, revenues, cost control, people and culture, which are the topics that keep the management focused on the issues that the directors believe matter to the business.

The next respondent sees his role as being responsible for the stakeholders' view of the company's performance. He bases this on the presumption that it is the board that tends to be in the firing line if the company is in trouble. The CEO may be fired but ultimately performance is the board's responsibility. Again, he sees the complementary skills of the board as the driver of performance, both short-term and long-term, with the balanced board being the basis. He sees one of the benefits of the balanced board is that all issues that the company faces will be understood by at least one of the directors. It would therefore be difficult for management to pull the wool over the directors' eyes on any subject, thereby ensuring that management is performing to its expectations.

Decision making by consensus is seen to be an important issue, with several of the respondents commenting that they want to avoid any decisions going to a vote. This can be seen to divide the board and have a negative impact on performance, as the different board members are not able to agree on certain issues. Rigorous debate can be very productive and usually results in good decisions, which can only be achieved if all directors contribute to the discussion.

Several of the respondents focused on the link between monitoring and performance. They monitor the other directors and senior management to ensure all are contributing and performing, thereby improving the company's performance. The independent directors are representing the shareholders and therefore should ensure that the board is performing as well as possible. The board members act together as a team to enhance board performance and the independent directors are there to contribute specifically in their areas of skill and experience. The independent directors can also enhance board performance in other ways. They bring different views on other issues and ask difficult questions of the CEO and other executive directors. They also continually question the senior management to make sure that they are performing to the best of their abilities. One of the respondents observed that each board would operate differently due to differences in the activities and size of the company, and the skills and personalities of the board members.

The concepts in this category remain as listed in Table 5.2 (page 174), and the coding paradigm for Performance Enhancement, therefore, remains as depicted in Figure 5.4 (page 183).

5.6.4 Structure

An important role undertaken by independent directors is the structuring of the board and senior management. But more important is the involvement of the board, and specifically the independent directors, on some major issues faced by the company. It is not the role of the board to establish the internal structures, policies and procedures of an organisation, but the board must make sure these are in place and review them to ensure integrity and compliance with legal and moral requirements. The establishment of policies and procedures are the responsibility of senior management through delegated responsibility from the board of directors[80].

Public companies tend to identify and review potential candidates for board and senior management positions through the (remuneration and) nominations committee. Best practice recommends that majority membership of this committee are independent directors, and that the committee chair is an independent director[81]. Ensuring that the board is well structured is usually the board chair's responsibility, under the guidance of the nominations committee. All respondents believed they were asked to join their board because they brought specific skills, knowledge or experience to the board, and that a well-structured board would help to improve the performance of the company:

> *"I think the chairman of the public company is trying to establish a balanced board and looking for people with particular expertise, expertise specific to their business or somehow related to the business in which the company operates."*

It became obvious during the interviews that one class of independent directors could have problems in their role. A number of recently retired chief executives have become independent directors as they have much to contribute, but some have found it difficult to separate themselves from running the business:

> *"There is an increasing desire, certainly in the top 100 companies, to have a number of former CEOs on the board. As I say, that's one of those things that can work both ways and sometimes these people can make*

[80] Corporations Act 2001. ss. 198A, 198D.
[81] ASX Corporate Governance Council Principles of Good Corporate Governance and Best Practice Recommendations. Recommendation 2.4.

extraordinary contributions and other times they have difficulty keeping their hands out of the knitting."

Their new role as an independent director requires them to take a step back from a management role, and not get involved in the day-to-day running of the company:

"I think that as an independent director you are not management. That may sometimes be a little hard when you become an independent director, you can't actually tell people what to do so it is a matter of sometimes suggesting and cajoling and whatever, and I think independent directors realise where basically the roles of management finish and where their roles commence."

"Most of the boards I'm on it's not an issue but that doesn't mean that you can clearly articulate where the board is between the role of executives and independent directors. There is a degree of ambiguity and to some extent a bit of tension between what the roles are, you know what's your job, are you the guide dog or the pilot in that analogy. So are you leading the charge and telling them where to take the business or sitting back and simply watching events unfold."

There were conflicting comments from the respondents on the level of independence held by independent directors. One respondent became involved in an issue at the request of the chairman as *"he needed someone who was a bit independent from the debate"*. This involved the removal of an executive director. Other respondents discussed the involvement in the company by independent directors. This, however, related only to smaller companies in one respondent's experience, where the expertise of the independent director was required as the company had limited resources.

Independent directors are always closely involved in the company's undertakings due to their position on the board, and this role can take on several different aspects:

"I really think it's a sort of multifaceted role…these people sitting around the board table are almost like consultants to the company…They've got the task of hiring and firing the CEO, a very crucial task. I think succession planning is becoming more and more important."

The requirement to structure the board and senior management is only part of the issue. The board is responsible for the performance of the CEO and senior management, and while reviewing performance is part of the task, planning for the future or for unforseen events is also critical. Succession plans are expected to be in place for independent directors, the CEO and all senior management positions, and the independent directors expect themselves to be involved in this:

> *"I would like to think that independent directors would increasingly be looking at the business side of the company, the strategy going forward, ensuring that the right people are in place to help run the company, and to ensure that succession planning with regards to senior management is in place."*

Another respondent discussed succession planning and its importance in one of the companies of which he is an independent director. This company has listed only in the past few years, and has several positions in senior management occupied by family members. The board wants to broaden the expertise of senior management by gradually bringing in outsiders and is actively undertaking succession planning to achieve this strategy.

The potential legal liabilities that directors can face are considerable, and the independent directors in particular should ensure that the proper policies and procedures are in place:

> *"...the legal obligations as the directors must be seen to be, and in fact done all they can do realistically and reasonably do in terms of making inquiries and having management ensure that these are the processes that are properly documented."*

The independent directors have more self-interest and therefore responsibility in this issue as they are more removed from the company than the other directors. The process of checking proper documentation of policies and procedures is through management reporting and the internal audit process, the latter of which should be controlled by the independent directors.

If a board is poorly structured, it lead not only to underperformance but also to larger problems. If a board becomes dysfunctional due to issues with a director, it is often an independent director that gets the job of somehow removing that director. These issues can take several forms, including conflicting personalities, failure to contribute, previously undiscovered conflicts, etc., and a level of independence is sometimes called for to help resolve the situation.

A board has to be well structured to work positively and perform well. Similarly, the company's senior management must be well structured, but all parties must understand the line between the board and management, and act accordingly. While the board puts much trust in senior management, it must also be satisfied that senior management is acting properly, and the board puts its own policies and procedures in place to satisfy itself that management is doing what is expected of it. The independent directors are expected to use their experience to satisfy themselves that management is acting properly.

The concepts in the Structure category remain as listed in Table 5.2 (page 174), and the coding paradigm for Structure remains unchanged, as depicted in Figure 5.5 (page 184).

5.6.5 Representative

The respondents' comments indicate that acting as a representative is a less important but still necessary role of independent directors. Stakeholders outside the confines of the board and the company look to the independent directors to be impartial on any number of issues. The term 'stakeholders' covers a range of interested parties, the most important in the eyes of the independent directors being the shareholders:

> *"There have been occasions where I have sat on boards where I have felt that the decisions of management haven't necessarily represented the best interests of shareholders and I've said so."*

One respondent with significant legal and regulatory experience considered the legal technicalities when responding to the interview questions:

> *"At the end of the day the directors duties require that they act in the interests of the company as a whole, so that overrides and overshadows a representative role that any director may have from a legal perspective and I think that even with the Shareholders Association in particular I think directors do represent shareholders. I mean, that's their job, to look after the shareholders."*

These two quotes raise an issue of conflict of interests. The respondents recognise that a director's duty is to the company, but their actions recognise that they are there to represent the shareholders. There were numerous references made by the respondents to the lack of understanding by outsiders of what actually takes place in the boardroom. Part of this is the lack of understanding of the role of the independent director, particularly by shareholders.

The commonly held view is that the independent directors are there to represent the shareholders and look after their interests. One respondent noted that independent directors are appointed by their fellow directors, but owe their livelihood to the shareholders: *"directors are representatives of the shareholders, they are appointed by the other directors, but they are voted in or out by shareholders"*. And in certain circumstances the independent directors take a greater role than the other directors:

> *"To me the independent directors essentially look after the interests of the shareholders, particularly the other shareholders when there is a major shareholder."*

> *"When you make the decision to restructure, that's the easy part. The hard part is actually making it happen, getting it done right for your shareholders."*

While the shareholders are considered to be the most important stakeholders, the respondents recognised the existence of other stakeholders including employees, suppliers, customers, regulators and industry bodies. However, on closer review, the discussions involving the other stakeholders did not relate to the independent directors being just a representative of these other stakeholders. This closer analysis revealed the existence of a strong relationship between the independent directors and stakeholders, other than the shareholders. On recognising this, the concepts making up the

Representative category were amended with the concept of representing the stakeholders removed from this category. The concept of the relationship between the independent directors and the stakeholders was already included in the Relationship category, and will be discussed in section 5.6.6.

The reputation of the company and the independent directors can be damaged should the independent directors act improperly. One's reputation is critically important and the respondents were very aware of how they conducted themselves so as not to damage their reputation, or that of the company:

> *"But you're there and I guess this sounds a bit old-fashioned, but it's to provide a high level of moral leadership as you would want the company's reputation to be enhanced. Conversely you don't want your own reputation to be damaged…If you keep the company operating honestly and making profits, because the worst of all companies is the one that goes under, and everybody gets hurt in that. Suppliers, shareholders and employees, everybody, so keeping your focus on running the company honestly and ethically…"*

This ties in with one of the other concepts in this category. All directors are expected to take a common ground as representatives of a company. To be comfortable in doing this, each director should be able to trust and respect the other directors, and trust senior management. While the executive and non-executive directors are privy to more information than the independent directors, the independent directors are expected to keep abreast of events. The independent directors must always assume that others are acting honestly, unless they have knowledge to the contrary:

> *"But in some ways it can be unfair…to expect them to be totally responsible for the actions of some executives when those executives have been less than honest with the board."*

The independent directors can act based only upon the information they have, and the expectation that those around them are acting honestly. As one respondent put it, *"It's almost like being a bit of an ambassador sometimes for the board…"'*

The amended concepts in this category are:

- represent shareholders
- represent moral and ethical leadership
- accept responsibility for others in the company
- act as ambassador for the company.

If an individual is employed by an organisation, they are a representative of that organisation. The higher the individual's position, the more visible a representative they are. Independent directors hold a unique position in public companies. They are not considered to be full-time employees but those outside the company view them as having power and authority, with the ability to make sure nothing goes wrong in the company. The shareholders in particular look to the independent directors as their representatives, to protect their investments and to make sure the decisions made in the boardroom are in the best interests of the shareholders.

The revised coding paradigm for Representative is shown in Figure 5.9.

Figure 5.9 Revised coding paradigm for Category 5: Representative

	Representing shareholders Impacting conditions	
Representing moral and ethical leadership Causal Condition	**REPRESENTATIVE**	**Accepting responsibility for others in the company** Actions/Interactions
	Ambassador for company Consequences	

5.6.6 Relationships

Strong relationships help to form a bond of trust and respect between the parties in the relationship. For the directors to perform to the best of their abilities, the relationships they form with those around them are vital. The board as a whole needs to act in unison even if the individual directors have differing points of view: *"You could have an environment where the chairman encourages people to say whatever they have on their mind, that's really what you want to happen, constructive debate".* These relationships go beyond the boardroom. In the previous section the relationship between the independent directors and stakeholders was highlighted. In addition to shareholders, stakeholders look to the independent directors as a trustworthy link between themselves and the board. By strengthening their relationships with the independent directors, stakeholders consider their relationship with the company also strengthened.

In the initial grouping of the concepts in this category as detailed in Section 5.2.1, two concepts involved stakeholders: i) interaction with customers and suppliers, and ii) sounding board for suppliers, customers and staff. After further analysis, these two concepts were combined into one new concept, interaction with stakeholders. The main stakeholders under this concept are customers, suppliers and staff, the last group including senior management:

> *"…but outside of the chairman the average director interacts sometimes with customers and the staff."*

Stakeholders who have issues with the company need someone they see as being in a position of authority but somewhat removed from the company to help them. They see the independent directors in this position as they are not full-time employees of the company, but do have some influence over what happens:

> *"And I also think that role that you have to handle with great discretion, but the board needs another sounding board for disgruntled suppliers or disgruntled staff and you have to play that role very, very carefully."*

The relationship with senior management, including the CEO, goes to building trust and showing senior management that the independent directors are not trying to tell them how to do their job but are giving them the benefit of their experience. The independent directors expect loyalty and honesty in return, especially regarding the validity of the information provided to them. Through these relationships, the independent directors can also build an informal relationship whereby they can get additional information:

> *"And working with senior management, I think that's very important because sometimes you know the board, the chairman, the CEO, and the formal relationships they have. But sometimes it's informal."*

> *"And so as much or more of my time is spent talking to him (the CFO) about issues but I also am finding that the MD there is not only looking for my contribution in sorting out finance issues,………, but more than that he also likes the opportunities……to just sit and talk about the business generally."*

> *"But what I'll do is go have lunch with the members of the senior management team…. I see a lot of the folk around and there is a very regular dialogue here."*

One of the female respondents who had discussed her relevance on the board in relation to a female's view on issues faced by the board recognised the importance of the company's suppliers. She had met with all of the company's major suppliers over the previous 18 months as she thought it useful that the supplier had another contact point in addition to that through the normal course of business.

There were several other responses supporting the importance of the informal relationship between independent directors and senior management. Occasions where this occurred were at dinners, committee meetings, or one-on-one meetings. The importance of these relationships was validated by the respondents in many of their responses.

While the relationships between the independent directors and stakeholders were informal in many cases, relationships around the board table were both formal and informal. The board relationships are based on trust and respect. All board members should be able to contribute to any issue discussed around the board table. Several respondents discussed the collegiate nature of the board, suggesting that vigorous debate is good, but noted that total agreement should be reached on all issues. There was always a firm reluctance to allow anything to go to a vote at board level, as this would indicate a split in the board which may lead to a breakdown in communication and trust. This would only be detrimental to the performance of the board and of the company.

In analysing these issues, the two concepts of i) understanding relationships around the board table, and ii) ensuring that the board operates on consensus, were very closely linked, and should be considered as one concept. They are replaced by the concept of relationship building and consensus in the boardroom:

> *"…and obviously you should never be frightened to speak up and ask questions. But…the boards I've sat on…have always worked on consensus. And so you quite often have strong disagreements between members on issues but eventually you work out a consensus position so that you don't have to put things to a vote. I think that could be quite destructive."*

> *"So things never go to a vote because it gets dealt with in other ways because what you don't want to do is break the sense of collegiality around the board table but that collegiality is always done within the framework of everyone knows that at the end of the day you've got the ability to move the other way if it's required."*

One respondent discussed her experience when asked to join a new board that was being formed due to a spin off from an existing public company. Her main concern was to understand the relationships around the board table, learning about her colleagues and their expectations, their views on the company and how they could work together to create an effective board. Another respondent in a similar situation had the same opinion – developing good relationships with the other independent directors was very important. This was a recently listed company that was previously family owned, and the executive directors were all family members.

Independent directors have other relationships outside the boardroom that exclude the stakeholders. They bring a network of contacts to their position and are expected to use these contacts for the benefit of the company, if required. There is a fine line between being too involved on the commercial side of the business and creating an opportunity for the company:

> *"I've done it this week with one of my boards in introducing our CEO to the CEO of another company with which I am associated and where the two companies can in fact do business. And I see that as a facilitating role."*

This was a common view of why many of the respondents felt they were invited to join their boards. In addition to what they knew, it was also because of whom they knew, and how these relationships could be beneficial for the company.

Another factor that was recognised as being important in forming strong relationships based on trust and respect was the ability to judge people:

> *"I think the other issue is that you build up a real deep understanding of people issues in terms of your ability to judge people, you also learn the importance of getting structure and people right and its just an experience thing."*

One of the more experienced respondents brought people issues into many of his responses, and ended his responses with the following comment: *"In the end, as in all these things, you're relying on the goodwill and honesty of the people involved"*.

The revised concepts in this category are:

- interaction with stakeholders
- relationship building and consensus in the boardroom
- networking, facilitating on business development
- understanding others, judging people.

In this closer review, it became apparent that strong relationships are a major driver of how effectively the independent directors can perform. They go to great lengths to build strong relationships both inside and outside the boardroom. Their intent is to contribute as much as possible relative to what each personally brings to the position, in an effort to improve the board's performance, and that of the company.

The revised coding paradigm for Relationships is shown in Figure 5.10.

Figure 5.10 Revised coding paradigm for Category 6: Relationships

	Understanding others and being able to judge people Impacting conditions	
Interaction with stakeholders Causal Condition	**RELATIONSHIPS**	**Networking and facilitating business development** Actions/Interactions
	Relationship building and consensus in the boardroom Consequences	

5.6.7 Information

Having the right information is critical to the performance of an independent director. Without adequate or valid information, no independent director would be able to contribute to the best of their ability. Independent directors are unique in relation to the information that they may have in their possession. This information can come from many sources, such as the public domain, or the board papers. But sometimes an independent director may recognise that information is incorrect or incomplete. This is where the informal relationships that the independent director has established within the company can assist. Through this relationship, the independent director can either corroborate the information, or seek additional information.

Sources from which information is generally available include the press, the company's website, and documents prepared by the company such as annual reports. Independent directors are expected to have a good knowledge and understanding of this publicly available information. Other company-specific information that is not generally available will be provided to board members, but those having different board positions will have access to different information:

> *"…it kind of goes to the basis of what you know, what you were aware of and what you should have been aware of and probably someone who is the*

chairman of the board or of a committee may well be or should be more aware of things than somebody who is not…And on OneTel it appears that the chairman did know much more than the independent directors who were not told."

"Well, you're certainly not privy to all the information that the chief executive gets or the CFO, who are generally the only executive directors on the board. If you have the experience that most good directors have you tend to know the warning signs so you hopefully ask the questions."

In addition to being provided with information, the independent directors must make best use of it. While this can take considerable time, their experience should enable them to identify what information is important, what doesn't seem to be correct, and where the gaps may be:

"Well I thought my role was going to be…receiving a lot of material and analysing and discussing and questioning and I think that is certainly one of the major elements."

The content of information provided to the independent directors can be a sensitive topic. It should be enough for them to contribute as they would like or as is expected of them, but they should receive less information than management so their role does not become blurred:

"I suspect that there will be a push back sensibly in the theory to say if we want our independent directors to stay out of the management pool and genuinely be providing that oversight then we have to be realistic about the level of detailed knowledge they are supposed to have."

"Well I think the expectations were just as much as it sort of played out. That one would be asked on a regular but infrequent basis, I suppose, be presented with information and in some fashion have to understand and get to understand and learn about the business and then be able to contribute on a regular basis, more so in some areas than others, back to management and help them steer the organisation and deal with issues that I suppose

> *management feel are the major ones that need input from a group of outsiders."*

Several respondents discussed the connection between the expected contributions of independent directors, the amount of information provided to them, and the amount of time they spend at the company. The line between independent directors acting as directors or acting as management can sometimes be very fine, and all involved are expected to respect this line. The use of information is one way that can be used to ensure this line is not crossed. The other is to ensure that independent directors are not spending too much time at the company, unless there is an event that requires them to be there, such as an acquisition or similar.

> *"But you can't get involved in the day-to-day nitty-gritty of the company. I mean, that's not the role, it's not what you're paid to do, it could quite often be resented. There is a fine line but there are other times when the expertise of directors is sorely needed and particularly if you are doing an acquisition or a merger, then you could get involved."*

> *"I don't sort of work or have any other involvement, no day-to-day involvement. I think occasionally it is justified but it's really good if you can avoid it, it complicates your distance from it all…because it's very limited now as to when you can cross over that line and really do anything else for a company."*

> *"I think one has to be focused in on the business so as to help improve the way that business is run by management and that's the difference between management and independent directors, and of course you're not there full time and you can't get the same level of detail."*

If independent directors were provided with the same information as management they would be expected to contribute as much as management. But that is not their role. They are there to use their experience and knowledge to help management run the company better.

The fine line between independent directors is further blurred by what information management provides to the independent directors. Their effectiveness is relative to that information:

> *"One can only be effective I think as a non-executive director if one gets sufficient information about the business and about the issues so one is dependent on transparency from management in the boardroom. And if management tends to hog information, or feed one inadequate or incorrect information then it is very hard to do one's role. The independent non-executive director is very dependent on the relationship with management and the trust that exists."*

There must be a high level of trust and respect between the company's management and the independent directors. The independent directors cannot be effective unless they are provided with the right amount of information. But if they have too much information, they might become too involved in the business, and their role could become confused with management's role. To guard their position, management may provide incorrect or inadequate information to the independent directors, but there should be enough experience between the independent directors for them to recognise if this information is inadequate or incorrect.

It is in their interests for the independent directors not to become too involved in the company's day-to-day business. Besides the time this could take up, they are not compensated for this additional work, and their independence would become compromised.

Each independent director should be responsible for the information they use in undertaking their role. They can source the publicly available information themselves, should take time to research the company's industry, and should review the information provided to them through the formal company channels with a degree of scepticism. On this final point, they should then use their experience and their informal relationships in the company to determine the relevance and accuracy of the information provided to them.

The concepts in this category are as listed in Table 5.3 (page 190), and the coding paradigm for Information is given in Figure 5.11.

Figure 5.11 Coding paradigm for Category 7: Information

	Allotted time determines information provided **Adequacy of information** Impacting conditions	
General relative information **Information due to position** Causal Condition	**INFORMATION**	**Reviewing, analysing & discussing provided information** Actions/Interactions
	Effectiveness determined by information provided Consequences	

5.6.8 Company Position

In the respondents' comments during the interviews, there were a number of references to their performing different roles due to the size of the company or where the company was positioned in its life cycle. This second point refers to the company being mature or immature, recently listed on the stock exchange or in a period of change such as a restructure, acquisition, merger, etc.

In discussing his earlier experiences as an independent director, one respondent reflected on his roles on two of his earliest board positions. Both of the companies were small, and one couldn't afford to pay director's fees in cash, so they paid in share options instead. This being the case, they could attract only inexperienced independent directors, but who still had good experience in other areas of business, or good connections through their previous positions:

> *"…the role of the director of those smaller companies…And you can see that because I know these two companies that I sat on the board of in the past, and they were both start-ups they said when I went on the board, you know, we can't afford to pay you in dollars so we'll pay you in options…And they were calling on me all the time."*

Similarly, the smaller companies could only attract less experienced staff. This had an impact on their ability to fulfil their compliance and reporting requirements. As these requirements are mandatory, they often used the experience and expertise of the independent directors to assist with these tasks:

> *"But large companies have less difficulty dealing with these new requirements than smaller companies. They've got the company secretary, the CFO, they've got sufficient resources to pay for lawyers and accountants. When you get down to company that's only got a market cap of $10 or $20 million, I think it becomes very onerous. And you can ditto say the role of the independent director in those smaller companies…they relied on their directors a lot more than just giving strategic advice and turning up to board meetings."*

Another respondent had the experience after joining the board of a company that was in the process of listing on the stock market:

> *"…to be a bit more involved than you would have been in a large company because there needed to be some things set up as it was a brand new float and therefore there were issues of corporate governance that needed to be done. I'd even get involved in reporting, even financial reporting and management reporting on a monthly basis."*

The additional time that independent directors are expected to commit is shown by the experiences already quoted in this section. The respondent commenting on his input as the company was a new float later spoke about the demands on his time, *"and because they were all recent floats my expectation was that there would be a lot more commitment than just a day a month at a board meeting and a quick read of the folder the night before, and that expectation has certainly been borne out".* This time commitment outside of the boardroom refers to the additional use of the independent directors' knowledge and experience by the company.

Another respondent on the board of a newly listed company related the board's use of the *"guy with the finance skills to help the finance guy do a few things",* one of which was to negotiate with the external auditors to get a better deal. He also discusses another experience where the company was going through a period of change and had some legal issues with one of their new projects. He and another of the independent directors were asked for their expert input on the issue, including going to the project for a full review, and then reporting back to the rest of the board. His concern with roles such as these is ensuring that their independence remains clear and that their objectivity doesn't get blurred.

Another of the respondents, who considers himself to be a professional director, regularly spends time in the finance department of one of the companies of which he is an independent director. This is a small company that had recently listed, and in addition to the CEO using him as a sounding board, this independent director spent considerable additional time in the finance department:

> *"I've been drawn into some of the finance issues…the MD there is not only looking for my contribution in sorting out finance issues, for example I spent time up there today just burying myself in the finance department."*

He experiences this in all three of the companies of which he is an independent director. They are all small and recently listed, and *"haven't got the resources to do some of the things that a big company can do, so I have to get a bit more involved"*. However, he is conscious about how involved he gets, not to take a spearhead role, but to provide assistance and guidance and giving them the benefit of his experience.

The position of a company can have a significant impact on the roles the independent directors take, whether the company is small, recently listed, or going through a restructure or other form of change. In these instances, the independent directors are expected to provide more of their expertise and experience to benefit the company. But, as several of the respondents highlighted, they must be very careful where their contribution fits. They must make sure that they are not leading, but are merely acting as highly qualified advisors.

The concepts in this category remain as listed in Table 5.3 (page 190), and the coding paradigm for Company Position is given in Figure 5.12.

Figure 5.12 Coding paradigm for Category 8: Company Position

	Compliance capabilities determined by staff numbers & expertise Impacting conditions	
Size determines ability to attract best staff & directors Causal Condition	**COMPANY POSITION**	**Stage in cycle determines time requirement of independent directors** Actions/Interactions
	Use of independent directors outside boardroom Consequences	

5.7 Stage 3 data collection

A third stage of interviews was then undertaken to ensure that the rigour and thoroughness requirements established through the Methodology structure as detailed in Section 4.8 were met. These were:

1. to ensure that no additional interviews were required when the researcher reached the stage when no new information was discovered through the final stage of the interview process

2. to ensure saturation of the core categories.

Once the transcripts of the final three interviews had been reviewed and the coding had been completed, the concepts were compared with those included in the eight categories that were discussed in sections 5.6.1–5.6.8.

It was expected that few, if any, new concepts would come out of the final three interviews as the last two interviews of the second stage provided few new concepts. The first of these three interviews revealed one new concept, with additional instances of this new concept appearing in the final two interviews. Otherwise, no other new concepts were identified, but many examples of existing concepts were evident, further adding to the rigour of the process.

To determine the importance of the new concept, the first nine interview transcripts were again reviewed to identify any instances where this concept appeared. The tenth respondent discussed his emotional detachment to the companies on which he is an independent director, and his motivation for accepting appointments as an independent director. This respondent is on three boards, with the companies operating in different industries and varying significantly in size, nature and complexity.

During the open coding of the last two interview transcripts, and then reviewing the first nine transcripts, this concept was found to have been raised in many of the interviews. As the concept appeared in different discussion points in the various interviews, it was not initially easily identifiable. But when the concept and the associated discussion had been defined and analysed through its appearance in the tenth transcript, it was easier to identify in the other transcripts.

The concept of emotional detachment was highlighted by its relationship to the unique position of an independent director. As this respondent described it:

> *"It is a consultant role, and you're neither fish nor fowl. You're part of the company but you're not part of the company. You quiz management, you hold management's feet to the fire but you're not management. You're an employee of the company by virtue of the fact that they pay you, but you are not part of the company."*

He went on to support this by looking at how few days an independent director would devote to any one company, maybe 20 days in an average year. He also looked at the board meeting being process-driven. It is done in line with the agenda; each meeting is along similar lines to the last; once the board meeting is finished, you go home, and do not come back tomorrow. The respondent then compared this with the full time employees who are emotionally engaged and have that bond with the company. Coming from a team environment in both his working and sporting careers he finds this emotional detachment a tough challenge.

When asked what his motivation was to take on the independent director roles, he replied that the key is the stimulation provided by the diversity of issues that he gets involved in through the three different companies.

In reviewing the other transcripts to find the motivations of the other respondents, it became apparent from their comments that only some had an emotional attachment to their companies. This came from three points of view. One was the individual's personality, the second was how the board chair ran the board and its internal relationships, and the third was their motivation to take on these independent director roles.

Some people will always thrive in a team environment and will put in the effort to make sure any team of which they are a member works well as a whole, and that the members get on well with each other:

> *"Understanding the relationships around the table in terms of these are people who have never worked together before. The board is new…so it was a bit about learning about your colleagues and what their expectations were...to work together to make an effective board."*

Others see the role of an independent director as just a job. While they recognise that it is better for all directors to work together, they do not have to work together as a team for the board to be effective. This comes down to their motivation for joining their boards, and what they intend to achieve as an independent director.

There are also those who, while highly qualified, do not have any interest in being independent directors. Reasons given for this revolved around the inherent risks such as the potential financial liabilities or the potential damage to their personal reputation should anything go wrong. Others felt that there were too many controls and preferred to work in private companies or in the growing private equity space.

For some, becoming an independent director just happened. They were approached to join a board. Others went looking for the positions having decided to make this their career, while some used this as a stepping-stone to retirement, as a way of moving from working full-time to not working at all:

"Because most of the directors are people like me who are doing this for no other reason than they think they are making a contribution and it's a way of going from full-time to no work at all, and it's a form of transition for part of your life, and you don't need to do it. Most of us certainly aren't doing it for the money."

This concept was phrased 'motivation and emotional attachment', and being individual to each of the respondents, was included in the first category of Personal Attributes.

The revised concepts in this category are:

1. acting as a specialist consultant or advisor
2. providing specific knowledge and expertise
3. providing specific skills and expertise
4. providing generalist or broad management skills
5. bringing a unique perspective to the position
6. providing motivation and emotional attachment

The category of Personal Attributes has been revised and therefore the new coding paradigm is shown in Figure 5.13.

Now that all interview transcripts had been coded and analysed, and noting that the two final interview transcripts did not reveal any new concepts, the core categories could be considered to be saturated. The process undertaken to this stage meets with the requirements described in Section 4.6.4. This interview process in three stages shows the iterative nature of grounded theory research in which the researcher continues to return to the field until all categories have been saturated (Charmaz, 2006). The names of the core categories do not necessarily reflect the role that independent directors may undertake, but to represent the eight building blocks that allow the reader to easily identify the concepts contained therein.

Figure 5.13 Revised coding paradigm for Category 1: Personal Attributes

	Specific skills and expertise **Specific knowledge and experience** Impacting conditions	
Generalist or broad management skills **Motivation and emotional attachment** Causal Condition	**PERSONAL ATTRIBUTES**	**Bringing a unique perspective to the position** Actions/Interactions
	Acting as a specialist consultant or advisor Consequences	

To summarise, the eight core categories identified through the research are:

1. Personal Attributes
2. Monitoring
3. Performance Enhancement
4. Structure
5. Representative
6. Relationships
7. Information
8. Company Position.

The next stage in the coding process was selective coding in which the central category was selected (Parker & Roffey, 1997) but before this, the other data collected in the triangulation procedure were analysed.

5.8 Reconsideration of other collected data

While the principal data collection method was the interviews, other data were used to confirm the findings through triangulation (Miles & Huberman, 1994; Denzin, 1970). As detailed in sections 4.5.2 and 4.8, data were also collected through participation observation and interviewing industry experts during the review phase of the ASX Corporate Governance Council Good Corporate Governance and Best Practice Recommendations (ASX CGC).

5.8.1 Participant observation

Participant observation was undertaken through the interviews with the twelve respondents, attendance at a presentation sponsored by the Australian Institute of Company Directors (AICD), and interviews with industry experts.

In the interviews, the researcher was fully involved with the participants, which is one of the variations of participant observation described by Denzin (1970, 1989). With the researcher and the respondent the only participants in the interview, the researcher was able to read the respondent's body language and note any reactions that may indicate something other than what the respondent was saying at the time.

In this study, the interviewer used recording devices in the interviews for several reasons. One was to accurately record the respondents' comments. Another was to allow the researcher to consider the responses so the probing questions would be well directed and relevant. Finally, it allowed the researcher to observe the respondents' non-verbal responses, such as body movements, facial expressions, and the tone and pitch of their responses.

All of the respondents have spent many years working as professionals in business or government, and all have substantial experience either on boards, as a CEO or CFO, or in parliament. They all spoke with the expected level of confidence and the researcher observed no non-verbal signs to indicate that the respondents were unsure of their responses or were being anything other than completely frank and honest. While the observations made during the interviews did not add to the research by providing additional data, the absence of conflicting observations confirmed that the respondents and their comments could be taken at face value.

On December 7, 2006 the AICD arranged a presentation on the amendments to the ASX CGC Good Corporate Governance and Best Practice Recommendations.

The ASX released its Principles of Good Corporate Governance and Best Practice Recommendations in 2003 with the intention of review three years later. On 2 November 2006 the ASX released draft amendments to their Principles and Recommendations, with amendments to issues dealing with Independence of Directors included in the review.

While the contents of the review were closely aligned with 'relationships affecting independent status' and 'independent judgement', the researcher took the opportunity to listen to and discuss with several important players the subject of independent directors. After reviewing the draft amendments to the Principles and Recommendations, the researcher attended a presentation in Sydney on 7 December 2006 by Eric Mayne, Chief Supervisory Officer, ASX Markets Supervision and Chair of the ASX Corporate Governance Council that was followed by a discussion involving Eric Mayne and Tony Berg, with Bill Beerworth as the facilitator. Other presentations were held in other cities with different participants.

A number of the proposed amendments were discussed, but when questioned on director independence, Tony Berg suggested that Australia has had a history of appointing independent directors who are useless. In his opinion, all directors should have independence of mind, should have something to say and contribute positively, but it is difficult to determine independence of mind. This highlights the importance of having independent directors on public company boards.

There were several proposed amendments to the Best Practice Recommendations, one of which was amending the definition of an independent director to a definition of relationships affecting independent status. When this amendment was discussed in the presentation it attracted much attention and a good level of debate, ranging from the definition of independence to factors affecting independent status to independence of mind.

The facts that the ASX CGC reviewed this definition, and that it was well discussed in the presentation indicate that the issue of independent directors and their role on boards is important, and something that industry participants want clarified. Only one member of the audience argued against having independent directors on public company boards, as he does not believe that they have adequate company or industry knowledge to make a positive contribution. Others disagreed, considering the other contributions made by independent directors would outweigh their lack of company or industry knowledge.

5.8.2 Interviews with industry experts

To further investigate these issues, two important industry participants were later interviewed on the proposed amendments: Eric Mayne, Chief Supervisory Officer ASX Markets Supervision and Chair of the ASX Corporate Governance Council (interviewed on 15 January 2007) and Ralph Evans, CEO of the AICD (interviewed on 17 January 2007). Both experts consider that having independent directors on public company boards is critical to good corporate governance.

When Mr Mayne was questioned on the ASX Council's views, his response was that the Council sees independent directors as an important feature of public company boards. In theory, the Council feels that independent directors should bring independence of mind. But this raises the question of whether a director who may or may not satisfy the definition of independence can still bring independence of mind.

While the Council issues Recommendations, companies have the option of either complying or explaining why they don't comply. But companies with a majority of independent directors on the board are less likely to encounter problems. An independent director should have an enquiring mind, and not readily accept what management is telling them but test and ask questions of management. If a director is not independent, and especially in the case of executive directors, it may not be in their best interests to question management, especially the CEO, as they may be beholden to them for their livelihood. Non-independent directors with some commercial relationship with the company may risk damaging their relationship if they question the company's management too harshly.

One of the arguments for having independent directors on public company boards is that they give the appearance of good corporate governance. Mr. Mayne thought that this was just part of the benefit:

> *"You may say that they do bring this [the appearance of good corporate governance] but what of the decisions they are making, what is the expertise they are bringing, what is the value add they are providing at board level. The value add is just satisfying the definition of independence."*

The interview with Ralph Evans raised the AICD's interest in the ability of directors to exercise their judgement with an independent mind, so they act in the best interests of the company. But Mr Evans feels that the regulators have confused the issue of independence, or acting with an independent mind, with conflicts of interest, the latter covered quite extensively in the Corporations Act (s.191).

The effectiveness of independent directors was highlighted by the current example of the proposed buyout of Alinta by some of the company's management in conjunction with Macquarie Bank. The independent chairman was criticised for being involved in the transaction, and subsequently was pressured to resign. The independent directors then took the lead in opining on the proposed buyout, as they were considered independent of the transaction and could therefore make recommendations that were in the best interests of the company. Mr. Evans thought this an excellent example whereby the independent directors were demonstrating their value:

> *"So independent directors in the sense that I described there are enormously important to a company. It goes right back to where they originated from. They were invented because the shareholders couldn't meet all the time to make the daily decisions necessary to run the company. ... The inner group could meet regularly, and the shareholders couldn't. And*

> *that is why they were invented, and you want people who will act in the best interests of the shareholders and to do so to the best of their ability, which means definitely not compromised by conflicts of interest, but also means not all doing the same thing. You've got to have people that will challenge a kind of accepted or dominant school of thought in the interests of the company."*

Mr Evans sees the most important duty of independent directors is appointing, motivating and de-appointing the CEO. This comes back to the discussion with Mr Mayne, that executive directors or non executive directors could be concerned as this may affect their livelihood.

But having independent directors is not enough; they must be independent of mind. Mr Evans quoted the HIH case, where the board was well structured, but the independent directors were heavily influenced by the stronger personality of the CEO. While there was nominal independence, it was not working adequately.

Independence of mind is difficult to assess. Some company boards, such as QBE, are structured with a non-executive board chair who cannot be considered independent as he was the previous CEO. In such cases, the board will nominate a lead independent director as companies stress the importance of having independence on the board.

Both respondents felt strongly about this topic, and their body language and tone of voice reflected this. When asked how important they thought independent directors were, they both sat up as if to highlight their responses. Their tone was also stronger, ensuring that the interviewer recognised how highly they viewed the importance of this issue.

The data collected in addition to the twelve original interviews did not provide any additional information, but did support the analysis of the initial data. The fact that the subject of independent directors was given significant importance within the industry only adds weight to the importance of this study at present.

5.9 Selective coding and selection of the core category

5.9.1 Selective coding

Selective coding requires selecting the main core category, which is the central phenomenon resulting from the axial coding process (Parker & Roffey, 1997). It is the process whereby categories developed during axial coding are grouped to form the core category (Flick, 2002). Once the core category has been identified the researcher should then examine the relationships between the core category and the other categories.

During the analysis of the data collected through the interviews the researcher continually searched for relationships between the eight categories. One category stood out as having strong relationships with all other categories. This was the third category identified during the axial coding process, Performance Enhancement. On initial analysis, each of the other seven categories can be seen as actions or factors involving independent directors and which influence their performance.

The strength of the relationships between performance enhancement and each of the remaining seven categories was tested to confirm or negate this initial selection.

Several of the respondents linked performance enhancement to other categories. In some instances the respondents linked their contribution to adding value to the board or to the company, and suggested that they should not be there if that was not the case.

Independent directors' personal attributes affect how their personal contribution could benefit the board and the company, and the combined personal attributes of the independent directors help the board chair to build a balanced board. With each of the independent directors contributing positively from their own personal experiences, the board as a whole should better understand and direct the company's business and therefore make a more meaningful and positive contribution to the board's and the company's performance.

The board, and particularly the independent directors, are given the responsibility of monitoring others in the organisation to ensure that the other board members and senior management are behaving ethically and performing to expectation. They also monitor the performance of the company against strategy and other expectations, both financial and non-financial.

The structure in and around the board and the organisation ensures that the company operates effectively and efficiently. The structure should help differentiate between the board and senior management and provide both with the security that each can perform their duties without interference while allowing others to observe and to make sure that performance is enhanced.

In the eyes of the stakeholders the independent directors can often be considered as the senior representatives of the company. While their fiduciary duty is to the company it is considered that their prime duty is to the company, that is, the members or shareholders (Baxt, 2002b). The independent directors are expected to be above reproach and should be looking after the interests of those outside the company. This can vary from oversight to monitoring to ethical responsibility of those in the company, but overall the independent directors represent those outside the company to make sure that performance is enhanced to maximise the returns to the shareholders.

Independent directors build relationships in and around the boardroom as well as using relationships they have developed outside the company. Better relationships inside the company ensure cooperation and collegiality, and the better the directors work together, the better the board performs. The independent directors can also use their external relationships for the benefit of the company, which may lead to improved performance.

The best decisions are made using the best information. Independent directors rely on the processes in the company for information that is not generally available to the public. The quality and quantity of this information will determine the level of contribution made by the independent directors. Typically, independent directors aim to make the best contributions and decisions possible but they may be limited by the information provided to them. Better information provided to them translates to better contributions and decisions, and ultimately improved performance by the board.

Company position may determine the level of involvement by the independent directors. Smaller companies, those going through change or those in a difficult position in their life cycle sometimes use their independent directors to assist staff outside the boardroom. By using the skills and knowledge of independent directors outside the boardroom, the companies are benefiting from their skills and experience to improve the performance of the company.

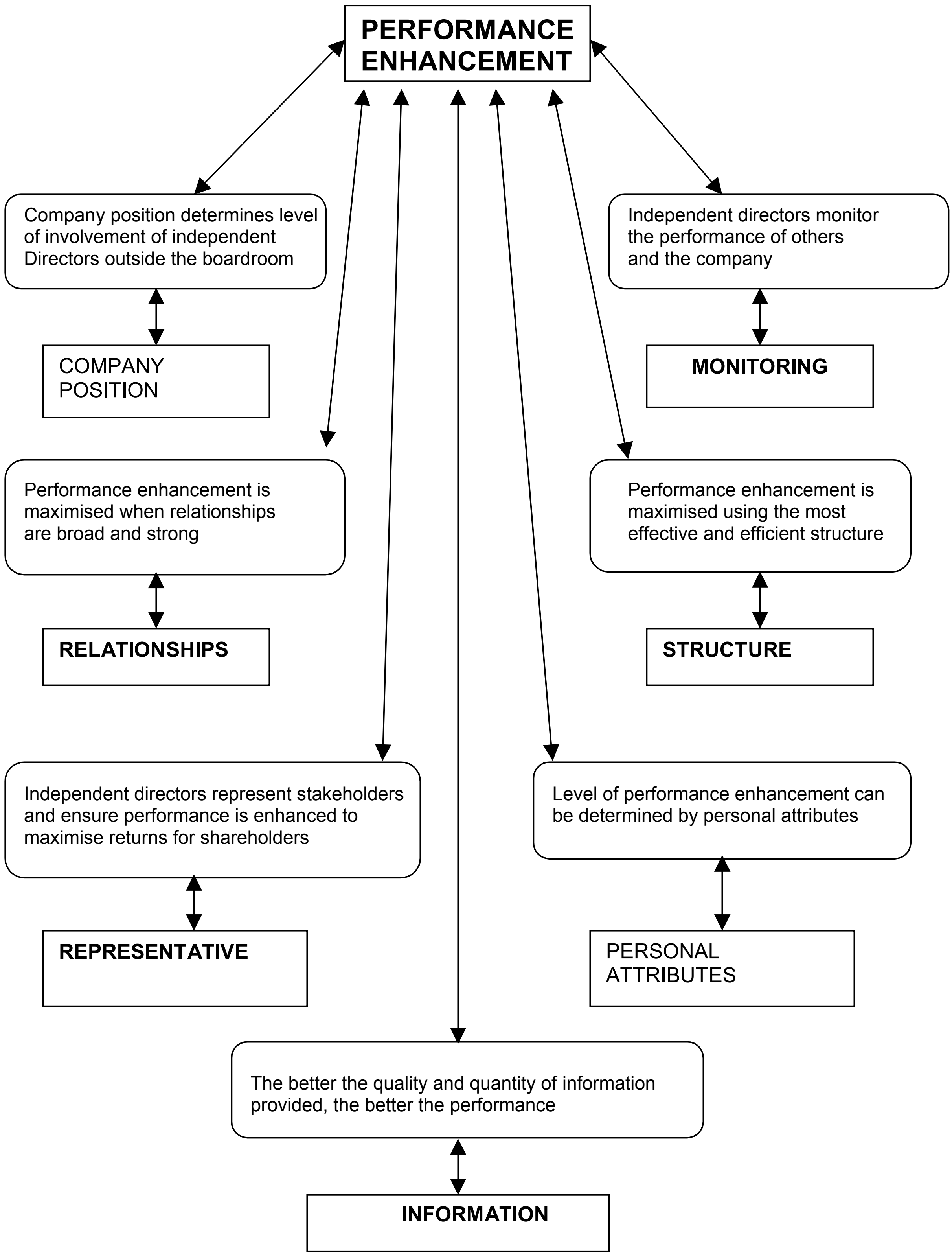
5.9.2 Selection of the core category

While Performance Enhancement can be considered as an obvious choice for the core category, another candidate is Information. This category was identified following the second stage of interviews and therefore was not an obvious candidate. Further reflection on the relative importance of Performance Enhancement and Information leans towards Performance Enhancement as the preferred candidate. The logic behind the selection does not rest on the relationships between each of these two candidates and the other categories, but on the actions of independent directors relative to each of the two categories.

Information is not so much an action or a role undertaken by independent directors, it is a means of assisting them perform their duties. They are not information providers, but use information to assist them in doing their job. Performance enhancement is why independent directors are appointed to company boards. They are expected to use every asset at their disposal to help both the board and the company perform better. The distinction between these two candidate categories is clear.

The selective coding process identified the relationships between Performance Enhancement and all other categories, as illustrated in Figure 5.14.

Figure 5.14 Selective Coding: Performance Enhancement as the core category



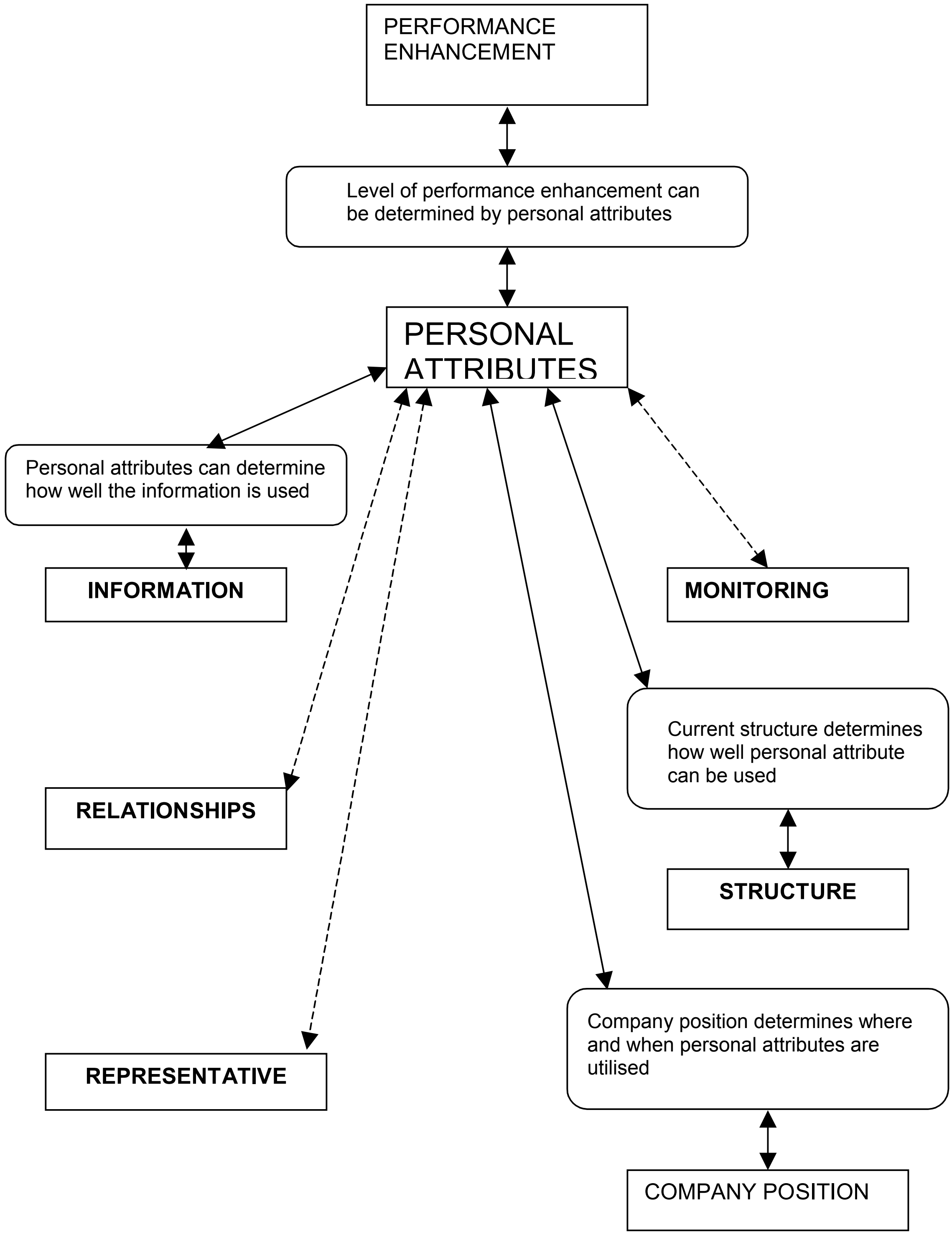
5.9.3 Relationships between categories

Following the identification of the core category, the process of analysing the relationships between the core category and the other categories continued, in order to determine the path of the relationships. Each category has some form of relationship with each other category, but weak relationships that add no depth to this discussion are excluded from the analysis. This exclusion helps identify those categories with greatest impact on the core category, and also any issues that affect the performance of independent directors, thus providing depth and meaning to the core category.

Personal Attributes

The position of a company can determine how the personal attributes of the independent directors are used. In smaller companies, the skills and experiences of independent directors are put to greater use, usually due to the relative inexperience of the staff or the low level of staff numbers. Companies going through change tend to use the experience of their independent directors to help them through this process. The structure of the board or of the company can determine how the personal attributes of the independent directors are used, and the personal attributes of the independent directors can also determine how well the information provided to them is used. Figure 5.15 illustrates the relationships between the Personal Attributes category and other categories.

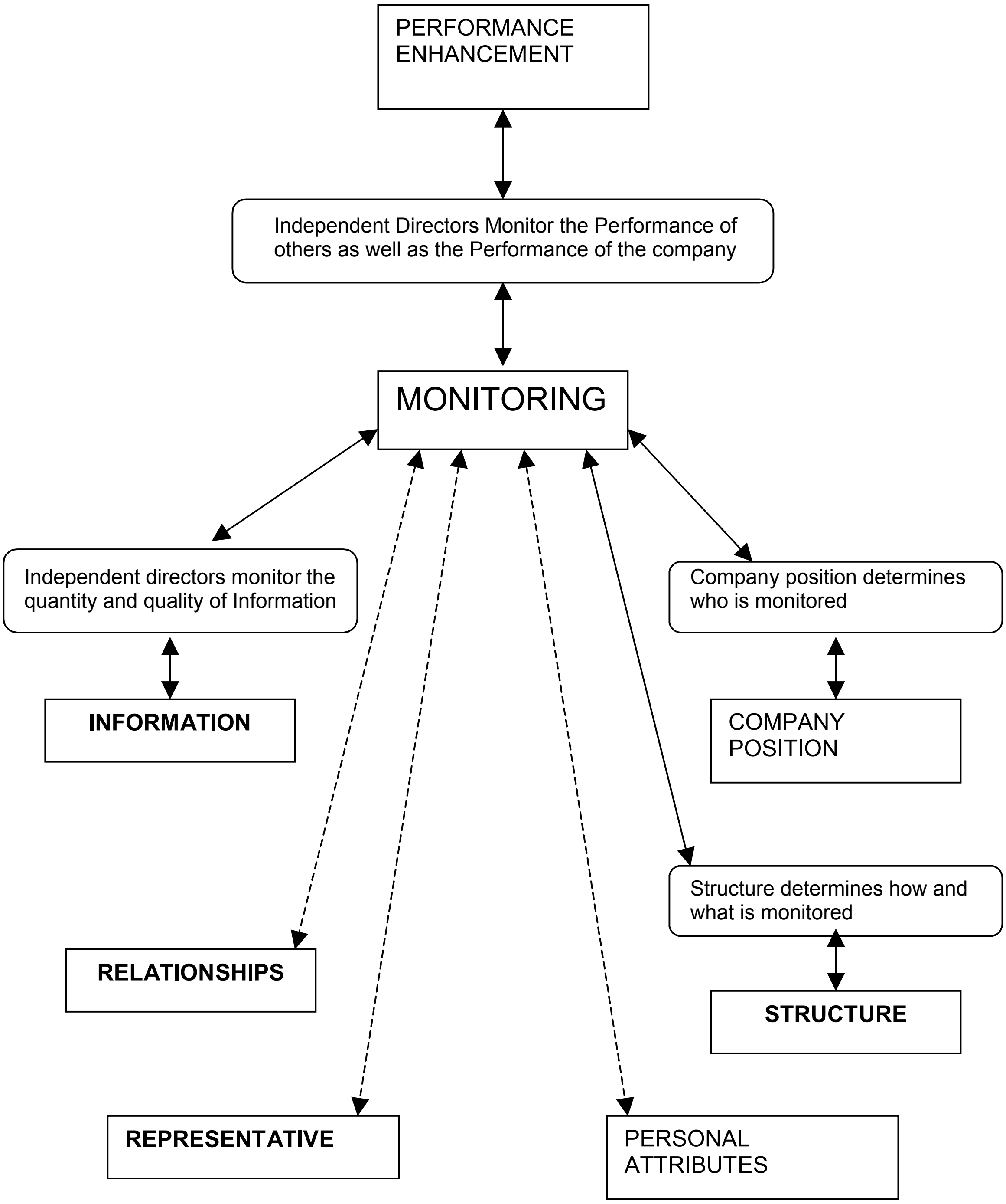
Figure 5.15 Personal Attributes category and relationships with other categories



Monitoring

Between the structure of the organisation and the position of the company, what, who and how is monitored can be determined. Increased monitoring may be required during times of change in the organisation, and a changing structure can determine where the emphasis on this monitoring is placed. The independent directors will monitor the quantity and quality of information provided to them, and this can also change over time. Figure 5.16 illustrates the relationships between the Monitoring category and other categories.

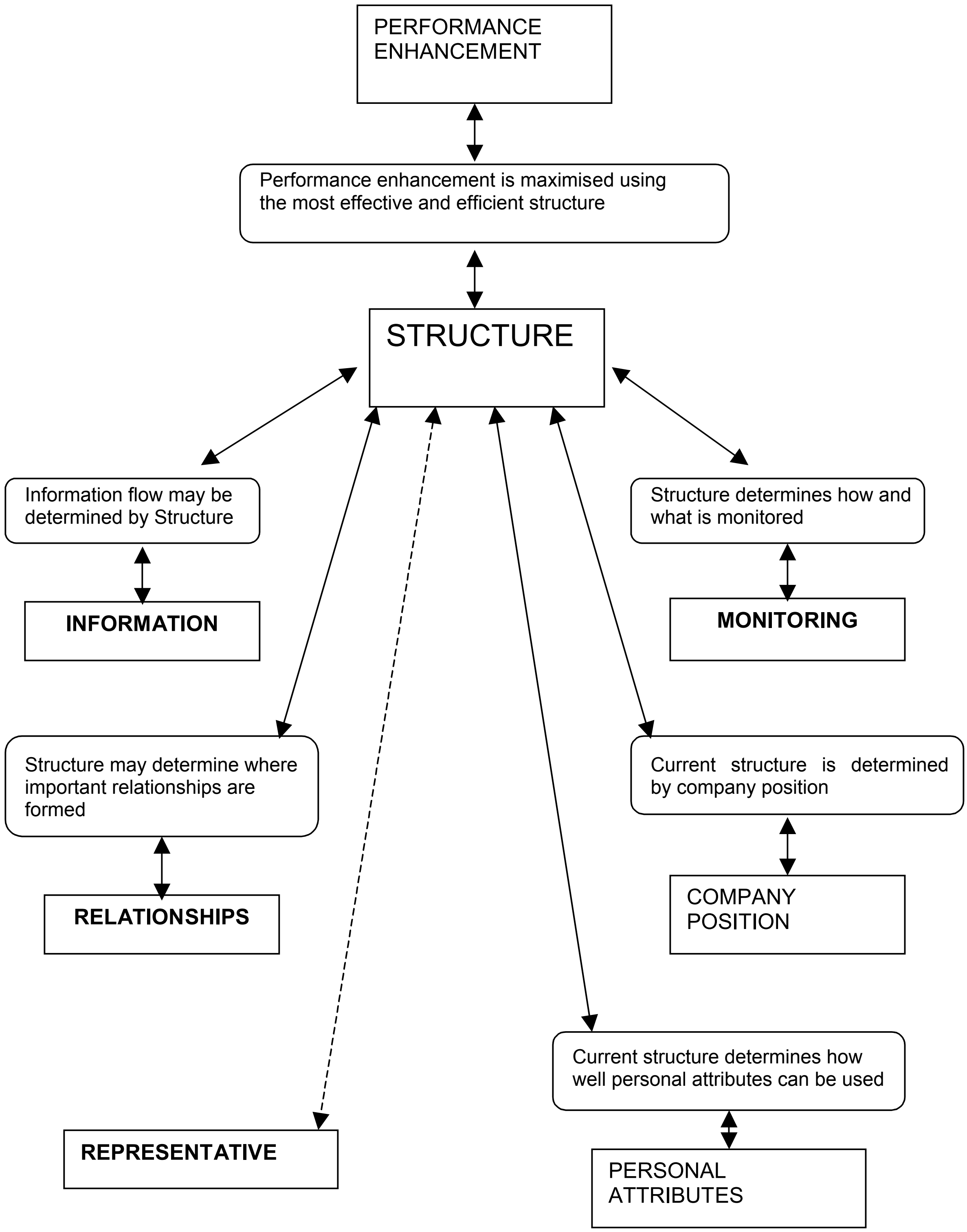
Figure 5.16 Monitoring category and relationships with other categories



Structure

While the structure of the board or the organisation can determine how the personal attributes of the independent directors are used, it can also determine what, who and how monitoring is done in the organisation. Within this framework, the current position of the organisation can influence its structure at that time. The structure may also determine where the important relationships, both formal and informal, are formed in the organisation. Figure 5.17 illustrates the relationships between the Structure category and other categories.

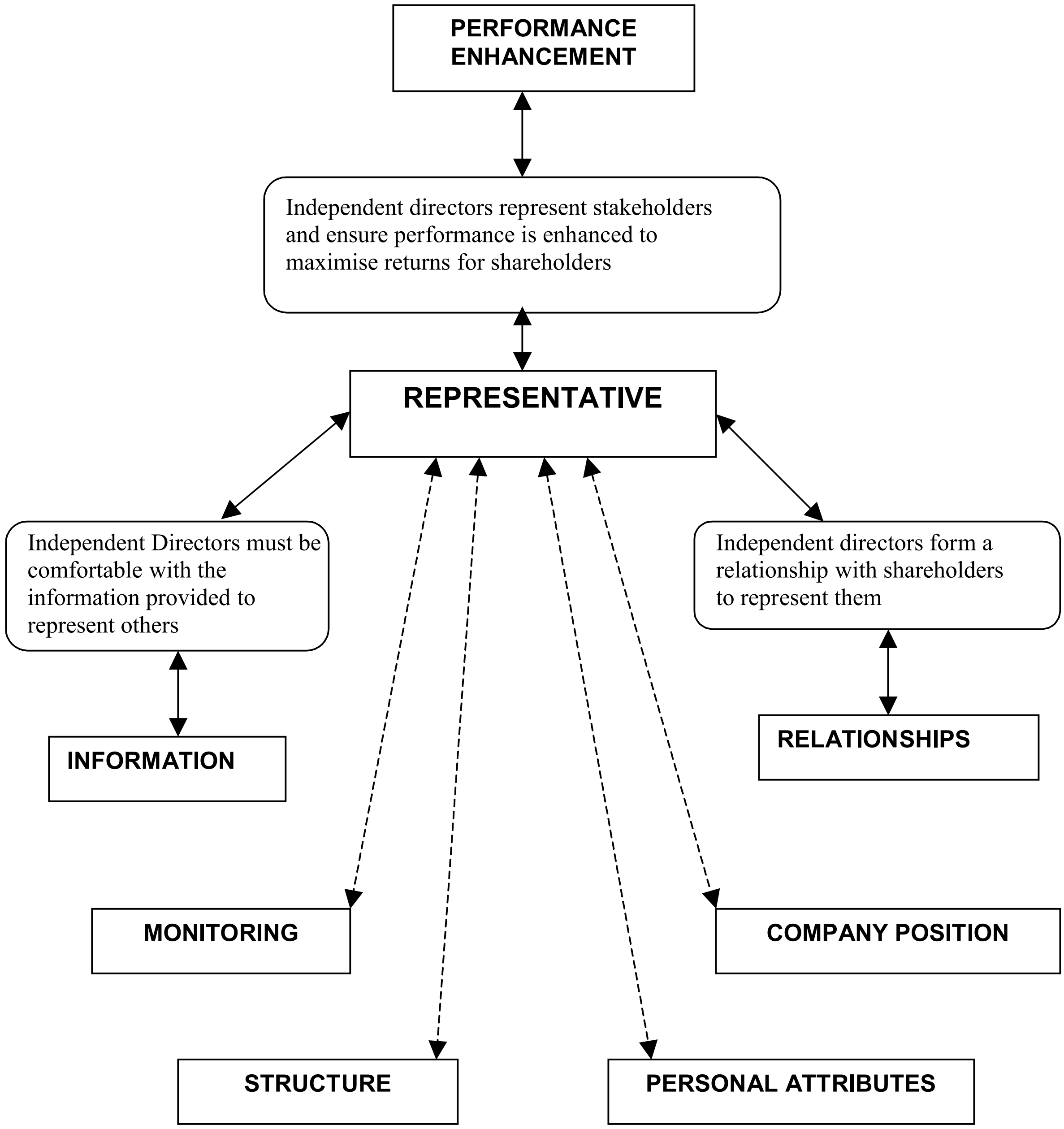
Figure 5.17 Structure category and relationships with other categories



Representative

One of the more recognised roles of independent directors is to represent the shareholders. The independent directors also accept responsibility for others in the company as they act upon a combination of their own experience and the information provided to them through the formal channels in the organisation. To do this, they must have confidence in the information that is provided to them. Figure 5.18 illustrates the relationships between the Representative category and other categories.

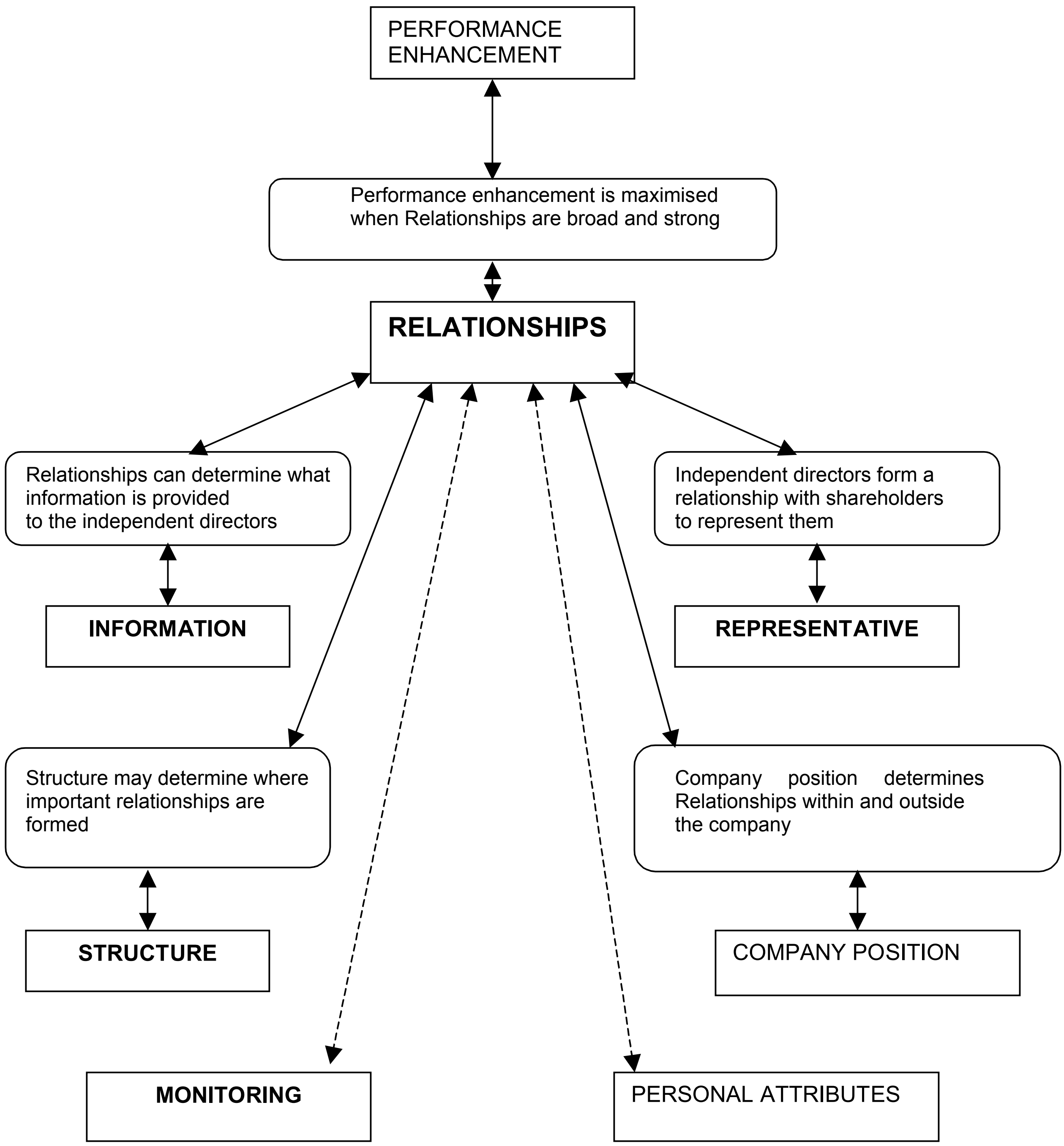
Figure 5.18 Representative category and relationships with other categories



Relationships

The relationships formed by the independent directors may be determined by the structures of the organisation, while the company position may determine what relationships are formed inside and outside the organisation. The information provided to the independent directors through the informal relationships they have established significantly influences how well they can do their job. Finally, the strength of the relationship between the independent directors and the shareholders may have an effect on how hard the independent directors fight for the shareholders in their recommendations during the board process. Figure 5.19 illustrates the relationships between the Relationship category and other categories.

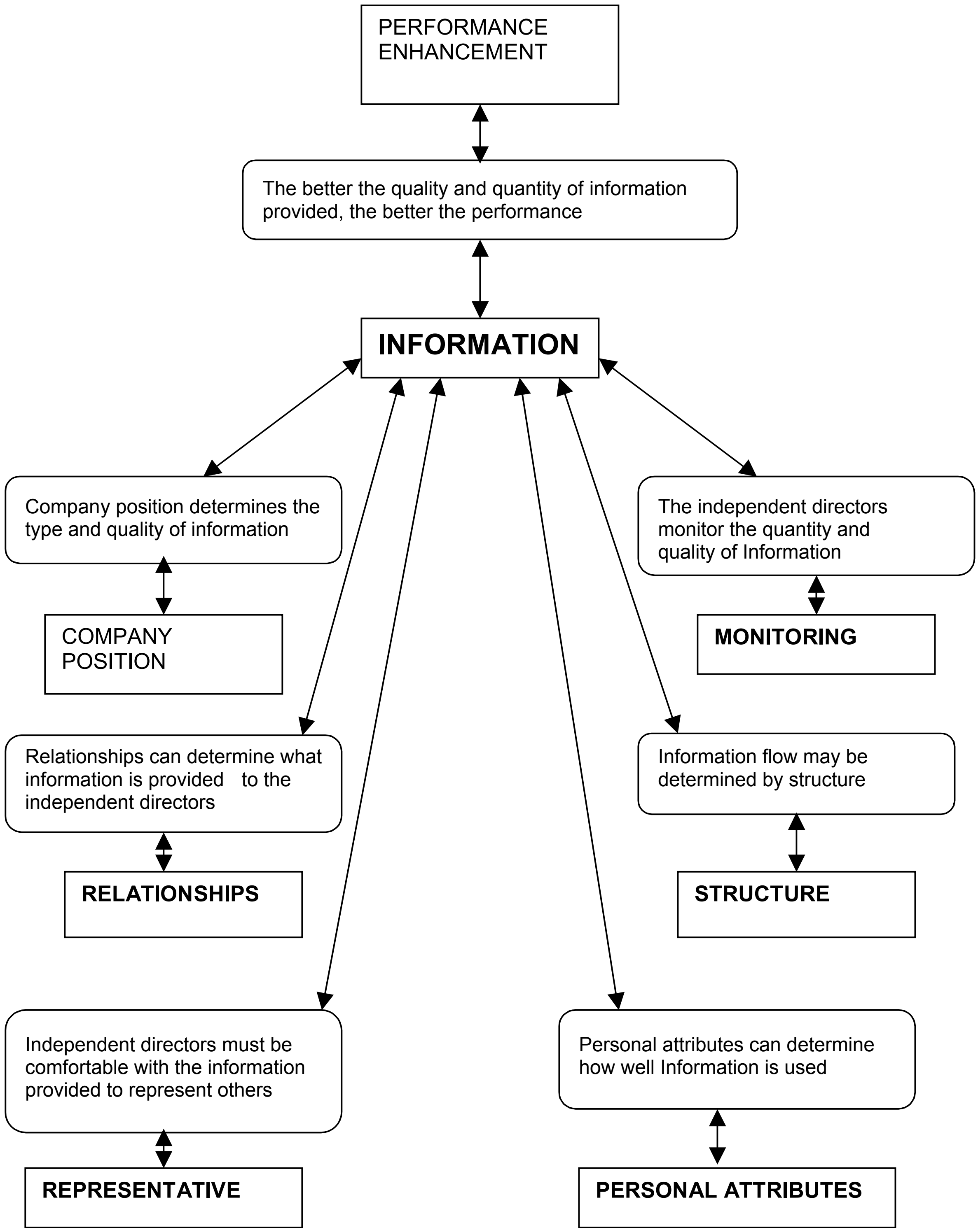
Figure 5.19 Relationship category and relationships with other categories



Information

In the previous section the Information category was considered as a candidate as the core category due to its relationships with other categories. The better the quality and quantity of information provided to the independent directors, the better they can perform, and the structure of the organisation can influence this. Independent directors are expected to monitor the quality and quantity of information provided to them in the formal process. Informal relationships can be a source of other information, and the company position can influence the type and quality of information the independent directors receive. As they take responsibility for others in the organisation, the independent directors must have confidence in the information provided to them. Importantly, it is the personal attributes of each independent director that will determine how well the information is used. Figure 5.20 illustrates the relationships between the Information category and other categories.

Figure 5.20 Information category and relationships with other categories

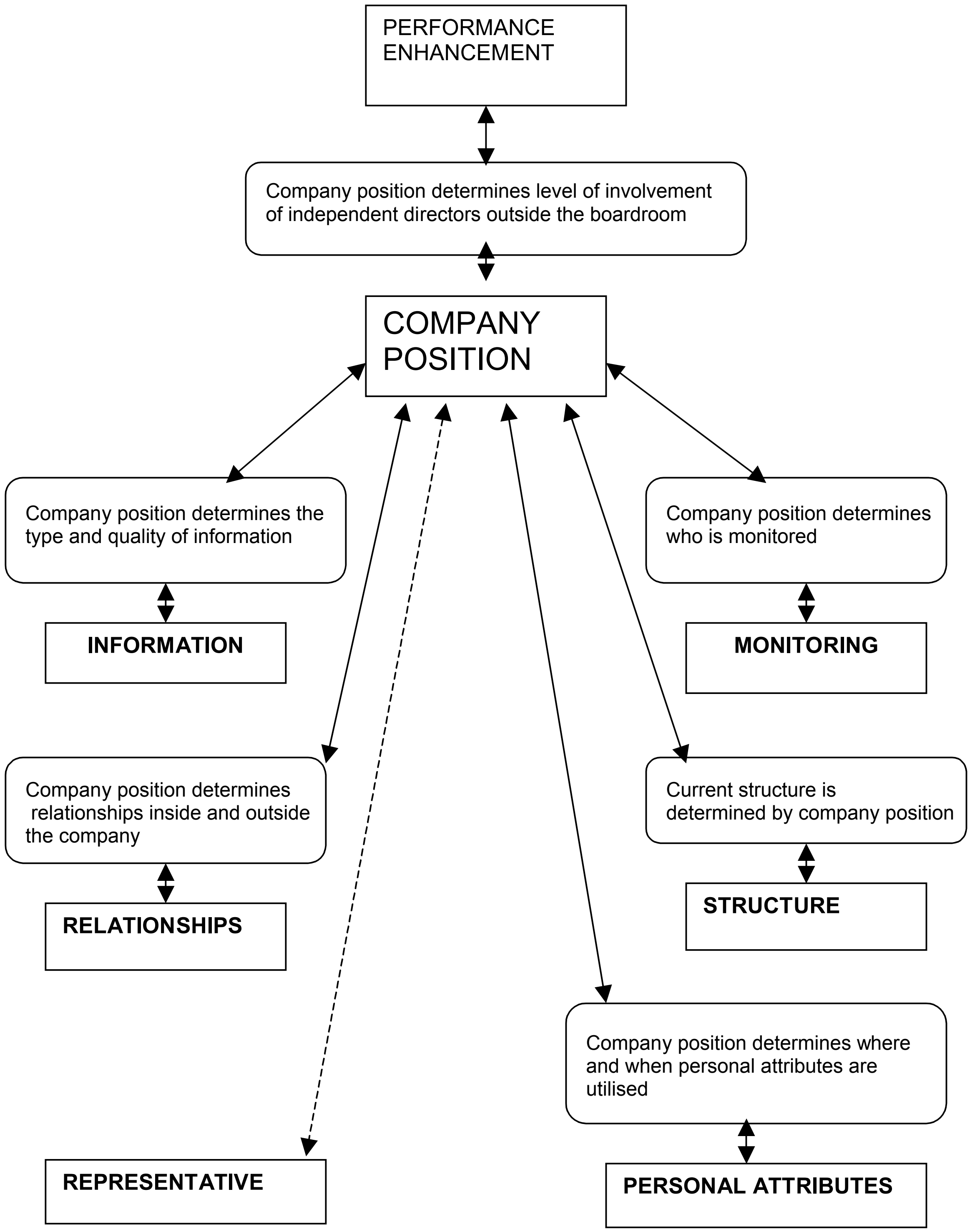


Company position

Company Position could also have been considered as the core category. However, similar to information, company position is not a role as such, although it can have a significant influence on how the independent directors perform their jobs.

The information provided to the independent directors may be affected by the company position, while the current structure of the organisation may be determined by the position of the company at that time. Again, the company position may impact on the relationships formed in and outside of the organisation and the company position will also influence how the personal attributes of the independent directors are used. Finally, the structure and company position may also influence who, how and what is monitored. Figure 5.21 illustrates the relationships between the Company Position category and other categories.

Figure 5.21 Company Position category and relationships with other categories



Depth of category relationships

Each of the categories has relationships with a number of the other categories. Where no relationship between categories has been discussed, there may be a weak relationship that would have little or no impact on the role of the independent directors.

There are a number of relationships, and many of these are considered strong. The depth and number of these relationships supports the findings of this research and supports the proposition that Performance Enhancement is the core category. While no other category apart from Information has a strong relationship with all of the other categories, the final categories of Information and Company Position are the most significant as they have the greater number of relationships after the core category. The importance of these two categories will be discussed in the development of policies and the direction for further research later in this study.

In the next section, the choice of Performance Enhancement as the core category is used as the foundation for the development of the theory.

5.10 Theory development

In finalising the theory development the researcher has analysed a substantial amount of information from various sources. This is a necessary component of the theory development as the theory is not decided before the study, but is generated from observations (Hussey & Hussey, 1997). The most significant component of this information is the transcripts of the interviews with the twelve respondents, but information was also gathered from interviews with industry experts, other printed information, and from observations in the field.

The thought process underlying this theory development is to comprehend the words and actions of those involved in the industry to allow the researcher to understand what the independent directors are attempting to achieve. As each respondent has a different background, different skills and experiences and as they were sitting on different boards, it was expected no two respondents would approach their role in the same way. Nonetheless, they are all doing the same job, albeit in different ways, and all have the same goal, to improve the performance of the board and of the company. This forms the basis of the grounded theory.

During the research and analysis processes, the researcher continually searched for relationships between the categories as they were beginning to emerge, and regularly reviewed data that had previously been analysed when new concepts or categories emerged from the subsequent data. The general objectives of a grounded theory established by Glaser and Strauss (1967) were kept in mind. These are to include the creation of a platform to allow behaviour to be better understood, to establish some level of explanatory and predictive capability, to apply the theory in practice practically, and to set a starting point for future research into this and related fields.

While reviewing and analysing the data, the researcher also sought evidence that supported the respondents comments, and ways these clues could support the development of the theory. This supporting evidence came through the addition of the Information and Company Position categories, as these two issues had significant impact not only on what the respondents did, but how they approached their roles and why they approached their roles in certain ways.

The grounded theory needs to be specific enough to reflect the detail of the data yet simultaneously be general enough to allow further research to use this theory as a reference point. The grounded theory should also be understood by those involved in the area being researched. Those closely involved in and around the board process, including all directors, the company secretary and the chairman and senior management, should have a close understanding. Those further removed but still involved, which includes shareholders, regulators and other stakeholders, should also have a level of understanding to enable them to comprehend the impact the theory has on their relationship with the independent directors. All players in the field should take into account that this theory relates to independent directors and not necessarily to non-executive or executive directors.

The grounded theory is presented below in narrative form (Creswell, 1998) to allow the researcher to link the categories to the central phenomenon, the core category of Performance Enhancement. Grounded theory is an interpretative method (see Section 4.6.1) in which the researcher uses the observation and analysis of actions and reactions around a certain event or situation (Hussey & Hussey, 1997). As such, the researcher enters the situation and allows the data collected and analysed to develop the theory.

This method has enabled the researcher to identify the central phenomenon and the seven other categories, and to recognise and construct the relationships between the categories. Each category has a strong relationship with the central category. Many strong and several weak relationships also occur between the non-core categories.

The personal attributes of each independent director tell us what individual and unique combination of elements each brings to their role. The Monitoring category brings to the theory actions that are more specific to the independent directors, as it is their independence that allows them to monitor others without retribution. Structure sets the boundaries in which the independent directors operate while also describing where and how the influences of the independent directors lie. The independence of the role allows independent directors to act differently from the other directors, in that they are expected to lead in certain areas while being cognisant of their responsibilities. In a similar vein, the relationships held by the independent directors by virtue of their past or of their position differs from other directors and brings positive influences to the board.

The Information and Company Position categories are separate from the other categories in that they are not so much roles played by the independent directors, but issues that significantly impact on their performance by providing explanations of why there are differences in the roles that are not due just to the personal attributes of independent directors.

The eight categories identified through the analysis of the data and the relationships that have been established between each of them have enabled the researcher to use the interpretive model to generate the grounded theory.

5.11 The grounded theory

There is no specific form that a grounded theory should take. Creswell (1998) discusses a number of grounded theory studies in which the theory is presented in various forms. These can be in the narrative form as used by Strauss and Corbin (1990) in their theory of protective governing and by Conrad (1978) in a theory of academic change, or in the form of a logic diagram, such as that used by Morrow and Smith (1995) in a study of women. In this study, the grounded theory is presented in narrative form.

The theory has been developed around the core category of Performance Enhancement. The theory uses propositions that have arisen in the data and enable the researcher to propose a view for those outside the boardroom of the contributions that independent directors make to the board and to the company.

Relationships between Performance Enhancement and the remaining categories are explained by the theory. The theory and the strong relationships between Performance Enhancement and the other categories, particularly those of Information and Company Position, allow the researcher to propose theoretical and practical applications for possible reforms of the legal issues that impact upon independent directors. Recommendations for reform are detailed in Section 6.4.

The theory can be related to the research question, The Role of the Independent Non-Executive Director in Australia, which highlights its relevance. The theory is sufficiently general in nature to allow its use for future research, while still being directly pertinent to the area under investigation.

This grounded theory is articulated as follows:

> ***The attitude of the legal system to the independent director has changed over time but still does not recognise the differences between independent directors and executive directors. This lack of recognition has spread to other stakeholders, with those most affected being the shareholders and the regulators. This calls for a better understanding of the role of independent directors and the issues that impact on their role. This understanding should result in the identification of different classes of directors from a legal perspective, to enable all interested parties to understand their place in the regime of the boardroom.***
>
> ***Each independent director will bring a unique perspective to how they perform their role, with the data defining the role as being "to improve the performance of the board and the company".***

In each situation, the two most important issues that determine the capacity of each independent director to perform to the best of their abilities are the information that is provided to them, and the position of the company at that point in time.

Importantly, the information provided to the independent directors has a significant impact on their performance. The recognition of this by the courts in the past was a sensible and logical approach, but to expect the independent directors to benefit from the same information as the other directors is not logical, as shown by the data. The legislators and the courts must consider this important issue.

Similarly, the position of the company at any time may heavily influence the nature of the role of an independent director. The data indicate that small companies or companies going through significant change will use the expertise of their independent directors to a much greater extent than larger or stable companies. The more that independent directors are used in these companies, the greater will be their influence on the company.

Each independent director will bring different personal attributes to the role, and these attributes will form the base of each individual contribution. These attributes are based on each individual's life experiences. Each independent director's selection is based on these experiences, to add something to the board that no one other director can provide. The combination of the board members forms a strong board, with greater strength leading to better performance.

The other theoretical issues that have been generated by the data support the role undertaken by the independent directors. Their independence allows them to monitor others within the board and senior management in a way that is different from other board members. The data also show that the structural issues around the board and senior management provide the independent directors with set boundaries in which they can perform.

The independence of these directors allows them to represent stakeholders in ways not possible for other directors. Shareholders in particular look to

the independent directors to represent them as they are distanced from other relationships within the company.

The data indicate that everything an independent director does in the performance of their duties is to improve the performance of the board and of the company, but the particular position of each independent director should be defined, as their circumstances on each board will differ.

In summary, the grounded theory informs us that the independent directors strive to improve the performance of the board and the company, but the information provided to them, and the position of the company at any time may significantly affect that role. This finding should impact on future investigation and provide the basis for further research into the legislative and legal issues surrounding independent directors.

5.12 Conclusion

Following the analysis of the data and the formulation of the grounded theory, the impacts on policy and practice remain to be discussed. The following chapter compares the findings reported here with the conclusions arising from the review of the literature, as detailed in Chapter 3, and explores the practical application of the findings of this research study.

Chapter 6 CONCLUSIONS

6.1 Introduction

The findings of this research dictate a grounded theory that the role of the independent non-executive director in Australia is to improve the performance of the board and the company. It was found that seven factors impacted on this role, the two most influential being information and company position.

This chapter discusses first the grounded theory relative to the research problem described in Section 4.2.1, with the first part of this section reviewing the impacting factors. This includes comparing the findings from the literature review in Chapter 3 and the grounded theory developed in Chapter 5, which reflects the 20^{th} phase of the grounded theory as described by Figure 4.3.

This study and the resulting grounded theory were undertaken through a necessarily narrow point of view, and the limitations relating to this study are reviewed. The expectations that this thesis will make a contribution to knowledge and to the improvement of professional practice or policy are then described in detail, thus completing the grounded theory process detailed in Section 4.8. Finally, areas for further research into this and related topics are explored.

6.2 The results

A simplified view of the result of this study is that the role of the independent non-executive director in Australia is to 'improve the performance of the board and the company'. But this simplification does not indicate the full implications of the results of this study; the true picture is much more complex.

In the previous chapter, seven other 'roles' were identified, with a closer analysis revealing that these 'roles' reflect how independent directors go about their jobs, and what they do, to improve the performance of the board and of the company. They are the seven factors that influence the behaviour of independent directors.

What each independent director brings to the role through their *personal attributes* is unique, and enables him or her to contribute in ways that others cannot. This in itself improves performance, but the sum of the parts leads to a stronger whole. The board chair constructs a strong board combining the unique capabilities of the independent directors on the board. The independent directors are able to *monitor* the contributions and performances of their peers, senior management and the company from their position of not relying on any one board position for their livelihood. This allows them to be candid and honest, leading to deeper debate and, one could assume, a better result.

The more common board *structure* with a ratio of independent directors to executive directors of about 70/30 gives the independent directors a strong voice. As a group, they can be more persuasive than the executive directors, and ensure that their views are heard. This structure also provides the shareholders and others with whom they have a *relationship* with a level of confidence that the independent directors are *representing* their best interests on their deliberations on the board. Furthermore, their independence allows them to represent interested parties, with those involved knowing that the independent directors are acting in the best interests of the company, and that there is no self-interest.

The final two 'roles' are not considered to be in the same category as the five described above. Information and company position were found to be critical influences on not only how independent directors perform their roles, but also how effective they can be.

All respondents raised the concept of what information independent directors can access. This is an issue that is under constant vigilance. If the independent directors do not have enough or the right information, they cannot be effective. If they have too much information, either the workload is excessive and they cannot digest and analyse it all, or they may get too close to managing the company through their detailed knowledge of its operations, and may lose their independence.

The respondent that was on three small company boards at the time of the interviews, with these companies recently listed on the stock exchange, first highlighted the influence of the company position on the role of independent directors. He had previously been an executive finance director of a large public company, so was able to differentiate between the roles on companies of different sizes, and companies going through a period of change. This issue was discussed in all interviews at appropriate points, resulting in more evidence supporting its importance.

Both information and company position heavily influence the role of independent directors, and should be more fully investigated through further research. This is covered later in this chapter.

6.2.1 Relating the results to the research problem

The research problem, highlighted in Section 4.2.1, was to investigate the role of the independent director from a commercial aspect through a well designed and robust study, structured and carried out in accordance with academic principles. This section compares the findings from the research with the existing knowledge identified in the literature review, as detailed in Chapter 3. This comparison indicates areas in the current literature that are aligned to the current research and, more importantly, highlights the areas in the current research that have previously been largely ignored or not considered important.

In the first part of this study, the relevant literature was reviewed through three pillars, with the analysis presented in Section 3.5.3. In summary, these results identified through the three pillars are:

LEGAL	GOVERNANCE	COMMERCIAL
•Performance Improvement	•Performance Improvement	•Performance Improvement
•Monitoring	•Monitoring	•Monitoring
	•Boundary Spanner	•Boundary Spanner

This study identified eight roles, the central one being performance enhancement:

- performance enhancement
- monitoring
- personal attributes

- structure
- representative
- relationships
- information
- company position.

One common factor between all three pillars in the analysis of the literature is performance improvement. From the legal view it is evident that independent directors have legal obligations to behave in certain ways, ensuring that they always act in the best interests of the company and, by performing to the best of their abilities, improving the performance of the board and the company. Similarly through the governance view, a series of guidelines and regulations have been established to encourage independent directors to perform their board duties to the full extent of their abilities. These guidelines and regulations have been structured to ensure that a company's board has a greater proportion of independent directors, and that they have the support structure that enables them to contribute to the performance of the board and the company.

While the literature in the commercial pillar lacks a proper foundation and is therefore unstructured, the conclusions that can be drawn from this view on performance improvement mirror those of the other pillars. The independence of this class of directors is highlighted as a main force behind their contributions, enabling them to contribute to the performance of the board and the company without major concern for any impact their comments or suggestions may have on others around the board table.

The performance improvement concept has been identified as the most significant in this study, and supports the analysis of the current literature which shows that this concept has also been regarded important in the past. However, the literature review identified three main concepts; performance improvement was merely one of these. In this study, it was the main concept identified through the methodological analysis of the data as defined by the use of grounded theory, and therefore its prominence is increased.

Monitoring is another common factor between the three pillars. In the literature review, this concept is found to be more specific to a 'policing' action by monitoring the behaviour and actions of others than actually monitoring their contributions. However, in the commercial pillar, monitoring the performance of others for the benefit of peer performance reviews is a consideration. The analysis of this role in the research through the interviews shows that monitoring is one of the functions undertaken by independent directors, and it is more closely aligned to the performance aspect around the board table. Both the literature review and this research confirm that monitoring is considered one of the more important concepts, which has been impacted upon by the spread of issues that are monitored, including the performance and contribution of others, monitoring against fraud, and monitoring performance against expectations.

The boundary spanner role is identified only in the governance and commercial pillars. It has not been legislated that independent directors should form a relationship with those outside the board, nor should it be. Therefore there are no instances of this in the legal pillar. Being a moral rather than a legal concept, it is logical for this issue to be raised in the two other pillars. The boundary spanner role identified in the literature review can be loosely compared with the relationship role identified through the analysis of the interview data. It could also possibly be compared with the representative role, but this would require further research to confirm. One of the concepts identified in the relationships category is the interaction with customers and suppliers, which was amended to interaction with stakeholders following further analysis. The boundary spanner role per se is not common to both data sets, although the results of this study indicate that independent directors interact with stakeholders, but not to the extent suggested through the literature review. This may change in the future with the inquiry into shareholder engagement (see Section 6.3 below, point 4), but most comments from this research indicate that the boundary spanner role be undertaken by the board chair, and not by independent directors, unless the board chair is an executive of the company.

The personal attributes concept identified in this research as having a major impact on performance improvement was discussed during the literature review at a less important level. In this research, the benefits that various independent directors bring to a board are considered to be more important now than in the past, as global and local market complexities have increased and companies and therefore boards face more issues now than they did previously. The balanced board concept has become more prominent, and shareholder and other stakeholder concerns of who is on the board and what they bring have also raised the importance of this issue. The personal attributes concept discussed through the literature is more concerned with governance issues – who the independent directors are and their level of independence – than with what they bring to the board table. In the commercial space, the concept has started to evolve more towards what has been identified in this research, supporting the observation that this is an emerging but increasingly important concept.

Structure is a concept that is rarely evident through the literature review. The main discussion in the literature concerns structure of the board regarding the proportion of independent and non-executive directors compared with executive directors. This concept has become more significant over time, similar to the personal attributes concept. In this research, structure issues are seen to have major impacts on performance, with structural issues now broader than initially discussed. The broader issues include the impact of structure on the other concepts identified in this study, such as the ability of the independent directors to obtain and verify information, and the combined impact of these relationships on performance enhancement.

The concept of information has been identified in this research as one of the major concepts regarding the role of independent directors. This concept has strong relationships with all other concepts, and is a major factor influencing whether independent directors perform their role to the best of their abilities. It is also an important issue raised through the literature review, particularly through the commercial space on the quality and reliability of information provided by others to the independent directors. The main difference, which can be viewed as the progression of the issue over time, is that through this research, independent directors should take more responsibility in obtaining, analysing and verifying information. They should have more contacts in and outside of the company from which to source information, and there is now more information generally available through the internet and other sources. Other than information being raised as an issue in the AWA case, the discussion around this concept is limited. It is not considered to be of great importance, especially following the second AWA case when some of the findings of the first case were overturned, but this research elevates the importance of this concept.

The concept of company position, with limited inclusion in past literature, has been identified by this research as one of the most influential concepts on the role of the independent director. In the literature, company position is shown to impact on structure, as smaller companies have fewer board members. There is also some limited discussion on smaller company board chairs being more selective on the skills and experience of independent directors, but the other related issues identified in this research are not discussed. Similar to information, as companies change over time in size, number, structure, complexity, markets and other influencing factors, company position has become more relevant and has emerged as a major defining concept on the role of independent directors.

The comparison between the literature review and this research has highlighted the relevance of the research and its contribution to knowledge. While all eight concepts identified in this research appear through the literature review, this research has shown how the importance of some of these concepts has evolved.

Performance enhancement has been identified in this research as the main role of the independent director, whereas it had been identified in the literature review as only one of three main roles. This difference shows its evolving importance relative to the role of independent directors.

The monitoring, personal attributes and structure concepts are also growing in importance. They have become more diverse over time as economic complexities increase. But the boundary spanner role of the independent director seems to have taken on less significance. This role is more evident in the literature on a theoretical basis, and investigation into current practices indicates that this role is one for the board chair and not the independent directors.

The evolving importance of information and company position as being the most critical to the role of the independent director has taken this research on the role of the independent director to the next level. As the role continues to evolve, this research has shown that these concepts will grow in importance. This conclusion will impact on the future behaviour of independent directors, and has a significant impact on practice and policy. This is discussed further in Section 6.4.4.

6.3 Limitations of the study

This study was necessarily narrow, focussing on independent directors and their role within Australia. The following limitations were identified:

1. This study concentrated on the role of independent directors. At the time of the interviews, all of the respondents were independent directors on at least one public company board, as well as not-for-profit and private company boards. Some respondents also held positions as executive directors and/or board chairs or deputy chairs on various types of organisations. While respondents were requested to limit their comments and responses to the role of independent directors, it was not always possible to ensure that this occurred.

2. The representativeness of the sample cannot be determined unless many more independent directors are interviewed under similar conditions. However, the commonality of responses and the lack of any new concepts revealed in the final two interviews mitigate this problem to some extent.

3. The invitation to participate was sent to 38 potential respondents, with 12 agreeing to be interviewed. Those who declined may have contributed differently from those who agreed to be interviewed.

4. The timing of the interviews may have impacted on the results, since three significant milestones occurred after the interviews had been completed. One was the review by the ASX of its Corporate Governance Principles. The second was the allowance by the High Court for shareholders to be treated as unsecured creditors in certain instances, as per the Sons of Gwalia case. The third was the more recently announced Parliamentary Joint Committee on Corporations and Financial Services inquiry into shareholder engagement and participation in the governance of companies.

5. Researcher bias could have been introduced as the researcher collected and analysed the data. However, the analytical methodology and triangulation used to analyse and verify the data should mitigate this.

6.4 Contribution to knowledge and to the improvement of professional practice or policy

In Section 3.5.3 the research topic was identified, and then further refined in Section 4.2.1. The aim of this study was to generate a theory on the role of the independent non-executive director in Australia. This theory was generated through research undertaken from a commercial aspect, as the analysis of the relevant literature identified a gap in this area of the literature. While the basic finding – that the role is to improve the performance of the board and the company – is not a revelation, the supporting data evidence this finding in a new light.

Seven other concepts were identified around the role, with five of these categorised as supporting roles: how independent directors go about their roles to maximise performance enhancement, why they are appointed to their boards, and what they do in performing their role. These five concepts could be used to construct a plan for improving performance.

Once appointed to a board, the independent director should learn about and understand the structure that has been built around the board, they should search around and define who and what they are representing, and they should take note of the relationships attached to that particular board as well as the impact of those they brought to the board with them. Within this structure and the understanding of those around them, the independent director should use their personal attributes to contribute, and monitor the impact of those contributions and other issues that surround the board and its undertakings. While some independent directors may do this subconsciously, it could be set out in a formal guide for new board members.

6.4.1 Significance of this research

The two other concepts that were identified around the role of the independent director were information and company position. These two concepts need to be strongly considered when contemplating the actions of independent directors in any situation that warrants examination.

6.4.2 Information

As was reviewed in Section 3.2.2, the subject of information was considered by the courts in the AWA cases relative to how much knowledge the independent directors had of the company's affairs. But the courts have subsequently moved away from distinguishing between different classes of directors and the impact of information available to them.

Comments from the respondents in this study indicate that it is not possible for independent directors to benefit from the same quantity and quality of information as executive directors. Independent directors are expected to make inquiry into issues of which they are not fully informed. They should question the CEO, other executive directors and senior management to clarify the information that has been provided to them. They should also question the same people on what other relevant information is available. Independent directors can also access information generally available to the public on the company, its competitors and the industry in which it participates, and, in some instances, they have also developed informal relationships within the company through which they can access other information.

However, this does not mean that independent directors will always be fully informed and have the same information as others in the company. The CEO, other executive directors and senior management may all be privy to information of which independent directors are unaware, or which they cannot access. If they so choose, these groups are able to keep this information hidden from the independent directors, no matter how diligent the independent directors may be in trying to access this information.

The courts and regulators should acknowledge that different classes of directors would probably have different information, as this can influence their deliberations in the boardroom, and could impact on decisions made in the boardroom. If these decisions are not fully informed and something goes wrong, the independent directors may be found to be liable. But if they have made every effort to obtain all relevant information, despite these efforts being unsuccessful, then they should not be held liable. It is recommended that legislators and regulators consider revisions to current policy with regard to different classes of directors.

6.4.3 Company position

The position of a company can have a significant effect on the role of an independent director. The position of a company can be determined by the size of the company, its position in its life cycle, recent changes to its structure, its profitability or its reputation, or if it is in the process of substantial change such as a merger, acquisition, divestment or major restructure. General economic, industry and competitor issues can also have an effect on a company's position.

Independent directors tend to become more involved in a company's operations in certain circumstances. In smaller companies, independent directors may become involved in day-to-day activities if the companies lack staff numbers or staff experience in some areas. This study saw a number of examples where independent directors on boards of companies recently listed on the stock exchange have become more involved in the business. This was mainly to bring the benefit of their experience to those working in the company, and it would not normally be an ongoing role.

Other examples highlighted by interview respondents include one senior independent director being requested by the board chair to review one of the company's major projects that was experiencing major difficulties. This respondent, together with another independent director, reviewed the project, reported back to the board, provided recommendations for correcting the problems, and then oversaw the project on behalf of the board until it was performing to expectations. This is an example of being highly involved in part of the company's operations in a special circumstance. There were other similar examples in cases of a major corporate restructure, and several cases of companies newly listing on the stock market either through an IPO or a spin-off from an existing public company.

The issues raised in this concept put independent directors on the opposite side to the issues discussed in the previous section. Here, they were more involved and knew more about certain aspects of the company, whereas in the previous section, they knew less about the company through lack of information.

If companies suffer problems, the courts and regulators should look closely at what involvement, if any, the independent directors have in the company's operations outside the boardroom. Those independent directors who are closely involved could be more liable than others.

6.4.4 Impact on professional practice and policy

In Section 6.2.2 the results of this research were compared with the previous literature. The issues that have progressed indicate the areas of the greatest impact on practice and policy.

Independent directors should be aware of the impacts these findings have on how they undertake their roles. Through the education available through the AICD and other similar bodies, and the induction program that any reasonable company should provide, independent directors should have good knowledge of what is expected from them and the risks inherent in their jobs. These findings add another dimension to the role.

The issues arising from the relevant findings about information and company position add another chapter to the already complex instruction book for the boardroom. These two issues appear to be strongly related, and practitioners should be aware of the relevant impact for each board position that they hold.

Independent directors need to be aware of the expectations of them for each board position. They need to recognise that a board position for a company that is small or going through a period of change will possibly require work beyond the boardroom, which could put them in a position of greater risk. They may be more involved in the operational side, crossing the line between the board and management, and will be privy to more information than otherwise.

If independent directors' crossing this line to advise on an issue is a once-only occurrence, then that is just the chairman using the personal attributes of that independent director to assist in improving the company's performance. But if this crossing of the line becomes a regular occurrence, there is the danger of that independent director being seen as part of management.

This research has shown that an increasing number of interested parties are questioning the reasons behind the appointment of new independent directors. The expected contributions of new independent directors are more important to investors, shareholders and other interested parties. New appointees must be aware of what is expected of them. They should be seen to bring expert knowledge and skills in their area of specialisation, they should probably have contacts outside the organisation that can benefit the company, and they should be able to positively contribute in other areas. This rising awareness on both sides has come from the increased reliance of many investors on the equity markets for their financial security and future living expenses.

There is a growing tendency to appoint new and inexperienced independent directors to public company boards (Korn/Ferry, 2002). Good governance indicates that each new director be provided with an induction pack, and that the board chair explain why they had been selected to join the board. But from a theoretical viewpoint, new independent directors may be unaware of what or how they are expected to contribute. The findings of this study could be used as the basis for a training guide for new independent directors.

While all independent directors should analyse all information provided to them, they should ask questions of others if they do not fully understand this information, or its relevance or importance. They should also request additional information if they consider that what has been provided to them is inadequate or incorrect. Information flow is critical to being informed and therefore being in a position to add value. But too much information can also be a problem. Independent directors should not be involved in the management of an organisation, which can be the result if they are provided with too much information. They should be able to understand how the company is performing and the issues that affect this performance, by using the information provided to them. There is a fine line between too much or not enough information.

The findings from this research have further advanced the importance of information to the role of independent directors. Having the right amount and quality of information is critical in enabling independent directors to perform to the best of their abilities. As most non-public information provided to the independent directors comes from the company's management, this research indicates that independent directors should attempt to independently verify this information and establish informal sources of information from within other areas of the company to ensure that they are aware of all critical issues. This is a check against possible fraud or simple underperformance of senior management, but it may also ensure the health and viability of the company. The impact of this could be enhanced by independent directors establishing other sources of information outside the company. This would provide a positive addition to their knowledge and should assist in improving their contribution.

If the independent directors become too involved through the level of contribution due to their expertise, or too knowledgeable through the level of information they have obtained, they may come to be seen as part of management. This may have a significant impact on their independence, whether this is real or perceived. One of the reasons for employing independent directors is for their independence. Once this is compromised and they can no longer be considered independent, the structure of the board changes, which may impact on how investors view the company.

This may also be an issue for how legislators and regulators view independent directors. It would be difficult to impose legislation or regulations that determine what independent directors can do, or how deeply they can become involved in the company's operations on a casual or regular basis. Regulators such as the ASX can recommend best practice, with non-compliance explained by the company in its annual report. But legislators cannot direct how involved independent directors can become. This may lead to a constraint on their contribution to the performance of the board and the company, which defeats the purpose of having independent directors.

The benefit of increased information enabling independent directors to check against fraud becomes more significant as the amount of monitoring conducted by independent directors also increases. This research has shown that this is a greater expectation of independent directors than it was previously. Monitoring the contribution and performance of the other directors, senior management and the performance of the company generally by independent directors is an increasingly important role, and this has been recognised by the expectation that all boards undertake performance reviews. Monitoring for fraud prevention is more recent, and this should impact on policy and practice.

The most important contribution of this research is that company position has a significant influence on the role of the independent director. All other seven identified concepts may influence the impact of company position at any one time, but legislators and regulators should be aware of the position of the company and the interaction of the independent directors within that company through both law and oversight.

The results of this study have highlighted the impact of information and company position on the role of the independent director. Further research needs to be undertaken to enable practitioners, legislators and regulators to quantify the magnitude of this impact.

6.5 Areas for further research

From the discussions in the previous section, the results of this study open up a new area of research: the independent directors' level of activity in a company's operations due to either the position of the company or the information they have been provided, or a combination of both. This may assist in judging the continuing independence of an independent director, or how informed an independent director had become on issues that may have led to the downfall of a company.

The link between information and company position, while evident, has not been investigated in depth in this study, but it appears to be strong. As independent directors in smaller companies spend more time working in the company than on board issues, it follows that they have more information than they would have otherwise. Similarly, independent directors in a company going through significant change, such as a divestment or major restructure, would also be more involved in company matters. One of the respondents who was on the board of a major public company commented that while that company was going through significant change, the board met at least three times each month, instead of the usual once. In addition, two of the independent directors worked on a special sub-committee on a full-time basis and reported back to the board periodically.

To further study the link between information and company position relative to the role of independent directors, research could compare the amount and type of information received by independent directors working on the boards of both large and small companies. For an alternative view, studying the information received by independent directors on boards of companies that go from a period of stability to significant change could be considered. An example of this would be the independent directors on the board of Qantas, before, during and after the failed takeover attempt by APA.

This study has investigated the role of independent directors from their own point of view, but the role could be considered from other viewpoints. These should be from other groups that have both an interest in the issue and the ability to comment from an educated stance. These groups could include board chairs, shareholders and/or stakeholders, executive directors, and those who closely observe but do not participate, company secretaries.

6.6 Summary and conclusion

This study has resulted in a grounded theory that the role of the independent non-executive director in Australia is to improve the performance of the board and the company.

This role is influenced by seven factors. The first five – personal attributes, monitoring, structure, relationships and representative – inform us of what independent directors do in undertaking their roles. The last two –information and company position – inform us of the two external issues that impact on how independent directors carry out their roles. Between them, the seven factors inform us why independent directors act as they do in performing their roles.

REFERENCES

Arbouw, J. 2004. *The Empty Boardroom, Is this becoming a reality?* Company Director, October, pp. 8 – 14.

ASX Corporate Governance Council. 2003. *Principles of Good Corporate Governance and Best Practice Recommendations.* Sydney. Australian Stock Exchange.

Australian Corporations Legislation, 1997. *Corporations Law.* Sydney, Butterworths.

Australian Government Solicitor, 1997. Legal Briefing No. 38.

Bailey, K. D. 1982, *Methods of Social Research,* New York, The Free Press, 2nd Edition, Chapter 8.

Barratt, R. & Korac-Kakabadse, N. 2002. *Developing reflexive corporate leadership: The role of the non-executive director*. Corporate Governance. Bradford. Volume 2. Issue #3.

Barrow, C. 2001. *The Role of Non-Executive Directors in High Tech SMEs.* International Journal of Business in Society. Cranfield. Volume 1. Issue #2.

Bartholomeusz, S. 2002. *After Enron: The New Reform Debate.* University of New South Wales Law Journal. Sydney. Volume 25(2).

Baxt, R. 1990a. *Directors Cannot Escape Liability by Doing Nothing*. Australian Business Law Review. Sydney. Volume 18. Issue #6.

Baxt, R. 1990b. *The Role and Behaviour of Company Directors – Phase 2*. Australian Business Law Review. Sydney. Volume 18. Issue #1.

Baxt, R. 1992a. *Company Law: Sleeping Directors Get a Second Chance.* Australian Business Law Review. Sydney. Volume 20. Issue #1.

Baxt, R. 1992b. *Company Law: Historic Statement on the Duties of Directors.* Australian Business Law Review. Sydney. Volume 20. Issue #5.

Baxt, R. 1994. *Have the Courts Been Too Generous in Excluding Directors for Breaches of Duty?* Australian Business Law Review. Sydney. Volume 22. Issue #3.

Baxt, R. 1995. *Defining Directors' Duties.* Charter. Sydney. Volume 66. Issue #7.

Baxt, R. 2000a, *Duties and Responsibilities of Directors and Officers,* Sydney, Australian Institute of Company Directors, 16th Edition.

Baxt, R. 2000b. *Are we going too far in changing the duties of directors?* CA Charter. Sydney. Volume 71. Issue #5.

Baxt, R. 2001. *Caught sleeping*. CA Charter. Sydney. Volume 72. Issue #7.

Baxt, R. 2002a. *Duties and Responsibilities of Directors and Officers.* The Australian Institute of Company Directors. Sydney. 17th Edition.

Baxt, R. 2002b. *The HIH litigation.* Australian Business Law Review. Sydney. Volume 30. Issue # 2.

Baxt, R., Renard, I., Simkiss. R., Webster, J., & Ramsay, I. 2000. *"CLERP" Explained.* CCH Australia, Sydney.

Berle, A.A. & Means, G.C. 1932. *The Modern Corporation and Private Property.* New York. Macmillan.

Bertaux, D. 1981. *Biography and Society: The Life History Approach in the Social Sciences.* Beverly Hills. Sage.

Bird, H. 1995. *The Rise and Fall of the Independent Director.* Australian Journal of Corporate Law. Sydney. Volume 5.

Black, A., Bostock, T., Golding, G. & Healey, D. 2000. *CLERP and the new Corporations Law.* Sydney, Butterworths. 2nd Edition.

Blainey, G. 2001. *The Tyranny of Distance,* Pan Macmillan, Sydney.

Bosch, H. 1995a. *Corporate Practices and Conduct.* Pitman, Melbourne.

Bosch, H. 1995b. *The Director at Risk, Accountability in the Boardroom.* Pitman, Melbourne.

Bosch, H. 2002. *The Changing Face of Corporate Governance.* University of New South Wales Law Review. Sydney, Volume 25(2)

Bouy, C. 2005. *On Corporate Governance, Management and Entrepreneurship in OECD Countries.* Corporate Ownership & Control. Volume 2 Issue 3.

Boyd, C. 1996. *Ethics and Corporate Governance: The issues raised by the Cadbury Report in the United Kingdom.* Journal of Business Ethics. Dordrecht. Volume 15. Issue #2.

Bryman, A. 2004. *Social Research Methods,* Oxford, Oxford University Press. 2nd Edition.

Buffini, F. 2004. 'Directors face even greater expectations', *Australian Financial Review,* 11 March, Special Report p. 16.

Burgess, R.G. 1982. *Field Research: A Sourcebook and Field Manual.* London. Allen & Unwin.

Business Law Education Centre, 1996. *Accountability in the Boardroom,* Business Law Education Centre. Melbourne.

Byrt, W. J. 1981. *The Australian Company: Studies in Strategy and Structure.* London. Croom Helm.

Cadbury Report, 1992. *The Financial Aspects of Corporate Governance.* London.

Carroll, G. R. & Teece, D. J. 1999. *Firms, Markets, and Hierarchies*. New York. Oxford University Press.

Carter, C & Losch, J. 2004. *Back to the Drawing Board – Designing Corporate Boards for a Complex World.* CCH Auastralia. Viewed 29 March 2004 <http://www.ccc.com.au/feature_story.asp?document_id=47265

Cassidy, J. 1995. *An Evaluation of Section 232(4) of the Corporations Law and the Directors' Duty of Due Care, Skill and Diligence.* Australian Business Law Review. Sydney. Volume 23. Issue #3.

Cassidy, J. 2006. *Concise Corporations Law.* Sydney, Federation Press. 5th Edition.

Charmaz, K. 2000 *Grounded Theory: Objectivist and Constructivist* Methods in Denzin, N. K. & Lincoln, Y. S. 2000. *Handbook of Qualitative Research,* Thousand Oaks, Sage Publications.

Charmaz, K. 2006. *Constructing Grounded Theory. A Practical Guide Through Qualitative Analysis,* London, Thousand Oaks.

Chartered Institute of Management Accountants 2000. *Corporate Governance: Executive Summary,* Chartered Institute of Management Accountants, London.

Clarke, T. 1998. *The contribution of non-executive directors to the effectiveness of corporate governance*. Career Development International. Bradford. Volume 3. Issue #3.

Companies & Securities Advisory Committee. 1999. *Shareholder Participation in the Modern Listed Public Company. Discussion Paper.* Sydney. Australian Securities and Investments Commission.

Conrad, C.F. 1978. *A Grounded Theory of Academic Change.* Sociology of Education. Volume 51.

Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill, 2003.

Corporate World News. 2005. *One Shareholder One Vote.* Corporate Ownership & Control. Volume 2 Issue 4.

Corporations Act, 2001.

Coulson-Thomas, C. 1992. *Creating the Global Company*. London. McGraw-Hill.

Cox, P. 2001. *Corporate governance: Getting the benefits* .CA Charter. Sydney. Volume 72. Issue #3.

Crabtree, B. F. & Miller, W. L. 1999, *Doing Qualitative Research,* California, Sage Publications, 2nd Edition.

Creswell, J. W. 1998, *Qualitative Inquiry and Research Design: Choosing Among Five Traditions*, Thousand Oaks, Sage Publications.

Creswell, J.W. & Miller, DL. 1997. *Validity (verification) in qualitative research: Perspectives, Terms, Procedures, and Methodologies.* Unpublished manuscript, Department of Educational Psychology, University of Nebraska – Lincoln.

Cutting, B. & Kouzmin, A. 2000. *The Emerging Patterns of Power in Corporate Governance – Back to the Future in improving Corporate Decision Making.* Journal of Managerial Psychology. Bradford. Volume 15. Issue #5.

Dallas, G., Bradley, N. & Byrne, I. 2003. *Measuring Corporate Governance.* Keeping Good Companies. ICSA International. March 2003.

De Miguel, A., Pindado, J. & de la Torre, C. 2005. *Ownership Structure and Performance: A Comparison of Different Corporate Governance Systems.* Corporate Ownership & Control. Volume 2 Issue 4.

Demsetz, H. 1997. *The Economics of the Business Firm.* Cambridge. Cambridge University Press.

Denzin, N. K. 1970, *Sociological Methods A Sourcebook,* Chicago, Aldine.

Denzin, N. K. 1989. *The Research Act: A Theoretical Introduction to Sociological Methods.* Chicago, Aldine.

Denzin, N. K. & Lincoln, Y. S. 1998. *Collecting and Interpreting Qualitative Materials,* Thousand Oaks, Sage Publications.

Denzin, N.K. & Lincoln, Y.S. 2000. *The Handbook of Qualitative Research. Thousand Oaks. Sage.*

DuBois, A. B. 1938. *The English Business Company after the Bubble Act 1720 – 1800.* New York. Octagon.

Du Plessis, J. J.,McConville, J., Bagaric, M. 2005. *Principles of Contemporary Corporate Governance.* New York. Cambridge University Press.

Emory, C. W. & Cooper, D. R. 1991. *Business Research Methods.* Homewood, Illinois, Irwin. 4th Edition.

Ezzy, D. 2002. *Qualitative Analysis. Practice and Innovation.* Sydney, Allen & Unwin.

Finlay, A. 1999. *CLERP: Non-executive directors' duty of care, monitoring and the business judgement rule.* Australian Business Law Review. Sydney. Volume 27. Issue #2.

Flick, U. 2002a, *"Semi-Structured Interviews" in An Introduction to Qualitative Research,* London, Sage Publications, Chapter 8, pp. 74-95.

Flick, U. 2002b, *An Introduction to Qualitative Research,* London, Sage Publications, 2nd Ed.

Fontana, A. & Frey, J. H. 2000, *"The Interview: From Structured Questions to Negotiated Text"* in N. K. Denzin and Y. S. Lincoln (eds) Handbook of Qualitative Research, Thousand Oaks, Sage Publications, 2nd Edition, Chapter 4, pp. 645 – 672.

Francis, I. 1997. *Future Direction. The Power of the Competitive Board.* Melbourne. FT Pitman.

Garrat, B. 2003. *The future for boards: professionalisation or incarceration?* ICSA International, October. ICSA, Sydney.

Gay, G & Simnett, R. 2000. *Auditing & Assurance: Services in Australia.* Sydney. McGraw Hill.

Geletkancyz, M. A. & Hambrick, D. C. 1997. *The external ties of top executives: implications for strategic choice performance.* Administrative Science Quarterly. Ithaca. Volume 42. Issue # 4.

Gething, M. 1996. *Do We Really Need Criminal and Civil Penalties for Contraventions of Directors' Duties?* Australian Business Law Review. Sydney. Volume 24. Issue #5.

Glaser, B.G. 1992. *Basics of Grounded Theory Analysis.* Mill Valley. Sociology Press.

Glaser, B. G. & Strauss, A. L. 1967. *The Discovery of Grounded Theory,* New York, Aldine Publishing.

Glesne, C. 1999. *"Making Words Fly: Developing Understanding Through Interviewing"* in Becoming Qualitative Researchers: An Introduction, New York, Longman, 2nd Edition, Chapter 4, pp. 67 – 94.

Greenbury Report, 1995. *Directors' remuneration.* London.

Greenhow, A. 1999. *The statutory business judgement rule: putting the wind into directors' sails.* Bond University, 11 Bond LR.

Ham, P. 2002. *New-age NEDs.* CA Charter. Sydney. Volume 73. Issue #2,

The Hampel Report, 1998. *Committee on Corporate Governance.* The Committee on Corporate Governance and Gee Publishing, London.

Hart, C. 1998. *"Doing a Literature Review"* London, Sage Publications.

Heracleous, L. & Luh, L.L. 2002. *Who Wants to be a Competent Director? An Evaluation Tool of Directors' Knowledge of Governance Principles and Legal Duties.* Corporate Governance. Volume 2 Issue 4.

Heywood, D. 1996. *Treasury Risk Management: What Directors Need to Know.* Australian CPA. Melbourne. Volume 66. Issue #4.

The Higgs Report. 2003. *Review of the role and effectiveness of non-executive directors.* The Stationery Office, London.

Hii, S-K. 1999. *Directors' duties to prevent insolvent trading*. Australian Business Law Review. Sydney. Volume 27, Issue # 3.

Hilmer, F. G. 1998. *Strictly Boardroom, 2nd ed.* Information Australia, Melbourne.

Horrigan, B. 2002. *Fault lines in the intersection between corporate governance and social responsibility.* University of New South Wales Law Journal, Volume 25(2).

Horwarth, 2002. *Corporate Governance Report.* Horwarth, Sydney.

Huberman, A.M. & Miles, M.B. 2002. *The Qualitative Researcher's Companion.* Thousand Oaks. Sage.

Hussey, J. & Hussey, R. 1997. *Business Research: A Practical Guide for Undergraduate and Postgraduate Students,* Palgrave, Hampshire.

Kakabadse, A., Ward, K., Korac-Kakabadse, N. & Bowman, C. 2001. *Role and Contribution of Non-Executive Directors*. Corporate Governance. Bradford. Volume 1. Issue #1.

Keay, J. 1991. *The Honourable Company: a history of the East India Company.* London. Harper Collins.

Korn/Ferry, 2000. *Boards of Directors Study in Australia and New Zealand.* Korn/Ferry, Sydney.

Korn/Ferry, 2002. *Boards of Directors Study in Australia and New Zealand.* Korn/Ferry, Sydney.

Korn/Ferry. 2006. *Boards of Directors Study in Australia and New Zealand.* Korn/Ferry, Sydney.

Leith, P. 2002. *Independence, bunkum!* ICSA International, October. ICSA, Sydney.

Leninger, M. 1994. *Evaluation Criteria and Critique of Qualitative Research Studies* in Morse, J. M. (ed) *Critical Issues in Qualitative Research Methods.* Thousand Oaks, Sage.

Lincoln, Y. S. & Guba, E. G. 1985. *Naturalistic Inquiry.* Beverly Hills, Sage Publications.

Locke, L. F., Silverman, S. J. & Spirduso, W. W. 2004. *Reading and Understanding Research*, Thousand Oaks, Sage Publications.

Locke, L. F., Spirduso, W. W. & Silverman, S. J. 1993. *Proposals That Work.* Newbury Park, Sage Publications. 3rd Edition.

Lofland, J. 1971. *Analyzing Social Settings: A Guide to Qualitative Observation and Analysis.* Belmont. Wadsworth.

Lyons, M. 1995. *Non-Executive Directors Have No Lesser Duty.* Australian CPA. Melbourne. Volume 65. Issue #7.

Maxwell, J. A. 1996. *Qualitative Research Design. An Interactive Approach.* Thousand Oaks, Sage Publications.

McConvill, J. 2001. *Current Developments and Notes: Ensuring Balance in Corporate Governance: Parts 2F.1 and 2F.1A of the Corporations Law.* Australian Journal of Corporate Law. Sydney. Volume 12.

McDonald, G. 1995. *Administering the Corporate Machine. Corporate Law Simplification Bill and other Proposals* in *Business & Corporate Practice Alert.* Sydney, Legal and Accounting Management Seminars.

McMillan, V. 2003. *Who'd be an independent director?* ICSA International, February. ICSA, Sydney.

Miles, M. B. & Huberman, A. M. 1994. *Qualitative Data Analysis,* Thousand Oaks, Sage Publications, 2nd Edition.

Miller, D C. 1991. *Handbook of Research Design and Social Measurement.* Newbury Park. Sage Publications. 5th Edition.

Moodie, A.M. 2003a. 'Corporate Governance, The art of the long view in Australian Boardrooms', *Journal of Banking & Financial Services,* August / September, pp. 22 – 25.

Moodie, A.M. 2003b. *Talk less, argue more*. CFO. September, p. 18.

Morrow, S.L. & Smith, M.L. 1995. *Constructions of Survival and Coping by Women Who Have Suffered Childhood Sexual Abuse.* Journal of Counselling Psychology. Volume 42.

Morse, J. M. & Richards, L. 2002. *Readme First for a User's Guide to Qualitative Methods.* Thousand Oaks, Sage Publications.

Muth, M. M. & Donaldson, L. 1998. *Stewardship Theory and Board Structure: a contingency approach.* Corporate Governance. Volume 6 No. 1.

Nelson, R. 2002. *The Combined Code: towards a risk management culture.* Risk Transfer Magazine. Volume 1 Issue 1, pp.84-92.

Nicholas, K. 2004. *'Independents not welcome on board'*, Australian Financial Review, 16 March, p. 16.

Nichols, T. 1969. *Ownership Control and Ideology.* London. George Allen & Unwin.

Nicoll, G. 1994. *The Changing Face of the "Company as a Whole" and Directors' Responsibilities to Members in the Exercise of Management Powers.* Australian Journal of Corporate Law. Sydney. Volume 4.

Northcutt, N. & McCoy, D. 2004. *Interactive Qualitative Analysis. A Systems Method for Qualitative Research.* Thousand Oaks, Sage Publications.

Organisation for Economic Co-Operation and Development 1997. *Current issues in corporate governance (Australia).* OECD. Paris.

Organisation for Economic Co-Operation and Development. 1999. *OECD Principles of Corporate Governance.* OECD. Paris.

Organisation for Economic Co-operation and Development. 2004a. *OECD Principles of Corporate Governance. Draft Revised Text.* OECD. Paris.

Organisation for Economic Co-operation and Development. 2004b. *OECD Principles of Corporate Governance.* OECD. Paris.

Parker, L. D. & Roffey, B. H. 1997. *Back to the Drawing Board: Revisiting Grounded Theory and the Everyday Accountant's and Manager's Reality,* Accounting, Auditing and Accountability Journal. Vol. 10, No. 2, pp. 212-247.

Patton, M. Q. 2002. *Qualitative Research & Evaluation Methods.* Thousand Oaks. Sage Publications. 3rd Edition.

Pease, G. & McMillan, K. 1993. *The independent non-executive director.* Longman, Melbourne.

Pole, C. & Lampard, R. 2002. *Practical Social Investigation. Qualitative and Quantitative Methods in Social Research.* Edinburgh Gate, Prentice Hall.

Ponssard, J-P., Plihon, D. & Zarlowski, P. 2005. *Towards a Convergence of the Shareholder and Stakeholder Models.* Corporate Ownership & Control. Volume 2 Issue 3.

Prasad, P. 2005. *Crafting Qualitative Research. Working in the Postpositivist Traditions.* Armonk. M.E.Sharp.

The Ramsay Report. 2001. *Independence of Australian Company Auditors.* Commonwealth of Australia, Parkes.

Ravlic, T. 1999. *CLERP sets a new framework.* Australian CPA. Melbourne. Volume 69. Issue #11.

Rogers, A. 2002. *AWA to HIH: Asleep at the post?* ICSA International. November. ISCA, Sydney.

Rubin, H. J. & Rubin, I. S. 1995. *Qualitative Interviewing: The Art of Hearing Data,* Thousand Oaks, Sage Publications, Chapter 7, pp. 145 – 167.

Rubner, A. 1965. *The Ensnared Shareholder.* Middlesex. Penguin.

Sarbanes-Oxley Act of 2002.

Scherrer, P. S. 2003. *Directors' responsibilities and participation in the strategic decision making process.* Corporate Governance. Bradford. Volume 3. Issue #1.

Seale, C. 2004, *Social Research Methods. A Reader,* London, Routledge.

Segal, J. 2002. *Corporate Governance: Substance over form.* University of New South Wales Law Journal. Volume 25(2).

Seidman, I. 1998. *Interviewing as Qualitative Research.* Teachers College Press, Teachers College, Columbia University, New York.

Sexton, T-L. 2001. *Corporate collapse: Who's to blame?* Australian CPA. Melbourne. Volume 71. Issue #11.

Sievers, A.S. 1993. *Farewell to the Sleeping Director.* Australian Business Law Review. Sydney. Volume 21. Issue #2.

Silverman, D. 2005, *Doing Qualitative Research,* London, Sage Publications, 2nd Edition.

Sims, M. A. 2003. *Corporate Governance and Company Director Responsibilities.* Charles Sturt University, Wagga Wagga.

Singleton, R. A. Jr, & Straits, B. C. 2005. *Approaches to Social Research.* New York, Oxford University Press, 2nd Edition.

Smith, R., 2003, *Audit Committees - Combined Code Guidance: A Report and Proposed Guidance by an FRC Appointed Group Chaired by Sir Robert Smith*, Financial Reporting Council (United Kingdom), London.

Stapledon, G. P. 1998. *The Hampel report on corporate governance.* Company and Securities Law Journal. Volume 16.

Stapledon, G. P. & Lawrence, J. 1997. *Board Composition, Structure and Independence in Australia's Largest Listed Companies.* Melbourne University Law Review, Volume 21.

Strauss, A. L. 1987, *Qualitative Analysis for Social Scientists*. Cambridge, Cambridge University Press.

Strauss, A.L. & Corbin, J. 1990. *Basics of Qualitative Research: Grounded Theory Procedures and Techniques.* Newbury Park. Sage.

Strauss A. L. & Corbin, J. 1997, *Grounded Theory in Practice,* Thousand Oaks, Sage Publications.

Surgeon, P. 2003. *Corporate Governance and directors' duties.* Global Corporate Governance and Directors' Duties Handbook. London.

Teng, K. L. L., Fie, D. Y. G. & Shanmugam, B. 2004. *The Enigma of Corporate Governance.* Corporate Ownership & Control. Volume 1 Issue 3.

Tomasic, R. 2001. *Governance and the Evaluation of Corporate Law and Regulation in Australia.* Corporate Governance. Volume 1 Issue3.

Tricker, B. 2005. *Corporate Governance – A subject Whose Time Has Come.* Corporate Ownership & Control. Volume 2 Issue 2.

Tricker, R. I. 1978. *"The Independent Director" A Study of the Non-Executive Director and of the Audit Committee.* Deloitte Haskins & Sells. Croydon, Tolley Publishing Company

Turnbull, S. 1999. *Governance codes are misleading.* CA Charter. Sydney. Volume 71. Issue #11.

The Turnbull Report. 1999. *Internal control – Guidance for directors on the combined code.* The Institute of Chartered Accountants in England & Wales. London.

Unkles, J. 2002. *Corporate governance in Australia – a fork in the road.* Journal of Banking and Financial Services. October. pp. 2-3.

Vinten, G. 2001. *Corporate governance and the sons of Cadbury.* Corporate Governance, Volume 1. Issue # 4.

Wallis, S. 2000. *Corporate governance – conformance or performance.* Journal of Banking and Financial Services. August, pp. 14 –19.

Weinberg, D. 2002. *Qualitative Research Methods.* Malden, Blackwell.

Wengraf, T. 2002. *Qualitative Research Interviewing. Biographic Narrative and Semi-Structured Methods.* London, Sage Publications.

Appendices

Appendix 1
Number of listed companies on various stock exchanges from 1990 to 2005

Total, excluding investment funds

Exchange	End 1990	End 1991	End 1992	End 1993	End 1994	End 1995	End 1996	End 1997	End 1998	End 1999	End 2000	End 2001	End 2002	End 2003	End 2004	End 2005
Americas																
American SE	859	860	843	889	824	791	751	710	711	650	649	606	571	557	575	595
Bermuda SE	NA	NA	NA	NA	NA	NA	NA	NA	62	45	47	50	54	55	58	56
Buenos Aires SE	179	170	170	165	156	149	147	136	131	125	125	119	114	110	107	104
Colombia SE	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	108	106	98
Lima SE	NA	NA	NA	235	220	243	238	248	249	239	227	227	230	227	224	224
Mexican Exchange	390	207	199	190	206	185	193	198	195	190	177	172	169	237	326	326
Nasdaq	4,132	4,094	4,113	4,611	4,902	5,127	5,556	5,487	5,068	4,829	4,734	4,063	3,649	3,294	3,229	3,164
NYSE	1,774	1,989	1,750	1,945	2,128	2,242	2,476	2,626	2,670	3,025	2,468	2,400	2,366	2,308	2,293	2,270
Santiago SE	216	223	244	263	277	282	290	294	287	282	261	249	246	240	240	246
Sao Paulo SE	579	570	565	551	549	544	551	545	535	487	467	441	412	391	388	381
TSX Group 1	1,193	1,138	1,119	1,193	1,251	1,258	1,323	1,420	1,433	1,456	1,394	1,299	3,791	3,599	3,604	3,758
Asia - Pacific																
Australian SE	1,136	1,005	1,073	1,107	1,185	1,178	1,190	1,219	1,222	1,287	1,406	1,410	1,421	1,471	1,583	1,714
Bombay SE	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA				4,730	4,763
Bursa Malaysia	271	321	366	410	475	526	618	703	731	752	790	807	861	902	959	1,019
Colombo SE	NA	NA	NA	197	211	222	235	239	240	237	239	238	238	244	242	239
Hong Kong Exchanges	299	357	413	477	529	542	583	658	680	708	790	867	978	1,037	1,096	1,135
Jakarta SE	123	139	153	172	217	237	252	281	287	276	286	315	331	333	331	336
Korea Exchange 2	677	686	688	693	699	721	760	776	748	712	702	688	683	684	683	1,616
National Stock Exchange India	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	1,041	916	911	957	1,034
New Zealand Exchange	245	196	167	180	187	175	170	180	182	189	203	195	196	208	200	185
Osaka SE	1,138	1,158	1,163	1,178	1,199	1,222	1,256	1,275	1,272	1,281	1,310	1,335	1,312	1,140	1,090	1,064
Philippine SE	153	161	169	178	189	205	216	221	222	226	230	232	234	236	235	237
Shanghai SE	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	646	715	780	837	833
Shenzhen SE	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	508	508	505	536	544
Singapore Exchange 3	172	182	195	216	251	272	296	334	358	408	480	492	501	560	633	686
Taiwan SE Corp.	205	221	256	285	313	347	382	404	437	462	532	586	641	674	702	696
Thailand SE	159	270	305	347	389	416	454	431	418	392	381	385	398	420	463	504
Tokyo SE	1,752	1,764	1,768	1,775	1,782	1,791	1,833	1,865	1,890	1,935	2,096	2,141	2,153	2,206	2,306	2,351

Source: World Federation of Exchanges

Appendix 1 (continued)

Exchange	End 1990	End 1991	End 1992	End 1993	End 1994	End 1995	End 1996	End 1997	End 1998	End 1999	End 2000	End 2001	End 2002	End 2003	End 2004	End 2005
Europe - Africa - Middle East																
Athens Exchange	140	151	156	145	173	186	200	210	229	262	310	314	324	332	341	304
BME Spanish Exchanges	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Borsa Italiana	220	267	258	259	260	254	248	239	243	270	297	294	295	279	278	282
Budapest SE	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	59	56	48	51	46	44
Cairo & Alexandria SEs	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	795	744
Cyprus SE	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	124	119
Deutsche Börse 4	NA	NA	NA	NA	NA	NA	NA	NA	662	851	983	983	934	866	819	764
Euronext	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	1,216	1,195	1,114	1,392	1,333	1,259
Irish SE	NA	NA	NA	NA	NA	89	86	102	100	101	96	87	76	66	65	66
Istanbul SE	110	134	145	160	176	205	228	259	278	286	316	311	289	285	297	304
JSE	769	728	671	631	624	638	626	642	669	658	606	532	451	411	389	373
Ljubljana SE	NA	NA	NA	16	17	17	45	78	90	130	149	151	135	134	140	116
London SE	2,559	2,572	2,440	2,412	2,416	2,502	2,623	2,513	2,423	2,274	2,374	2,332	2,824	2,692	2,837	3,091
Luxembourg SE	732	218	221	217	272	283	278	284	276	277	270	257	245	242	234	245
Malta SE	NA	NA	NA	NA	NA	5	6	6	7	9	10	12	13	13	13	13
Mauritius SE	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	29	30
OMX Copenhagen SE	284	271	219	257	251	252	249	249	254	242	235	217	201	194	183	-
OMX Helsinki SE	77	65	62	58	65	73	71	126	131	150	158	155	149	145	137	-
OMX Stockholm SE	132	127	205	205	228	223	229	261	276	300	311	305	297	282	276	-
OMX 5	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	678
Oslo Børs	121	112	123	135	146	165	172	217	235	215	214	212	203	178	188	219
Swiss Exchange	422	424	470	464	457	449	436	428	424	412	416	412	398	419	409	400
Tehran SE	NA	97	114	119	142	169	221	250	261	277	285	297	307	345	402	408
Tel-Aviv SE	216	286	378	558	638	654	655	659	662	654	665	649	624	577	578	584
Warsaw SE	NA	9	16	22	44	65	83	143	198	221	225	230	216	203	230	241
Wiener Börse	151	151	160	155	153	148	142	138	128	114	111	111	129	125	120	111

Information notes:
1 TSX Group : as from 2002, data include Toronto Exchange and TSX Venture
2 From 2004, Korea Exchange figures include Kosdaq following the integration of Korea Exchange
3 Since 2003, Singapore Exchange includes Singapore-incorporated companies, foreign-incorporated companies with a primary listing, and foreign-incorporated companies with a secondary listing but with the majority of their trading taking place on SGX
4 Deutsche Börse : excluding market segment "Freiverkehr" (unofficial regulated market)
5 OMX consolidated data started in 2005 and include Copenhagen, Helsinki, Stockholm, Tallinn, Riga and Vilnius Stock Exchanges
NA : Not Available

Source: World Federation of Exchanges

Appendix 2
Domestic market capitalisation of listed companies on various stock exchanges from 1990 to 2005

DOMESTIC MARKET CAPITALISATION
(Main & Parallel Markets)
(in USD millions)

End 1990 - end 1997

Exchange	End 1990	End 1991	End 1992	End 1993	End 1994	End 1995	End 1996	End 1997
Americas								
American SE	102,301.5	124,454.2	88,796.8	105,115.8	86,036.5	103,147.0	97,910.8	124,606.2
Bermuda SE	NA	NA	NA	NA	NA	NA	NA	NA
Buenos Aires SE	3,615.3	18,639.5	18,622.9	44,055.1	36,867.0	37,783.8	44,692.3	59,251.9
Colombia SE	NA	NA	NA	NA	NA	NA	NA	NA
Lima SE	812.0	1,118.0	2,630.0	5,113.0	8,178.0	10,907.0	12,583.0	15,484.5
Mexican Exchange	41,053.8	102,763.7	138,744.6	200,865.2	130,245.8	90,694.0	106,770.5	156,595.0
Nasdaq	310,800.0	490,684.7	618,774.0	791,706.0	793,668.7	1,159,939.8	1,511,824.4	1,726,390.4
NYSE	2,692,123.0	3,484,340.3	3,798,238.1	4,212,956.0	4,147,936.7	5,654,815.4	6,841,987.6	8,879,630.6
Santiago SE	13,636.1	27,989.6	29,595.2	44,886.7	68,194.6	72,927.7	65,971.3	72,046.2
Sao Paulo SE	11,201.2	32,152.1	45,416.4	96,779.1	189,303.3	147,635.8	216,906.2	255,478.0
TSX Group	241,924.1	265,696.9	241,875.4	326,548.9	315,054.0	366,344.6	486,977.9	567,635.1
Asia - Pacific								
Australian SE	107,936.0	142,404.1	133,555.0	202,013.8	216,825.9	243,474.7	311,864.8	295,765.6
Bombay SE	NA	NA	NA	NA	NA	NA	NA	NA
Bursa Malaysia	47,868.8	56,721.6	91,471.2	219,758.7	190,162.5	213,757.4	306,165.0	93,174.1
Colombo SE	917.0	1,936.0	1,439.0	2,501.4	2,856.6	1,998.1	1,865.2	2,096.0
Hong Kong Exchanges	83,385.9	121,880.9	171,983.5	385,042.7	269,507.8	303,705.3	449,218.8	413,322.6
Jakarta SE	8,081.0	6,823.0	12,038.0	32,824.0	47,240.8	66,453.8	90,857.4	29,050.0
Korea Exchange 1	110,301.1	96,466.0	107,661.1	139,583.9	191,778.1	181,954.8	139,121.7	41,881.4
National Stock Exchange India	NA	NA	NA	NA	NA	NA	NA	NA
New Zealand Exchange	8,823.8	14,284.9	14,680.3	24,595.3	27,117.7	31,949.8	36,879.3	29,889.2
Osaka SE	NA	NA	NA	NA	NA	NA	NA	NA
Philippine SE	6,631.5	10,835.3	15,335.2	40,148.2	56,648.0	58,779.6	80,464.0	31,211.4
Shanghai SE	NA	NA	NA	NA	NA	NA	NA	NA
Shenzhen SE	NA	NA	NA	NA	NA	NA	NA	NA
Singapore Exchange 2	34,268.5	47,593.5	48,933.7	135,050.2	136,302.8	150,958.6	153,106.7	106,317.0
Taiwan SE Corp.	98,927.0	123,459.8	100,166.4	193,251.5	247,325.1	187,206.0	273,776.4	287,813.1
Thailand SE	20,777.1	37,525.7	57,278.3	127,473.7	125,599.3	135,774.2	95,900.5	22,792.0
Tokyo SE	2,928,533.7	3,117,297.3	2,318,928.6	2,906,298.7	3,592,193.9	3,545,306.5	3,011,161.4	2,160,584.8

Source: World Federation of Exchanges

Appendix 2 (continued)

End 1990 – end 1997

Exchange	End 1990	End 1991	End 1992	End 1993	End 1994	End 1995	End 1996	End 1997
Europe - Africa - Middle East								
Athens Exchange	15,308.8	12,921.5	10,724.5	13,596.5	12,819.3	16,526.9	23,558.1	33,783.7
BME Spanish Exchanges	111,449.0	127,297.1	98,846.7	118,869.1	123,616.5	150,914.2	241,028.1	290,354.8
Borsa Italiana	148,765.5	158,811.1	123,659.4	145,299.6	185,970.7	209,521.9	256,595.3	344,665.0
Budapest SE	NA	NA	NA	NA	NA	NA	NA	NA
Cairo & Alexandria SEs	NA	NA	NA	NA	NA	NA	NA	NA
Cyprus SE	NA	NA	NA	NA	NA	NA	NA	NA
Deutsche Börse	355,310.8	392,470.1	346,891.0	460,753.6	499,278.4	577,364.8	664,913.2	825,232.7
Euronext	NA	NA	NA	NA	761,000.0	906,500.0	1,105,700.0	1,322,700.0
Irish SE	NA	NA	NA	NA	NA	25,835.9	34,737.6	49,371.4
Istanbul SE	19,065.0	15,508.0	9,755.9	36,612.7	21,605.1	20,771.7	30,311.8	61,095.0
JSE 3	136,868.7	167,958.0	148,675.0	215,882.8	240,026.0	277,108.8	239,578.8	211,598.7
Ljubljana SE	NA	NA	NA	NA	215.9	296.7	890.8	1,875.5
London SE	850,011.8	986,107.2	928,392.6	1,150,557.3	1,145,290.4	1,346,640.7	1,642,582.4	1,996,225.1
Luxembourg SE	10,455.5	11,275.8	11,920.9	19,314.4	28,518.4	30,443.3	32,410.6	33,892.2
Malta SE	NA	NA	NA	7.2	19.0	376.6	409.4	422.2
Mauritius SE	NA	NA	NA	NA	NA	NA	NA	NA
OMX Copenhagen SE 4	39,062.5	44,792.5	30,140.2	41,650.5	48,784.4	57,691.7	71,074.3	93,766.4
OMX Helsinki SE 4	22,721.3	14,236.7	12,205.4	23,595.2	38,307.6	44,137.5	62,579.3	73,322.2
OMX Stockholm SE 4	92,014.7	97,055.3	78,079.3	106,968.0	130,602.6	172,550.3	240,382.1	264,710.6
OMX 4	NA	NA	NA	NA	NA	NA	NA	NA
Oslo Børs	26,129.8	21,997.2	17,840.4	27,541.7	36,458.6	44,587.0	56,879.1	66,502.6
Swiss Exchange	157,634.6	173,765.7	189,117.1	270,879.1	284,721.3	398,088.1	400,285.4	575,338.7
Tehran SE	NA	NA	1,332.6	1,148.9	2,359.9	6,534.9	12,868.6	11,476.0
Tel Aviv SE	8,273.9	13,228.4	27,884.2	47,517.8	31,130.4	35,115.9	34,462.5	44,370.7
Warsaw SE	NA	145.8	227.1	2,718.7	3,057.1	4,564.1	8,413.4	12,134.8
Wiener Börse	26,319.8	26,039.7	21,679.9	28,321.5	30,792.1	32,513.2	33,629.2	37,280.5

Source: World Federation of Exchanges

Appendix 2 (continued)

End 1998 - end 2005

Exchange	End 1998	End 1999	End 2000	End 2001	End 2002	End 2003	End 2004	End 2005
Americas								
American SE	126,307.0	90,745.2	82,717.4	60,223.3	45,690.6	92,877.2	83,018.9	86,288.0
Bermuda SE	1,500.0	1,323.3	2,159.7	2,468.6	2,175.1	2,901.0	1,852.0	2,124.8
Buenos Aires SE	45,332.8	55,847.6	45,839.3	33,384.0	16,548.6	34,994.7	40,593.8	47,590.3
Colombia SE	NA	NA	NA	NA	NA	14,258.5	25,222.9	50,500.8
Lima SE	9,868.5	12,091.9	9,749.8	9,790.4	11,441.4	14,125.0	17,974.8	24,139.7
Mexican Exchange	91,745.8	154,043.8	125,203.9	126,258.4	103,941.2	122,533.0	171,940.3	239,128.0
Nasdaq	2,243,734.0	5,204,620.4	3,597,085.9	2,739,674.7	1,994,494.0	2,844,192.6	3,532,912.0	3,603,984.9
NYSE	10,277,899.8	11,437,597.3	11,534,612.9	11,026,586.5	9,015,270.5	11,328,953.1	12,707,578.3	13,310,591.6
Santiago SE	51,866.2	68,227.5	60,400.8	56,309.7	49,827.7	87,508.4	116,924.3	136,493.3
Sao Paulo SE	160,886.4	227,962.1	226,152.3	186,237.6	121,640.5	226,357.7	330,346.6	474,646.9
TSX Group	543,394.0	789,179.5	766,204.3	611,492.8	570,223.5	888,677.7	1,177,517.6	1,482,184.6
Asia - Pacific								
Australian SE	328,853.7	427,655.4	372,794.4	375,598.2	380,087.0	585,431.0	776,402.8	804,014.8
Bombay SE	NA	NA	NA	NA	130,390.2	278,662.8	386,321.1	553,073.7
Bursa Malaysia	95,560.6	139,907.9	113,155.3	118,980.7	122,892.4	160,970.3	181,623.8	180,517.5
Colombo SE	1,704.6	1,584.0	1,074.1	1,331.5	1,680.4	2,711.1	3,657.0	5,720.0
Hong Kong Exchanges	343,566.5	609,090.4	623,397.7	506,072.9	463,054.9	714,597.4	861,462.9	1,054,999.3
Jakarta SE	22,077.9	64,044.7	26,812.5	22,997.9	30,067.0	54,659.1	73,250.6	81,428.1
Korea Exchange 1	114,593.3	306,127.5	148,361.2	194,470.1	216,116.6	298,248.1	389,473.4	718,010.7
National Stock Exchange India	NA	NA	NA	NA	112,453.9	252,893.4	363,276.0	515,972.5
New Zealand Exchange	24,458.4	27,827.1	18,489.5	17,736.5	21,714.6	33,049.8	43,731.3	40,592.5
Osaka SE	NA	NA	NA	NA	NA	NA	2,287,047.8	2,969,814.6
Philippine SE	34,910.9	41,536.1	25,261.4	20,606.2	18,197.6	23,190.5	28,602.0	39,817.8
Shanghai SE	NA	NA	NA	NA	306,443.6	360,106.3	314,315.7	286,190.3
Shenzhen SE	NA	NA	NA	NA	156,647.6	152,872.4	133,404.6	115,661.9
Singapore Exchange 2	96,472.7	198,039.5	155,125.6	117,338.0	101,553.7	148,502.6	217,617.8	257,340.6
Taiwan SE Corp.	260,498.4	376,507.9	247,596.9	292,872.2	261,311.2	379,060.4	441,435.8	476,018.0
Thailand SE	34,117.8	57,176.6	29,217.4	35,950.4	45,405.9	119,017.2	115,390.4	123,885.0
Tokyo SE	2,439,548.8	4,463,297.8	3,157,221.8	2,264,527.9	2,069,299.1	2,953,098.3	3,557,674.4	4,572,901.0

Source: World Federation of Exchanges

Appendix 2 (continued)

End 1998 – end 2005

Exchange	End 1998	End 1999	End 2000	End 2001	End 2002	End 2003	End 2004	End 2005
Europe - Africa - Middle East								
Athens Exchange	80,125.8	196,846.9	107,502.5	83,481.3	66,040.0	103,764.5	121,921.4	145,120.7
BME Spanish Exchanges	399,847.6	431,649.2	504,221.9	468,203.2	461,559.6	726,243.4	940,672.9	959,910.4
Borsa Italiana	565,974.5	728,240.4	768,363.4	527,467.3	477,075.4	614,841.6	789,562.6	798,072.9
Budapest SE	NA	NA	11,908.5	10,367.0	12,988.9	18,868.2	28,300.0	32,575.7
Cairo & Alexandria SEs	NA	NA	NA	NA	NA	NA	38,533.1	79,508.9
Cyprus SE	NA	NA	NA	NA	NA	NA	4,880.0	6,583.0
Deutsche Börse	1,086,748.5	1,432,167.0	1,270,243.2	1,071,748.7	686,013.5	1,079,026.2	1,194,516.8	1,221,106.1
Euronext	1,903,268.0	2,444,300.0	2,271,727.5	1,889,455.1	1,538,684.4	2,076,410.2	2,441,261.4	2,706,803.5
Irish SE	66,596.2	68,773.2	81,882.5	75,297.8	59,937.5	85,070.6	114,085.9	114,086.2
Istanbul SE	33,645.6	112,715.8	69,658.9	47,149.9	34,216.7	68,379.2	98,298.9	161,537.6
JSE 3	150,670.0	180,462.9	131,321.0	84,343.5	116,544.4	260,748.3	442,525.5	549,310.3
Ljubljana SE	2,984.9	2,854.0	3,099.6	3,461.3	5,577.9	7,134.1	9,676.8	7,898.9
London SE	2,372,738.1	2,855,351.2	2,612,230.2	2,164,716.2	1,856,194.4	2,460,064.0	2,865,243.2	3,058,182.4
Luxembourg SE	37,930.7	35,938.7	34,016.4	23,782.8	24,550.5	37,333.2	50,143.6	51,248.4
Malta SE	788.0	3,861.6	2,024.3	1,356.9	1,373.7	1,844.7	2,841.9	4,097.5
Mauritius SE	NA	NA	NA	NA	NA	NA	2,102.9	2,330.0
OMX Copenhagen SE 4	98,881.0	105,292.7	107,665.0	85,145.0	76,749.9	118,167.1	-	-
OMX Helsinki SE 4	153,811.0	349,393.6	293,634.7	190,455.8	138,832.6	170,283.4	-	-
OMX Stockholm SE 4	278,707.6	373,277.7	328,339.0	236,514.4	179,117.4	293,016.8	-	-
OMX 4	NA	NA	NA	NA	NA	NA	728,769.2	802,561.4
Oslo Børs	46,272.6	63,695.3	65,266.7	69,444.8	68,103.1	95,919.9	141,624.2	190,952.1
Swiss Exchange	701,576.3	693,133.0	792,316.4	625,908.7	547,020.4	727,103.0	826,040.8	935,448.3
Tehran SE	11,115.1	17,242.5	5,892.5	7,385.0	11,760.6	27,544.2	42,600.4	36,440.2
Tel Aviv SE	39,230.1	63,472.3	65,337.5	58,228.9	40,774.2	68,904.4	90,157.9	122,577.9
Warsaw SE	20,461.1	29,576.8	31,428.6	26,155.0	28,849.2	37,404.5	71,547.2	93,602.2
Wiener Börse	35,543.5	33,023.0	29,935.2	25,204.3	33,578.1	56,522.5	87,776.3	126,309.3

Information notes:
1 Korea Exchange 2005 data include also Kosdaq following the integration of Korea Exchange
2 From 2004, include Singapore-incorporated companies, foreign-incorporated companies with a primary listing, and foreign-incorporated companies with a secondary listing but with the majority of their trading taking place on SGX
3 From 2004, JSE figures include the market capitalization of all listed companies
4 OMX Copenhagen, OMX Helsinki and OMX Stockholm have integrated OMX in 2005
OMX includes Copenhagen, Helsinki, Stockholm, Tallinn, Riga and Vilnius Stock Exchanges
NA : Not Available

Source: World Federation of Exchanges

Appendix 3: List of interview questions

1. Why do you think that you were asked/invited to join your Board(s)?
    - General Business Experience?
    - Specific Experience? If so, what?
    - Other reasons?

2. Do you think that Independent Non-Executive Directors should only be responsible for issues in their specialization?

3. What were your expectations of your role(s) when you first commenced working as an Independent Non-Executive Director? Were these expectations met?

4. What is your actual role on each Board, other than specific legal requirements? Boundary Spanner; Board Performance; Monitoring?
    - Has this changed over time?
    - Does this vary with each board position?
    - If so, what factor(s) influence this variation?

5. Do the legal issues that surround your position have any impact on how you perform your role, or what you do, or don't do, or to your responsibilities?

6. Do you spend time other than on the Board working in the company(ies)?
    - In any particular area?
    - In your specialized area?

7.What role(s) other than as a Director do you see other Independent Non-Executive Directors performing?

8. Do you see any confusion about what the role of an Independent Non-Executive Director is or should be? What do you see as the cause(s) of this confusion?

9. What do you see as the future role of Independent Non-Executive Directors? Is this influenced by the Board, shareholders, legal issues, other stakeholders, other issues?

10. In a few sentences, how would you define the role of an Independent Non-Executive Director in Australia?

Appendix 4
Companies represented by interview respondents. Analysis by Industry Group, Industry and Sub Industry per GICS specifications

	Last Balance Date	Sales at Last Balance Date $M	Sector	Industry Group	Industry	Sub Industry
Company 1	30-Jun-05	**954.763**	40 Financials	4010 Banks	401010 Commercial Banks	40101010 Diversified Banks
Company 2	31-May-05	**632.647**	20 Industrials	2010 Capital Goods	201070 Trading Companies & Distributors	20107010 Trading Companies & Distributors
Company 3	31-Dec-04	**1,148.900**	25 Consumer Discretionary	2510 Consumer Durables & Apparel	252020 Leisure Equipment & Products	25202010 Leisure Poducts
Company 4	30-Jun-05	**362.687**	40 Financials	4020 Diversified Financials	402020 Diversified Financial Services	40201040 Specialised Finance
Company 5	30-Jun-05	**9.505**	40 Financials	4040 Real Estate	404020 Real Estate Investment Trusts	40402040 Office REIT
Company 6	30-Jun-05	**485.100**	20 Industrials	2010 Capital Goods	201030 Construction & Engineering	20103010 Construction & Engineering
Company 7	30-Jun-05	**8,151.000**	20 Industrials	2020 Commercial Services & Supplies	202010 Commercial Services & Supplies	20201030 Diversified Commercial & Professional Services
Company 8	31-Jul-05	**766.418**	15 Materials	1510 Materials	15120 Construction Materials	15102010 Construction Materials
Company 9	31-Dec-04	**3,527.000**	15 Materials	1510 Materials	151050 Paper & Forest Products	15105010 Forest Products
Company 10	30-Jun-05	**527.617**	20 Industrials	2020 Commercial Services & Supplies	202010 Commercial Services & Supplies	20201030 Diversified Commercial & Professional Services
Company 11	31-Mar-05	**2,367.500**	20 Industrials	2010 Capital Goods	201050 Industrial Conglomerates	20105010 Industrial Conglomerates
Company 12	30-Jul-05	**1,799.123**	25 Consumer Discretionary	2550 Retailing	255030 Multiline Retailing	25503010 Department Stores
Company 13	30-Jun-05	**21.593**	40 Financials	4020 Diversified Financials	402030 Capital Markets	40203010 Asset Management & Custody
Company 14	31-Jul-05	**6,334.800**	30 Consumer Staples	3010 Food & Staples Retailing	301010 Food & Staples Retailing	30101030 Food Retail
Company 15	30-Jun-05	**151.994**	20 Industrials	2010 Capital Goods	201020 Building Products	20102010 Building Products

Source: Australian Stock Exchange

Appendix 4 (continued)

	Last Balance Date	Sales at Last Balance Date $M	Sector	Industry Group	Industry	Sub Industry
Company 16	31-Mar-05	**5,701.000**	40 Financials	4010 Banks	401010 Commercial Banks	40101010 Diversified Banks
Company 17	30-Jun-05	**846.700**	55 Utilities	5510 Utilities	551010 Electric Utilities	55101010 Electric Utilities
Company 18	30-Jun-05	**4,438.804**	20 Industrials	2030 Transportation	203050 Transportation Infrastructure	20305020 Highways & Railtracks
Company 19	30-Jun-05	**234.154**	40 Financials	4040 Real Estate	404020 Real Estate Investment Trusts	40402040 Office REIT
Company 20	30-Jun-05	**3,917.060**	35 Health Care	3510 Health Care Equipment & Services	351020 Health Care Providers & Services	35102015 Health Care Services
Company 21	30-Sep-05	**13,856.000**	40 Financials	4010 Banks	401010 Commercial Banks	40101010 Diversified Banks
Company 22	30-Jun-05	**54.217**	25 Consumer Discretionary	2550 Retailing	255030 Multiline Retailing	25504060 Homefurnishing Retail
Company 23	30-Jun-05	**4,914.281**	55 Utilities	5510 Utilities	551030 Multi-Utilities	55103010 Multi-Utilities
Company 24	30-Jun-05	**7,574.000**	15 Materials	1510 Materials	151050 Paper & Forest Products	15105020 Paper Products
Company 25	30-Jun-05	**2.173**	40 Financials	4020 Diversified Financials	402030 Capital Markets	40203010 Asset Management & Custody
Company 26	30-Jun-05	**351.700**	40 Financials	4020 Diversified Financials	402030 Capital Markets	40203010 Asset Management & Custody
Company 27	31-Dec-04	**3,080.000**	40 Financials	4030 Insurance	403010 Insurance	40301040 Property & Casualty Insurance
Company 28	30-Jun-05	**862.301**	25 Consumer Discretionary	2550 Retailing	255040 Speciality Retailing	25504050 Automotive Retailing
Company 29	30-Jun-05	**3,760.600**	25 Consumer Discretionary	2530 Consumer Services	253010 Hotels, Restaurants & Leisure	25301010 Casinos & Gambling
Company 30	30-Jun-05	**559.033**	25 Consumer Discretionary	2530 Consumer Services	253010 Hotels, Restaurants & Leisure	25301010 Casinos & Gambling
Company 31	31-Dec-04	**1,876.600**	40 Financials	4040 Real Estate	404020 Real Estate Investment Trusts	40402060 Retail REIT

Source: Australian Stock Exchange

Appendix 5: Invitation letter sent to respondents

"Dear

We are writing to seek your support for an important research project being undertaken on the topic of 'The Role of the Independent Non-Executive Director in Australia'. Trevor Lipman, who is a Director of BNP Paribas, is researching this topic for a Doctorate of Business Administration at Macquarie Graduate School of Management.

Trevor has spent considerable time reviewing the theory relating to the role of the non-executive director and has reached a conclusion of the definition of this role according to the theory. The next stage of his research is to undertake a series of interviews of Independent Non-Executive Directors to ascertain how they view their role, and then compare the two conclusions, ie the actual against the theory.

The interviews will be of about one hour duration and will be confidential in that all responses will be coded and no names will be disclosed in any part of the research or subsequent publications.

We would be most grateful if you would agree to participate in an interview, which could take place, to suit you, either in our office or at your premises. After Trevor's thesis has been published and passed by the University, he will make the results available to the participants in the interview process.

If you are able to participate, or if you would like further information, may I suggest that you call Trevor direct on 0419 606 898.

Thanking you in anticipation
Kind regards

Suzanne Williams"