

Submission

by

Business|NZ

to the

Securities Commission

on the

**Discussion Document regarding Corporate
Governance**

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1. INTRODUCTION

- 1.1. Encompassing five regional business organisations (Employers' & Manufacturers' Association (Northern), Employers' & Manufacturers' Association (Central), Canterbury Employers' Chamber of Commerce, Canterbury Manufacturers' Association, and the Otago-Southland Employers' Association), Business New Zealand is New Zealand's largest business advocacy body. Together with its 53-member Affiliated Industries Group (AIG), which comprises most of New Zealand's national industry associations, Business New Zealand is able to tap into the views of over 76,000 employers and businesses, ranging from the smallest to the largest and reflecting the make-up of the New Zealand economy.
- 1.2. In addition to advocacy on behalf of enterprise, Business New Zealand contributes to Governmental and tripartite working parties and international bodies including the ILO, the International Organisation of Employers and the Business and Industry Advisory Council to the OECD.
- 1.3. Business New Zealand's key goal is the implementation of policies that would see New Zealand retain a first world national income and regain a place in the top ten of the OECD (a high comparative OECD growth ranking is the most robust indicator of a country's ability to deliver quality health, education, superannuation and other social services). It is widely acknowledged that consistent, sustainable growth well in excess of 4% per capita per year would be required to achieve this goal in the medium term. If New Zealand is to achieve this goal, one way is to ensure the right processes exist to send a signal to domestic and overseas investors that high levels of corporate transparency exist for New Zealand enterprises, while at the same time taking into account the unique structure of the New Zealand market.
- 1.4. Business New Zealand therefore welcomes the opportunity to comment on the discussion document. Although the Securities Commission (SC) has released a questionnaire on corporate governance that asks 48 questions, covering nine broad issues, we believe that the answers to most questions lie

with decisions best made by shareholders of the company, rather than any governmental or outside organisation. Therefore, Business NZ would like to take the opportunity to instead provide general comments on particular issues we believe are important in terms of the future direction of corporate governance in New Zealand.

2. GENERAL COMMENTS

- 2.1. Various New Zealand organisations have recently done considerable work towards the issue of corporate governance in New Zealand, such as the Institute of Chartered Accountants of New Zealand (ICANZ), the New Zealand Exchange and the Institute of Directors in New Zealand. The involvement of these various organisations in the subject is indicative of the high level of interest, both within the private and public sectors, concerning the future path of corporate governance in New Zealand.
- 2.2. This strong interest has largely come about due to corporate scandals in the U.S., which have led other countries to also review their own corporate governance requirements. While Business NZ supports a review of the way corporate governance is generally undertaken from time to time, any outcomes should take into account New Zealand's relatively small economy and unique structure, rather than simply looking to place an international best practice model that may not be efficient or necessary in the New Zealand context. Simply put, Business NZ does not believe there should be any type of knee-jerk reaction by the Government particularly if governance systems currently in place are found to be sufficient.
- 2.3. Business NZ commented on the discussion document released by ICANZ entitled *Corporate Transparency: Making Markets Work Better*. In our submission, we emphasised the fact that in their essence, companies are entrepreneurial risk taking ventures. Failure in itself does not indicate a gap in rules and/or regulation. Through the formation of a working group, ICANZ then went on to publish a report entitled *Improving Corporate Reporting: A Shared Responsibility*. The report took into account the views of around 40

submissions and was handed to the Minister of Commerce. The report listed 22 recommendations, and found that *“The great majority of the business community carries out its work in an honest and professional manner”*¹. Although the recommendations of the report were confined to measures that applied to public issuers, many were still of wider interest and application to other forms of enterprises. Business NZ agreed with the findings of the report, given its reasoned and sensible approach to governance issues, and its principle based options for reform.

- 2.4. In addition, Business NZ believes that while attempts to minimise the risk of corporate governance failures are laudable, a major reporting failure in New Zealand is inevitable, no matter what types of processes are put in place. No amount of regulation can prevent failures from occurring because it is simply impossible for all risk factors to be eliminated. Also, attempts to reduce risk will always involve a cost, but investment in risk reduction would only be beneficial when the benefits are greater than the costs.
- 2.5. Despite the ICANZ report finding general agreement with other business groups and organisations, the Government has stated that they want to see the SC *“lead the development of a set of corporate governance principles to establish a benchmark for shaping the behaviour of New Zealand businesses”*². The scope of the task by the SC is much larger than prior reports on corporate governance in that its focus includes entities other than public issuers. However, we would question why there is a need for the SC to replicate much work that has already been investigated, in addition to examining potential solutions to problems that are less likely to occur in New Zealand?
- 2.6. Notwithstanding our reservations over the SC investigating the need for an agreed set of corporate governance principles, we would like to make some general comments in regards to the discussion questionnaire published.

¹ ICANZ, *Improving Corporate Reporting: A Shared Responsibility*, p1.

² Securities Commission, Press Release: *Advancing the Debate on Corporate Governance*, 10 July 2003

3. GENERAL COMMENTS ON THE QUESTIONNAIRE

- 3.1. The introduction of the questionnaire states, *“The Securities Commission, in undertaking this exercise, has not been mandated to develop rules or regulations or recommend legislative change or remedies with respect to these Corporate Governance Principles”*. Despite these assurances, Business NZ has two primary concerns regarding future development of the task.
- 3.2. Firstly, the Government has stated that the focus of the project is not law reform, and that the set of principles would contribute to better corporate governance. However, Business NZ is concerned that if the Government is to ensure these principles are heavily promoted, thus becoming widely accepted amongst businesses, they will evidently become the expected requirement over time. The Government needs to seriously consider any future ramifications of steps taken in this project as a set of principles would undoubtedly place heavy expectations on many smaller entities that simply may not have the resources to comply. New Zealand business demography statistics show that 96.8% of enterprises have fewer than 20 full-time equivalent employees³. A set of principles produced by the Government may fit well with the existing regimes of larger enterprises, but be completely inappropriate and costly for smaller ones. Many enterprises may find resources being directed towards following a set of principles that have drawn a high line in sand, rather than putting those resources towards effective business growth objectives.
- 3.3. Our other main concern is that while the SC may provide an agreed set of principles for businesses to follow in terms of corporate governance, and that the SC have not been mandated to develop rules or regulations with respect to the principles outlined, this would not stop another government agency feeling motivated to develop regulatory or legislation principles based on the work undertaken by the SC. The Minister for Commerce has already stated that the set of corporate governance principles for the country could point the

³ Statistics New Zealand, *New Zealand Business Demographic Statistics*, Feb 2003.

way to law changes⁴. Business NZ would be deeply concerned if the Government sees fit to look at any further regulatory steps towards corporate governance, which would invariably place another layer of forced compliance on businesses.

- 3.4. Business NZ agrees with the view of the SC that New Zealand businesses should inspire confidence in local and international investors, partners, suppliers and customers. Given the reliance New Zealand has on foreign investment (total stock worth \$177,949 million as at 31 March 2003⁵), it is important that overseas investors have some assurance that New Zealand companies have corporate governance structures in place that can help businesses become more innovative, competitive and financially sustainable. However, corporate governance is only one piece of the puzzle that investors look at when deciding to invest in a country. Other factors such as the skill level of the work force, stable government and macroeconomic environment, established infrastructures etc all contribute to decisions on investment. Corporate governance practices certainly play an important role, but would not be the sole determining factor for investment decisions.
- 3.5. Furthermore, we would not agree with the notion that to give overseas investors confidence to invest in New Zealand, there should be regulation in place like that overseas so international investors do not need to spend time and resources understanding the New Zealand regime. While corporate governance practices are vital, regulating for good corporate governance is not. This is due to various reasons such as the inability to legislate for the effectiveness of governance processes, compliance costs, moral hazard issues where people think the problem is solved through government action, as well as constraining the development of better practices over time. In attempting to improve any perceived problem(s), such regulatory actions are likely to make things worse, not better.

⁴ The New Zealand Herald, *Focus on Governance Could Point to Law Change*, 22 September 2003.

⁵ Statistics New Zealand, *Balance of Payments and International Investment Position: Year Ended 31 March 2003*.

- 3.6. A large proportion of the questions asked by the SC in each of the nine issue sections request an “either/or” answer for respondents to decide upon, such as whether a code of ethics should be published, should a CEO go on to become chair, the appropriateness for non-executive directors to receive retirement payments etc. Notwithstanding the fact that most of these questions have attracted considerable research elsewhere, we believe that the answers to most questions asked in the questionnaire are solely for each entity to decide, rather than by an outside organisation that develops a set of principles that are promoted, or worse still, through some type of regulatory action.
- 3.7. We also take the view that it is crucial to increase the quality of management within enterprises, especially those considered large by New Zealand standards. Prudent and sensible decisions made within a company go from the chairman, right down to lower management. By world standards, New Zealand’s domestic pool of managers and directors is small. Therefore, we have to ensure there are sufficient pathways for future managers and board members to continue to develop their skill base and decision-making processes as any type of prescriptive regime would not eliminate poor decision-making that could end in ‘scandal’ and/or company failure.
- 3.8. Taking into account our overall concerns with the questionnaire, we would like to make the following brief comments on the questions asked by the SC.

4. ISSUE ONE: ETHICAL CONDUCT

- 4.1. Ideally, all entities should behave in an ethical manner, given the responsibility that is placed on them to perform in the best interests of the company as well as ensuring their credibility and integrity in the economy. There is no doubting that certain companies can neglect ethical conduct from time to time. However, whether a company has a formal code of ethics or conduct, or whether it is published does not automatically mean unethical actions will not take place. Decisions on the role that formal ethical conduct takes should be solely determined by the enterprise.

- 4.2. Also, Business NZ believes a far more proactive approach would be the recommendation of the ICANZ working group that the teaching of ethics across qualifying programmes be reviewed to enhance their effectiveness.
- 4.3. Lastly, an enterprise should solely determine internal responses by an employee breaching any codes of ethics the enterprise has agreed upon. Any external response would depend on the severity and consequences of such unethical actions, of which there would be numerous outcomes, and therefore beyond the scope of this submission.

5. ISSUE TWO: BOARD COMPOSITION AND PERFORMANCE

- 5.1. While there has been considerable debate regarding a company board composition, size and review of performance, Business NZ would not be in favour of the Government coming out with a definitive position on these matters. The amount of debate on these issues is testament to the fact that a clear view by most has not been established, often because what suits one enterprise may not realistically suit another.

6. ISSUE THREE: BOARD COMMITTEES

- 6.1. Again, we take the view that all five questions asked in this section are options that should be decided by the individual enterprise, rather than any form of guiding principles or regulation. We believe that entities are in a better position to ascertain what would be the most effective role of board committees to enhance their business. If board committees are established, then the company should also have the autonomy to decide how the composition of board committees would best serve their needs.

7. ISSUE FOUR: REPORTING AND DISCLOSURE

- 7.1. Business NZ would not want to see any additional disclosure either be encouraged or made into regulation by the Government, as we view the current continuous disclosure regime as sufficient to keep shareholders and the market informed.

7.2. Also, Business NZ does not see any need for the CEO and CFO to publicly certify financial statements, given that they should be a true and accurate representation of the financial position of the company in the first place. While it is admirable for the company to voluntarily provide this level of assurance, in our view any mandatory requirement to do so would not generate greater accuracy or completeness of financial statements.

8. ISSUE FIVE: REMUNERATION

8.1. For questions asking a specific viewpoint on remuneration options in the questionnaire, Business NZ believes that these decisions should be left solely for shareholders/owners of the entity to decide upon, rather than any type of informal or formal principle that the Government would want to initiate.

9. ISSUE SIX: RISK MANAGEMENT

9.1. Business NZ would want to see decisions regarding risk management policies left to the entity to decide upon, rather than any type of formal principle that the Government would want to initiate.

10. ISSUE SEVEN: AUDITORS

10.1. Business NZ does not see the need for the establishment of an audit oversight body. We would have concerns regarding who would end up funding such a body. If it were through funds from enterprises, this may reallocate resources that would be better spent elsewhere, not least on their own audit processes.

10.2. Also, if such a body was put together, there may be start-up problems regarding finding enough members who have the right level of experience, as well as being completely independent and/or being free of any conflicts of interest from current or past association with audit firms.

11. ISSUE EIGHT: SHAREHOLDER RELATIONS

- 11.1. Business NZ believes that it is up to each company to ensure that there is meaningful dialogue between the board, management and shareholders. If an enterprise wishes to grow, they should already realise the importance of communication between groups that make important decisions on future directions of the company.
- 11.2. Business NZ would not be in favour of other business entities such as co-operatives, large trusts and unlisted companies providing more comprehensive public reporting on their performance, as this would again set benchmarks for reporting which are probably unnecessary given the financial reporting standards required through other legislation. Also, it is simply 'good business' to ensure financial reports are regularly collated, without the need for any regulatory enforcement.

12. ISSUE NINE: STAKEHOLDER INTERESTS

- 12.1. In section nine, the SC asks if other stakeholders, other than shareholders with legitimate interests that should be considered in the context of Corporate Governance. From Business NZ's point of view, this alludes to the notion of Corporate Social Responsibility (CSR). Despite the proposition that CSR goes some way towards the notion of a 'global corporate citizenship' through the implementation of common international standards, New Zealand's business demography dictates that CSR initiatives are generally not as relevant for New Zealand businesses. Out of the 147,000 employing enterprises currently operating in New Zealand, only 95 enterprises employ 500-999 FTEs, while only 48 employ 1000+ FTEs. The smallness of most New Zealand businesses means that many simply do not have the resources to undertake formal CSR initiatives.
- 12.2. While CSR is laudable, it should remain voluntary. Any regulatory approach to CSR whereby the promulgated expounded had to be adopted totally by all enterprises would provide an untenable layer of compliance upon mainly small businesses, inhibiting business growth. While the reasons for adopting

CSR are certainly supported, companies should be encouraged to do so, rather than mandated in any way. In any event, we would argue that only a growing healthy economy can sustain the social and environmental outcomes we all desire.

13. OTHER ISSUES SECTION

- 13.1. Under the Section entitled *Other Issues* in the questionnaire, the SC assesses that New Zealand opinion appears to be in favour of a principles versus rules-based approach concerning reporting standards. Business NZ strongly agrees with this assessment. While both approaches can lead to misrepresentation of a company's financial position, it is important that a true and fair view of performance is maintained, rather than a rules-based approach that can provide a technically accurate view, but is less likely to be viewed as breaching standards if misrepresentation occurs.
- 13.2. The costs on countries that have decided to adopt strict new rules based governance requirements, such as the U.S., are already beginning to be felt. Overseas companies have started to de-list from the NASDAQ because of sweeping changes and related increased compliance costs to corporate governance that the U.S. has recently introduced⁶. Business NZ would be deeply concerned if any strict and prescriptive governance rules implemented in this country caused similar repercussions.
- 13.3. A recent survey by Business NZ found that compliance costs have continued to increase, no matter what the size of the enterprise is⁷. In fact, only 1.8% of the 760 respondents that completed the survey in 2003 found that compliance costs had not increased in at least one of the compliance costs areas. Although companies and securities requirements were not regarded to be as onerous as other higher profile compliance cost areas (e.g. tax, OSH, ACC, employment relations, RMA etc) any regulation to come out of the corporate governance work done by the SC would add another level of compliance costs on enterprises. Regulation would exacerbate, rather than

⁶ Financial Times, *Creative Technology delists from Nasdaq*, September 28, 2003

reverse the lop-sided result of increased compliance costs on businesses that the survey recorded.

14. SUMMARY

14.1. While a review of the way Corporate Governance is handled in New Zealand should take place from time to time, this does not mean that any increasingly prescriptive and regulated principles should override a system that has so far served New Zealand governance well. Business NZ does not take the view that differing governance in comparison with international best practice will somehow greatly reduce our chances of investment in New Zealand companies. Stable governance is but one part of what investors look at when making investment decisions. Excessive rules and regulations can only make the increasingly difficult task of succeeding in business even more so. Therefore, Business NZ does not see the need for developing a set of corporate governance principles by the Government, as well as any further regulations relating to corporate governance being introduced.

⁷ Business NZ – KPMG, *Compliance Cost Survey 2003*.