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Contents

Editorial

Recent convictions of Australian citizens in China raises questions about whether different nationalities hold different views of what constitutes ethical and unethical business practices. The first three papers in this edition of the Journal explored issues for business ethics in different contexts. Segon and Booth conducted a survey of Australian managers to determine whether Australian businesses are as ethical and transparent as the Transparent International corruption index suggests. This study explored perceptions of ethics in organisations, compliance with ethical and unethical guidelines and organisation responses to reporting of unethical behaviour.

A different perspective on ethical standards was addressed by Bruce and Ahmed, whose paper reviews the means of establishing the professional standards and financial planners. Their extensive literature review provides and understanding of the profession and professionalism, and the role of professions in establishing compliance with standards. An innovative methodology using phenomenology described how data gathered from stakeholder groups in Australia, New Zealand and the United States compared their experience of education, examination, experience and ethics requirements

The final three papers address issues central to the governance of small and medium corporations (SMEs). They make the point that governance regulation of SMEs is usually inappropriate because it is designed for big business and potentially detrimental to their performance. Michal Adam's paper points out that the Australian government is on the one hand trying to reduce the regulatory burden, especially on SMEs, while at the same time the Corporations law regulator, ASIC , is pursuing cases to enforce compliance. The main defence for transgressions is the Business Judgement Rule which for small business is ineffectual because SME owners usually fail the "mutual personal interest criteria".

Heenetigala, Armstrong and Clarke reported the results from a study of the corporate supported by the Australian Research Council Grant and COSBOA. The research explored the regulatory difficulties experienced by SMEs and the regulatory factors that inhibited or promoted performance. The results confirmed that SMEs were not aware of their governance duties as directors, and that the main factors inhibiting performance were related to taxation, utilities and access to finance and skills.

The final paper in this issue investigated the linkages between agency cost, ownership structure and corporate governance in SMEs. In a study of New Zealand companies, Wellalage and Locke analysed eleven years of data for 100 unlisted small businesses, using a dynamic panel GMM estimation. The results indicated that ownership concentration had the most significant governance effect and that there was a U-shape relationship between internal ownership and performance,

Professor Anona Armstrong AM
Guest Editor

An Approach to Understanding the Professionalism of Financial Planners

Ken Bruce, Abdullahi Ahmed and Helen Huntly
CQ University, Australia

Abstract

The aim of this research is to investigate how key stakeholder groups involved with the certification of financial planners experience the phenomenon of the 'professionalism of financial planners'. The study is to be carried out to provide insight to the international financial planning community in establishing relevant and superior professional standards for Certified Financial Planner (CFP) professionals. This will be a qualitative study using phenomenography as a research methodology to describe the qualitatively different ways in which certified financial planners, lecturers of the CFP curriculum and association managers understand or experience the phenomenon of 'professionalism'. Research participants will be interviewed from the United States, Australia and Hong Kong and these interviews analysed to reveal the variations in the conceptions of 'professionalism' and the attributes that can be identified from the phenomenographic outcome space to inform financial planners, academics and professional associations of what is required to be a CFP professional

Keywords

Ethics, financial planners, standards

1. Introduction

The objective of this research is to investigate how key stakeholder groups involved with the certification of financial planners globally under the Certified Financial Planner (CFP [1]) brand, experience the phenomenon of the *professionalism of financial planners*. The aim of the study is to provide insight to the international financial planning community and in particular the CFP professionals, in establishing internationally relevant, superior professional standards for financial planners. This is a qualitative study at this stage which applies the phenomenographic research tradition that aims to describe qualitatively, the different ways in which people understand or experience a phenomenon.

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[1] The CFP designation is owned and controlled by the CFP Board of Standards in the United States and there are 24 member organizations of the Financial Planning Standards Board.

The demand for financial planning services is growing. This demand can be explained by the growing middle class in developing countries such as China and India and also by the growing affluence of developed countries such as Australia and the United States. An increasing number of individuals are relying on the services of financial planners[2] on an assumption that financial planners have attained an appropriate level of education, have appropriate level of technical knowledge and skills, and act in a professional manner. Against this back-drop, the financial services sector has struggled with an image problem, particularly as a result of the global financial crisis 2007-2010. In Australia, the collapses of Storm Financial and Opes Prime has eroded consumer and government confidence in financial product and service providers (Ripoll 2009).

The motivation for this research study is to identify the qualitatively limited number of ways in which financial planners, lecturers and association mangers understand the phenomenon of the *professionalism of financial planners*. This proposed study will limit investigation of the *professionalism of financial planners* to key stakeholder groups involved with the CFP brand. Whitfield's (2003) adaptation of Schwab's (1973) *five bodies of experience* has been adapted to identify three key stakeholder groups involved with financial planning as the research participants for this study.

The main research questions of this study are:

1. *What are the conceptions of professionalism of the key stakeholder groups of CFP professionals, lecturers of the CFP curriculum and association managers?*

2. *What variations can be identified among these conceptions and;*

3. *What attributes of 'professionalism' from the revealed conceptions can be used to inform financial planners, academics and professional associations of what is required to be a professional financial planner?*

2. Background: historical perspectives of financial planning

In order to understand how key stakeholder groups experience the professionalism of financial planners, it is necessary to understand the history of financial planning. An analysis of the historical development of financial planning will identify its path along a continuum towards how the occupation or profession is viewed today. Freidson (1986, pp. XIV-XV) captures the essence of this when he says, "both historical and contemporary studies are essential for a full understanding of the world, the one to follow the course of various streams of events flowing toward the present and the other to examine the contemporary pool into which all those separate streams flow".

Financial planning has a relatively short history with its origins dating back only to 1969 (Brandon Jr. & Welch 2009). Although other writers such as Thompson (2002) suggest that financial planning had its roots in investment counselling, a term used to describe advice given to the blue-blooded clients of Boston and Manhattan advisers back in the 1920s. He cites congressional hearings in 1940 on legislation to regulate investment advisers to support his contention. In contrast accounting has a much longer history, dating back to at least 1494 with Pacioli's treatise on double-entry accounting (Godfrey 2006) and possibly much earlier. Other writers also track the beginnings of financial planning as a new profession from the same time period. Warschauer (2002) says personal financial planning commenced its evolution as a distinct field of endeavour from the 1970's and most probably from earlier beginnings. Eyssell (1999) says independent practitioners formed the heart of the new profession in the 1970's. They were independent because they provided advice not linked to any particular product. It would seem that from this humble

[2] Individuals providing personal financial; planning services are also known as *financial adviser*. The term that is used in this thesis is *financial planner* as this is consistent with the scope of the study which focuses on understandings of financial planning as espoused by the CFP Board of Standards and the Financial Planning Standards Board.

beginning, personal financial planning commenced its evolution into what now defines the occupation of financial planning.

Personal financial planning has evolved from a narrow field into a profession (Eyssell 1999). Pahl (1996) identifies the Chicago meeting as December 12, 1969 and that the purpose was to form two organizations - The International Association for Financial Planning (as an industry association) and the College for Financial Planning (as the educational arm). The College for Financial Planning also registered the CFP and CFP designations as trademarks which licensed candidates to use the trademark (Pahl 1996). Brandon Jr. & Welch (2009) also suggest that seeds of financial planning may have in fact commenced as early as the late 1940's with the writings of Joseph Schumpeter about 'creative destruction'. This was period of great economic excitement in the US – post-war – characterized by a radical innovation leading to a process of radical transformation. If you look at the chronology of events impacting on finance and markets in the US (Brandon Jr. & Welch 2009), it might not be unreasonable to assert that financial planning had its beginnings in 1924 when mutual funds were introduced, or in 1933 when the Securities Act was passed.

The formation of the College of Financial Planning in 1972 was a critical event in the development of personal financial planning (Warschauer 2002) spawning many organizations such as the CFP Board of Standards Inc., the Financial Planning Association and the National Association of Personal Financial Advisors. Warschauer (2002) chronicles two important events as defining the "professional" era of the profession – the formation of the CFP Board of Standards in 1985, and the first job analysis study of CFP practitioners undertaken by the Board in 1987. Other designations followed with the Chartered Financial Consultant (ChFC) designation in 1982 by the American College followed by the American Institute of Certified Public Accountants Personal Financial Planning Division's Personal Financial Specialist (PFS) designation in 1986 (Pahl 1996). FPSB affiliates have largely adopted the US CFP Board's model of registering or accrediting education providers to deliver knowledge topic areas that prepare individuals for the CFP certification examination requirement. These knowledge topic areas essentially represent the body of knowledge of financial planning in the region of the FPSB affiliate member. The knowledge topic areas typically cover generic areas such as the process of financial planning and those characteristics of specialist knowledge areas that are generic in nature such as the principles of insurance, principles of investment or specific concepts such as risk and return, time value of money. The topics also mirror the practice of personal financial planning in the affiliate's own country. This related particularly to types and characteristics of financial products, legislation and regulation that may affect taxation considerations, estate planning and retirement planning strategies.

Gwen Fletcher, a leading Australian financial planning industry stalwart is attributed with bringing financial planning to Australia when she visited the United States in the early 1980's. Fletcher's discussions were about the creation and establishment of an affiliated chapter of the International Association of Financial Planning (IAFP) or a new industry body for Australia. The affiliation model was rejected by Department of Corporate Affairs, the regulatory body responsible at the time for issuing licenses to dealers of securities (Cowen *et al.* 2006). In 1982, the world convention of the IAFP was held in Australia with Gwen Fletcher as one of the organisers and from this meeting the Australian Investment Planner's Association (AIPA) was formed from primarily independent investment advisers. In 1984 after a group of Australians attended the annual American convention of the IAFP, IAFP (Australia) was formed (FPA Australia 2001). In the late 1980s, the AIPA was conscious that many practitioners held membership in both the AIPA and IAFP (Australia). The AIPA changed its name to the Australian Society of Investment & Financial Advisers in an attempt to broaden its membership base. At the time IAFP (Australia) had the support of the banks and life insurance companies and in 1992, both bodies amalgamated to form the Australian FPA (Cowen et al. 2006).

The development of a professional set of competencies can be viewed as providing a benchmark of best practice, a resource for organizational evaluation, and as a framework for exploring relationships between practice, education and training (Birkett 1996). More specifically, Birkett (1996) indicated that competency is a relational notion in that individual attributes (knowledge, skills, attributes) are drawn on in performing tasks in a particular work context. Thus, competency is realized in performance, but relies on a capacity to display a set of skills including both technical and behavioural skills (Jackling & Sullivan 2007). The Commonwealth Government introduced the Financial Services Reform Act (FSRA, 2001) aimed at regulating the situation where a client is unable to determine the competency of a financial intermediary because of lack of information or expertise. This regulation has had substantial implications for training in the financial services industry with amendments to the Corporations Act (2001) and particularly with the introduction of Policy Statement 146 (PS 146)[3] (ASIC 2005 cited in Jackling & Sullivan 2007).

The role of regulation and regulatory authorities in developing professions provides a contextual backdrop to the study. Regulators are very important in creating and guiding professional bodies and generating community trust. This is common for many professions, particularly the medical profession where governments play a role in protecting the public interest. Regulation is also important with financial services and specifically with respect to financial planning, where protection of the public is a key motivation for government. For the three countries that are the focus of this current study, examples of regulation aimed at ensuring that financial planners have appropriate competence can be seen through examination requirements. In the Unites States, the Financial Industry Regulatory Authority (FINRA) requires general securities representatives to sit a *Series 7 exam*; the Hong Kong Securities Institute (HKSI) also requires securities representatives to take an exam; and the Australian Securities and Investments Commission (ASIC) requires advisers to demonstrate competence by completing a training program listed on the ASIC Training Register as required by Regulatory Guide 146. ASIC has also released a discussion paper (CP 153), where among other measures it is recommending the introduction of a national exam for all current and new advisers with comments required by 1 June 2011.

3.Literature review

The focus of this proposed study is the professionalism of financial planners and a review of the literature reveals that very little is known about how key stakeholder groups experience the professionalism of financial planners. There is a substantial body of work on the professions and professionalism. Much of what is written about professions is from a sociological point of view, as studies of professions clearly indicate the interplay between the professions and society generally (Brante 1988). It is not the intent in this study to explore extensively the literature on the sociology of the professions and professionalism, but rather to provide context to identifying how key stakeholder groups experience the professionalism of financial planners. We are in a period where the traditional sociology of professions has been questioned and have moved into a period of post-professionalism and this is relevant to understanding the conceptions of professionalism.

Much has been researched and written on the professions, but few words have regularly experienced a shift in their meaning as have “profession” and “professional” (Watson 2002). These terms have different meanings if used in every-day use in society or if used in sociology. Watson (2002) also argues that ‘professionalism’, in certain usages, tends to be a vehicle used to further or defend a particular occupational interest. Authors have a tendency to write of occupations that have been successful in promoting themselves as a profession as if they were a profession, as opposed to being regarded as ‘occupations’ that have been successful in winning the respect attached to a profession (Watson 2002). Under the broadest possible definition of the term profession as used in society, carpenters, salesmen, and tailors would qualify as members of a profession, but it is apparent that they lack the philosophical direction that is commonly ascribed to a professional person (Roddenberry 1953).

According to O'Day (1986), historians were blinded to the importance of the growth of professions before the industrial revolution. A profession was defined as an occupation which exhibited certain traits including a collegial and hierarchical organization, group control of recruitment, entry qualifications and training, a self-imposed code of behaviour, and a claim to monopoly over the a defined body of knowledge and prac tical service (O'Day 1986). Furthermore, O’Day (1986) contends that although English awareness of the professions has a long history prior to 1800, it is more from a genealogical perspectiv,e without true investigation of the functions performed within a profession. Evetts (2003) argues that it is possible to draw a distinction between professions and occupations. Professions are essentially the knowledge-based category of occupations which usually follow a period of tertiary education and vocational training and

[3] Now referred to as Regulatory Guide 146

experience. Evetts (2003) also contends that maybe it is no longer so important to distinguish between professions and occupations but rather acknowledge them as similar social forms. Max Weber (1968) in his seminal work said much about the professions and the relationship between professionalization, bureaucratization and rationalization. He linked professionalization, to the rationalization of society. According to Ritzer, (1975) Weber linked professionals to the development of Western rationality, and to the development of a variety of specific institutions in the West. This was a two-sided relationship in that professionals contributed to rationalization of institutions and this process also developed professionals.

A study using secondary sources was carried out by Lee (1995), where he reviewed the nature of professionalization; the birth of the accountancy profession; the establishment and defence of professionalization; and a retrospect and prospect. The most obvious feature of early UK professionalization is the pursuit by accountants and their institutions of economic self-interest in the name of a public interest. Use of entry, examination and training requirements, lobbying over legislative matters, defending the exclusive use of professional designations and attempting statutory registration each illustrate this point. A similar pattern emerged in the USA in the late 1880s, although the specific rationale for professionalization was different from that of the Scots chartered accountants. For example, Walker (1988), and Kedslie (1990) point to the strengthening of the Scottish professionalization process by entry, education, examination and training requirements. Several writers (Brown 1905, Howitt 1966) identify a similar sequence of professionalization occurred in England, with the formation of local societies of accountants in the 1870s. However, unlike the Scottish formation, the English movement appears to have been little more than a series of imitating events as local accountants sought the credibility and authority of Scottish chartered accountants. According to Howitt (1966), the Institute proceeded quickly to impose standards of entry, examination and training, and was involved in influencing changes in law relating to accounting for bankruptcies and municipal auditing. Of particular concern were the Institute's requirement of an apprenticeship system, and the restricting of the activities of its members to those of public accountancy. In contrast, Society membership was UK-wide with regional organizations and members in both public and private sectors of the economy. An examination system was initiated, and specific professional designations were agreed. There also appears to have been a desire that the Society influence legislation affecting accountancy work (Garrett 1961). Lee (1996) examined the 1853 formation of the Institute of Accountants in Edinburgh (IAE), and its 1854 incorporation under charter as the Society of Accountants in Edinburgh (SAE) which he argues signalled the origins of sustained institutionalized professional accountancy, and therefore have considerable historical significance in helping to explain the professionalization process in public accountancy since the mid nineteenth century.

An understanding of *profession* and *professionalism* cannot ignore a post-professionalism perspective. Professions and the notion of professionalism are undergoing rapid change in a new global information age which necessitates new theories and explanations (Burns 2007). According to Kritzer (1999) post-professionalism is characterised by loss of exclusivity, increased segmentation through specialization of knowledge and the growth of technology. As a result, the services previously delivered exclusively by members of formal professions can now be delivered by general professionals or even non-professionals (Kritzer 1999). An example of this is can be found with conveyancing clerks as para-legal professionals offering transfer of land services. Kritzer (Kritzer 1999) concludes that in this new post-professionalism world, professionals will remain central but that traditional professions will fade. "The new professionalism will be much more dynamic, reflecting the rapidity of change in the workplace and the accompanying demand in the market (Kritzer 1999, p. 749).

Professional associations play a role in socializing their members to the skills, competencies, and roles needed to perform effectively in bureaucratic organizations (Rusaw 1995). Horsley & Thomas (2003) carried out a study to look at the exploration of unprofessional conduct procedures across the professions. The study was conducted to analyse (1) comparative information on how different professions structure, manage and organise procedures for accountability and professional misconduct; (2) the role of professional associations in the accountability process; (3) the role of government bodies' accreditation, registration and licensing as they relate to accountability. The researchers revealed that peer review played a pivotal role in the professional autonomy. Other writers such as Karseth and Nerland (2007) have argued that discourses of knowledge are employed by modern-day professional associations as a means of promoting professionalism. By analysing policy documents from the Norwegian associations for teachers, nurses, engineers and accountants, the authors revealed dominant knowledge discourses and argued how that these discourses serve to position the associations in distinct ways towards practitioners, working fields and the public community.

The hallmark of any profession is the presence of a common body of knowledge (CBOK) whose parts can be defined and defended (Lander & Reinstein 1987). The first CBOK for accountants in the United States was produced in 1967 by Roy and MacNeil (Palmer *et al.* 2004). Given the realtively short history of financial planning, there is a dearth of literature about the financial planning CBOK. Ioannides (2005) asserted that as the common body of knowledge grows and planners continue to accept responsibility for their advice, financial planning will be recognized as a true profession. Overton (2008) claims that a theoretical body of knowledge for the Financial Planning Profession has always existed, until recently theory was not often explored as such, and there was no written common understanding or agreement on the theoretical basis of the financial planning profession. A CBOK can influence the training provided to those who are to become professionals in a chosen field (Roy & MacNeill 1966). In Australia, that late Professor Bill Birkett developed a comprehensive competency framework for the major accounting bodies in the early 1990's, also contributing competency standards for the Financial Planning Association of Australia for financial planners in Australia and New Zealand (Birkett 1996).

The 1980s and 1990s witnessed a proliferation of studies of professionals, professions and processes of professionalization (Cooper & Robson 2006). The theoretical engagement of the studies during this time moved considerably beyond earlier trait and functionalist approaches that seemed to be characterized by an uncritical acceptance of professionals' self accounts (Cooper & Robson 2006). The authors argue that during this period, the actions of professionals and regulators are no longer rationalized by reference to public interest explanations but rather by the need for closure and so secure professional legitimacy and status within particular markets. A common position in the accounting literature is to examine the process of professionalization and accounting and audit regulation through the context of organizations such as standard setting bodies, regulatory agencies of government and supra-national regulatory bodies as if these institutions alone should be considered. (Cooper & Robson 2006). Professional closure is often discussed in relation to education practices and struggles between the state and professional associations about regulations over practice rights and similarly, professional regulation is typically viewed as involving struggles over accounting and audit laws and standards (Cooper & Robson 2006). This illustrates that the focus is on the relationship between professional bodies, standard setters and the government regulators. This situation mirrors what can be observed with financial planning. Financial planning is heavily controlled by the professional bodies such as CFP Board of Standards in the US, FPSB, FPA Australia and IFPHK.

A study undertaken by Jha *et al* (2006) investigated perceptions of professionalism in medicine. This was an interview study of medical educators, medical students, doctors, allied health professionals and lay professionals to assess views and experiences of professionalism in medicine. It involved thematic content analysis of the interview transcripts (Jha et al. 2006). The present study therefore is similar in that it offers an understanding of the professionalism of financial planners from different stakeholder perspectives. Instead of thematic content analysis, this present study will employ phenomenographic methods in attempting to understand the phenomenon of the *professionalism of financial planners* through an investigation of how financial planners, lecturers and professional association managers make meaning of *professionalism* from their own awareness (should be 'experience') of the phenomenon.

Very little is known about financial planning as a profession, the underlying theories of financial planning, nor the competence or professionalism of financial planners. A significant research study was undertaken in Australia (Smith 2009) however, that investigated professionalism and ethics in financial planning. This study focussed on the relationship between organisational environment and culture with the ethical decision making of financial planners. The findings of this study, among other things, identified patterns of unethical behaviour. The study proposed here is different from that of Smith (2009) in that it will take a second order perspective by understanding the phenomenon of *professionalism* through the eyes of those people closely involved in the CFP certification process. This research study will therefore be located in the current literature as contributing to the knowledge of 'profession', 'professionalism', and the professionalism of financial planners. A review of the literature on the closely allied profession of accounting provides a useful benchmark from which to understand historical perspectives of financial planning.

4.Research Framework and Methodological Approach

This research study will be unique in that the phenomenon will be investigated from the perspective of three major stakeholder groups who experience the phenomenon through their stake in the CFP certification process.[4] Whitefield's (2003) adaption of Schwab's (1973) five bodies of experience has been used as a model to identify three key stakeholder groups of *financial planners*, *lecturers* and *association managers* for which conceptions of professionalism will be investigated.

In reviewing curriculum, Schwab (1973) describes five bodies of experience as the agents of translating knowledge into curriculum. These five bodies of experience constitute the *subject matter* in the form of scholarly materials, *learners* who are the beneficiaries of the curriculum operation, *milieu* which includes community references and the environment in which learning takes place, knowledge and the flexibility of *teachers* to learn new knowledge; and the process of *curriculum making* itself. Schwab (1973) argues that each of these bodies of experience must discover the experience of the other as a preliminary to the process of designing a defensible curriculum. Of the five bodies of experience, *subject matter*, *learners*, *milieu* and *teachers* are referred to by Schwab (1973, p.502) as 'commonplaces of equal rank'. Whitefield (2003) has adapted Schwab's bodies of experience framework in applying it to a study on determining how a Bachelor of Business Accounting degree facilitates the development of personal and interpersonal skills. In Whitefield's (2003) adaptation of Schwab's framework *subject matter* is represented by the *curriculum* pertaining to personal and interpersonal skills development, *learners* is represented by *graduates* of the Bachelor of Business Accounting degree, *the milieu* is represented by *employers* as being representative of numerous external influences, and *teachers* is represented by the *lecturers* who design, develop and teach the curriculum. This framework has been developed further by Whitefield (2003) to take account of the literature and the realities dealing with personal and interpersonal skills development. Professional associations, government and overseas influences have been added to the framework. Whitefield (2003) argues that the professional associations through their role of accrediting accounting and business programs influence the curriculum design process. Whitefield (2003) argues also that government and overseas influences also guide the curriculum design process.

Figure 1: Comparison between Schwab's (1973), Whitefield's (2003) and the framework adopted for this research study.

Schwab's five bodies of knowledge	Whitefield's adaptation of Schwab's framework	Framework for this proposed study
Curriculum revision	**Skills development for accounting students**	**Conceptions of the professionalism of CFP professionals**
Subject matter	Curriculum	CFP curriculum
Learners	Graduates	CFP Professionals
Milieu	Employers	Association managers
Teachers	Lecturers	Lecturers
	Government	Regulation
	Overseas influences	
	Professional bodies	

Source: Developed by the authors

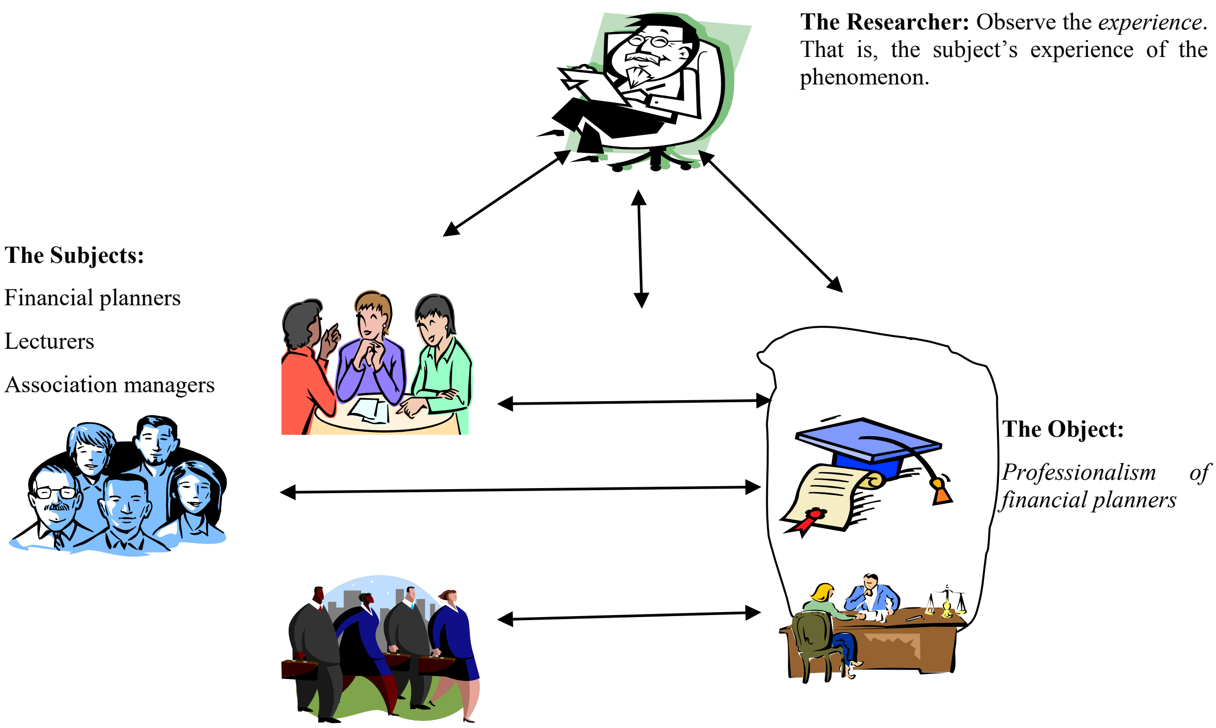
4 A follow-up second phase of the research consisting of a broader sample and conducting audio-taped interviews will be done next year.

Under Schwab's (1973) and Whitefield's (2003) constructs, financial planners are learners or students as the recipients of the CFP curriculum[5]; lecturers deliver the CFP curriculum to the students; and association managers provide the milieu as the gatekeepers to the profession in determining who meets entry requirements and who can maintain professional membership based on adherence to standards of ethical behaviour and practice standards (refer figure 1).

4.1.Methodological approach

The approach applied in this paper follows a recent study (Magub, 2006) which adopted a phenomenographic methodology to investigate the experiences of the phenomenon of using the internet for information sharing on IT projects. Magub (2006) identifies IT projects in Australia, UK and US as case studies from which research participants were sourced. The utterances of nineteen participants representing seven professional groups across the three countries were analysed into categories of description and outcome space. In this proposed study, CFP certification in Australia, Hong Kong and the United States will be presented as case studies from which research participants will be sourced. Fifteen CFP professionals, nine lecturers from the accredited education providers, and six association mangers will be interviewed individually in order to identify and describe the variation in how they experience the phenomenon of the *professionalism of financial planners*. Marton (1988) recommends a research group of between 15 and 30 participants to best achieve the aims of phenomenographic enquiry. Experiences from a large number of phenomenographic studies have shown that data from 20 informants is usually enough to discover all the different ways of understanding the phenomenon in question (Larsson and Holmström, 2007).

Figure 2 **An illustration of the second order perspective used in phenomenography adapted from Edwards(2005) and Berglund (2002)**



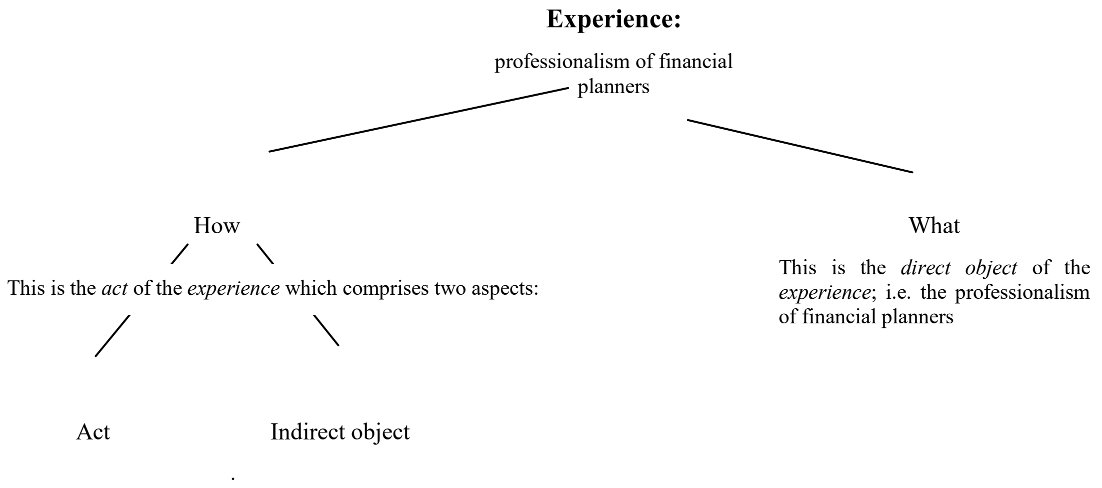
[5] CFP curriculum embraces entry level education requirements including registered/accredited CFP education courses, and on-going continuing professional development.

Participants from the stakeholder groups will be interviewed *in situ* and the interviews will be audio-taped and transcribed verbatim. The interviews are loosely structured and open-ended around the primary question of *"What does it mean to act with professionalism in the profession of financial planning?"*. This is to allow the researcher to explore the responses from participants in order to tease out the conceptions of the experience or awareness of the phenomenon. The interview transcripts will be analysed using iterative content analysis, where the utterances of the research participants are taken at face value and the researcher carries out a phenomenological reduction by delimiting his or her own understanding of the phenomenon (Uljens, 1996).

The study will identify a qualitatively limited number of ways the research participants experience the *professionalism of financial planners.* These will then be classified into categories of description and analysed to identify the hierarchical relationships between them as an outcome space which is anticipated to reflect an increased complexity of ways of experiencing the phenomenon and the logical inclusiveness of the categories. Phenomenography therefore takes a second order perspective (refer figure 2) with the researcher making statements about other peoples' experiences of the world, where the researcher attempts to see the world through the eyes of people experiencing it.

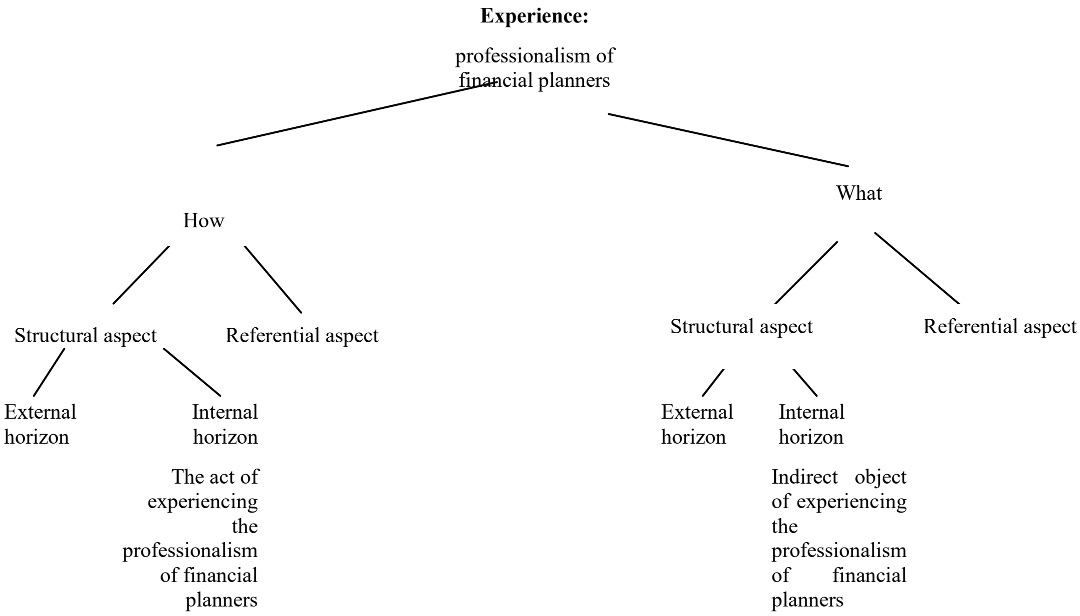
Conception is the unit of description in phenomenography (Marton and Pong, 2005) and therefore is the focus of the analysis. The literature reveals two frameworks that have been used by phenomenographers to analyse conceptions. The first framework distinguishing between the 'what' and 'how' aspects which are broken down to the 'act' itself, 'direct object' of the experience and the 'indirect object' of the experience (refer figure 3). The second framework distinguishes between structural and referential aspects of the experience which are further broken down into the internal and external horizons (Harris, 2011). Researchers such as Marton and Booth (1997) who have used the phenomenographic approach have variously used either framework or the two frameworks as one, as they are not mutually exclusive. This is highlighted in figure 4. An analysis of studies using phenomenography reveals differences in how these terms are defined and how they are used (Harris, 2011). For the purpose of this proposed study, the 'what' aspect of an experience is the direct object of experiencing the professionalism of financial planners; the 'how' aspect is the act of experiencing the phenomenon as well as an indirect object. The 'structural' aspect comprises an 'internal horizon' which consists of the aspects of the phenomenon which forms a theme of awareness, the relationships between these aspects and between the aspects and the phenomenon as a whole; and the 'external horizon' which consists of all aspects that are part of awareness.

Figure 3 **The 'how' and 'what' aspects of the experience of the professionalism of financial planners adapted from Marton and Booth (1997, p. 85)**



The 'referential' aspect is the intrinsic meaning attributed to the professionalism of financial planners. Therefore the internal horizon of the structural aspect of the how professionalism is experienced is the way in which the act of experiencing the professionalism of financial planners is carried out. For example an association manager might follow all the rules and procedures to certify an individual against the CFP mark. The internal horizon of the structural aspect of what is experienced about the professionalism of financial planners is the intention behind the act. For example for an association manager the intent might be to ensure that he/she is doing their job correctly or to protect the Professional Association from loss of reputation.

Figure 4 Aspects of the experience professionalism of financial planners adapted from Marton and Booth, (1997, p. 88 & p. 91)



5.Preliminary Findings and Some Policy Implications

The field research comprising phenomenographic interviews in Australia, Hong Kong and the United States will be carried out in the second half of 2011. The global standard setting body for the CFP certification marks - *Financial Planning Standards Board*, as well as *Financial Planning Association (US)*, *Financial Planning Association (Australia)* and the *Institute of Financial Planners of Hong Kong* have each expressed interest in the research and offered their assistance in sourcing interview participants. Preliminary discussions with these bodies have suggested a general lack of understanding of phenomenography as a qualitative research methodology that typically only involves small groups of research participants. As professional associations and standard setting bodies, these organisations frequently engage in quantitative research such as member satisfaction surveys and consumer sentiment surveys and are more comfortable with attributing numbers to research findings. This study presents a different approach that will contribute rich, descriptive data to the quantitative data already available

Table 1: Comparison of education, examination, experience and ethics requirements

	Australia	**Hong Kong**	**United States**
Education	Candidates complete an approved undergraduate or post graduate course* as entry to the CFP Certification Program** **A Transcript Review process is available for candidates who have completed a finance-related degree that has not been approved by the FPA.	Candidates must complete comprehensive education program from one of the approved education providers of IFPHK.	Candidates complete an education program registered by the CFP Board of Standards (includes over 300 college and university programs). Candidates can also apply under a Challenge Status if they hold certain credentials such as CPA or CFA. Candidates can also request a Transcript Review if they have not completed a registered education program.
Examination	CFP® Certification Assessment (CFP 5) makes up the examination part of the CFP Certification Program. The assessment verifies that those wishing to practice the profession of financial planning have mastered a certain level of theoretical knowledge and practical application of that knowledge	Candidates complete the CFP℠ Certification Examination Candidates are required to pass four (4) papers within five (5) years (11 exam intakes).	Candidates must complete a 10-hour exam is divided into three separate sessions. All questions are multiple-choice, including those questions related to case problems.
Experience	Three years of financial planning experience is required. OR two (2) years' experience in the delivery of any step in the financial planning process to a client, of which twelve (12) months experience in	Three years full-time, or the equivalent part-time (2,000 hours part-time equals one year full-time), if the candidate has an undergraduate degree from a recognized college or university.	Three years full-time, or the equivalent part-time (2,000 hours equals one year full-time). Six months of experience must have been gained within 12 months of reporting your work

	providing face-to-face comprehensive financial planning advice .	Six years full-time, or the equivalent part-time (2,000 hours part-time equals one year full-time), if the candidate does not have an undergraduate degree from a recognized college or university.	experience. Experience may be gained up to 10 years before or up to five years after the exam date.
Ethics	Candidates must: • disclose any involvement in any criminal, civil, self-regulatory organisation or government agency investigation or proceedings • agree to adhere to the FPA Code of Professional Practice which includes the Code of Ethics, Rules of Professional Conduct and Practice Standards; • Undertake ongoing Continuing Professional Development (CPD)	All candidates for CFP[CM] Certification must agree to abide by the: • The IFPHK's Code of Ethics and Professional Responsibility t • IFPHK's Financial Planning Practice Standards IFPHK also performs a background check and each candidate must disclose any investigations or legal proceedings related to their professional or business conduct.	Candidates must agree to adhere to CFP Board's *Standards of Professional Conduct* – including the *Code of Ethics and Professional Responsibility*, *Rules of Conduct*, and *Financial Planning Practice Standards* – and to acknowledge CFP Board's right to enforce them through its *Disciplinary Rules and Procedures*

The CFP Board of Standards has what is commonly referred to as the 4 E's of *education*, *examination*, *experience* and *ethics* as requirements of their certification process. The FPSB prescribes similar requirements for those CFP candidates outside the United States. Candidates for CFP certification must master theoretical and practical financial planning knowledge by completing a comprehensive course of study and must pass a comprehensive CFP Certification Examination that assesses their ability to apply integrated financial planning knowledge to real world client situations. Candidates must also meet relevant work experience standards (one-year supervised experience or a minimum of three years of unsupervised practice experience) in the financial planning process prior to being awarded CFP certification and agree to abide by a strict Code of Ethics and Professional Responsibility that defines their ethical responsibilities to the public, clients and employers. Certified financial planner professionals must disclose any investigations or legal proceedings related to their professional or business conduct and agree to place the interest of clients first, act fairly, diligently and with integrity, and offer clients professional services that are objective and based on clients' needs. CFP professionals must disclose in writing to clients information about their sources of compensation and conflicts of interest; maintain technical competence and fulfil ethical obligations. Every two years, they must complete at least 30 hours of continuing professional development education to remain current with developments in the financial planning profession. In addition, CFP professionals must disclose any public, civil, criminal or disciplinary actions that may have been taken against them during the certification period. Table 2 provides a comparison of the how the e E's of education, examination, experience and ethics are applied in Australia, Hong Kong and the US.

The FPSB has embarked on a program of applying consistency across all of its 24 affiliate organisations. In 2007 a meeting of academics and practitioners from affiliate organisations was convened to discuss issues relating to building a global financial planning curriculum. This program has developed to now involve several work groups developing standards on various aspects including curriculum, assessment, and professional framework. This work has continued since 2007 with the FPSB producing a CFP competency framework, knowledge topic areas and other guidance statements for its affiliate members. Through my professional involvement and experience with FPA Australia in working with several affiliate organisations and identified many areas of difference covering cultural, different education systems and nomenclature and difference understanding of ethical practice. Do CFP professionals identify with their professional standing as being a CFP professional or do they identify with their employer? Smith (2009) found that financial planners in Australia were largely influenced by their employer (licensee) when her research identified the presence of unethical cultures within financial planning practices.

6.Conclusion

This preliminary research offers an innovative approach to the study of professionalism for a specific profession. Much of the existing research on the *professions* and *professionalism* has focussed on historical perspectives and on identifying the characteristics that distinguish a profession and a professional from a sociological viewpoint. This research paper has described the variations in how key stakeholder groups experience professionalism as it relates to CFP professionals. In this context stakeholders refer to those groups directly involved in the certification of financial planners to prescribed standards of the CFP designation. These include the lecturers of the CFP Curriculum from accredited education providers, association managers who act as gatekeepers to those who have access to the CFP designation, and the Certified Financial Planners themselves.

The conceptions of professionalism will highlight potential gaps or weaknesses in the application of standards currently prescribed by the Financial Planning Association of Australia, the Institute of Financial Planners of Hong Kong and by implication the Financial Planning Standards Board, and the CFP Board of Standards in the US. It is hoped that the findings will signal to these standard setting and accrediting bodies whether the current prescribed standards and expectations of CFP professionals is reflected in the conceptions of these requirements through variations in how the key stakeholder groups experience or have awareness of the professionalism of CFP professionals.

This research study will contribute significantly to the existing literature by applying uniquely the phenomenon approach to investigate the issues of financial professionalism from the perspective of three major stakeholder groups who experience the phenomenon through their stake in the CFP certification process. The significance of this study is that it will identify the elements of professionalism that key stakeholder groups experience as being part of the professionalism of financial planners. The findings will contribute to work being undertaken by the *Financial Planning Standards Board* and its affiliate member organizations representing 23 countries and regions around the world including Australia and Hong Kong. The findings will also assist the *CFP Board of Standards* and the *Financial Planning Association* in the United States in developing the profession of financial planning. This study will contribute to the literature on the application of phenomenography as a qualitative approach in understanding how groups experience a phenomenon. Finally, the study will contribute to the body of knowledge on *professions* and *professionalism* - particularly in understanding the profession of *financial planning*.

The results of the study have the potential to influence the way in which the FPSB and its affiliate members develop their CFP certification process. The study will reveal how the three stakeholder groups experience the phenomenon of financial planners' professionalism and could identify gaps or omissions in the current programs and process underpinning CFP certification. This could result in revision of the CFP curriculum to those areas identified as important or essential for the professionalism of financial planners and the emphasis placed on these areas in delivering the curriculum. The results of the study also have the potential to inform the professional practice standards and code of ethics that the professional associations mandate of its CFP professionals.

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Bribery: What Do Australian Managers Know and What Do They Do?

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Abstract

The recent conviction and gaoling of former Rio Tinto executive Stern Hu and as well as a further 18 Australian citizens facing charges in relation to "fraud and other economic crimes raises a number of questions regarding ethical business practice. A key issue that should be considered is whether Australian businesses are as ethical and transparent as the current high ranking in the Transparency International corruption index tends to suggest.

This paper reviews literature pertaining to the normalisation of corrupt practices and the extent to which organisational members and managers are aware of and take action to report such practices. The paper will also present the findings of a survey of over 100 practicing managers that identifies whether they are aware of unethical practices and what they would do if they were to offer or receive an offer to engage in unethical practices. The survey focuses on a major corrupt practice, namely bribery. It also considers the reaction of managers to the request or order of a senior manager to engage in unethical practices inclusive of bribery. Conclusions will then be drawn regarding the extent of normalisation of corruption in Australian organisations.

Keywords

Business Ethics, Management, Bribery and Corruption, Cross Culture.

Introduction

Corporations operating in foreign countries, particularly developing economies, are frequently presented with the challenges of managing business processes that are not transparent and characterised by the use of facilitation payments. This highlights the importance of understanding what bribery and corruption actually involves, as they are interpreted differently around the globe. As stated above the recent case of Stern Hu and his Rio Tinto colleagues charged and found guilty of bribery charges under Chinese national law has given many transnational corporations operating in China and elsewhere pause to think (Lewis, 2006; Moran, Harris and Moran, 2007) not only about issues of standards and ethics in business practice in overseas locations but also to reconsider the critical subtleties in cultural mores as well as understanding the impacts of choices and actions in cross cultural contexts.

As Donaldson and Dunfee (1999a p. 47) noted “the importance of cultural differences to business are highlighted by Kluckhorn, Hofstede, Hamden-Turner and Trompenaars, yet the ethical implications remain largely unexplored”. For some the concept of bribery, to get goods through customs for example, is no different to that of tipping for better service in a restaurant whilst for others the two actions are very different. Gift giving also presents many challenges for organisations and managers. From one perspective it can clearly be seen as an act of reciprocity, yet Westerners often misconstrue it as bribery. Guanxi or gift giving appears to be an important element of Asian cultures (Davies, Leung, Luk and Wong, 1995). As a practice guanxi can be seen as a form of relationship investment that if cultivated well can 'uplift interactions' between businesses (D'Souza 2003, p. 27).

This paper considers the concept of bribery as a component of corrupt business practice and through a survey evaluates the attitudes of a diverse group of practising business managers in the Asia Pacific region towards bribery, corrupt business practice and ethical business decision making. The paper presents a literature review establishing definitions of bribery and corruption, considerations of corruption as a global phenomenon affecting many countries both developing and developed, and considerations of how corruption may become a normalised practice in organisations and business manager activities.

2.0 Literature Review

The review of literature considers discussions on the overarching concept of corruption and also bribery as a key attribute of corrupt practice. The review firstly discusses the concept of corruption in developing economies, moving through potential causes of corruption and finally consideration of bribery issues in cultural contexts.

2.1 Definitions of corruption and bribery

There has been considerable debate on the difficulty in defining the term corruption, as it is a multifaceted concept which figures across a wide landscape of contexts inclusive of society, law, politics, ethics, national culture, and in business, organizational contexts, economics and finance (Dion, 2010; Halter, Coutinho de Arruda and Halter, 2009; Kayes, D,.C. 2006; Von Aleman, 2004). Nevertheless a broad definition is needed to proceed with any purposeful analysis and discussion.

According to Transparency International (TI) (2011a) 'Corruption is operationally defined as the abuse of entrusted power for private gain.' In its definition TI focuses predominantly on bribery as a core consideration within the global context of corruption but also includes considerations of kickbacks in public procurement and embezzlement of public funds (Transparency International, 2011b).

Lindgreen (2004) also provides a broad based definition of corruption 'as individuals or enterprises misusing public resources for power and/or political gains through abusing public officials whose behaviour deviates from the rules of conduct (see for example Heidenheimer et al., 1989; Huntington, 1968; Khan, 1996; Nye, 1967; Poole-Robb and Bailey, 2002).' Lindgreen's definition precludes commercial corruption in terms of private to private sector corruption which Hess (2009) has identified as one of two well known national and international legislation exceptions regarding corruption. The other exception according to Hess (2009) relates to facilitation payments made to expedite lawful services and activities. Transparency International (2011a) however identifies a facilitation payment as 'according to the rule' corruption wherein the bribe is paid to receive preferential treatment for services or actions that the bribe recipient is required to do by law. Where a bribe is paid to secure service or action that the bribe recipient is prohibited of providing under law is classified as 'against the rule' corruption by Transparency International (2011a).

Osbourne (1997) classifies corruption into three groups: bureaucratic corruption where officials take bribes; political corruption where politicians take bribes; and grand corruption signifying misuse of public power by heads of states for private pecuniary benefit. The bribes are usually given by organisations to influence the outcome of government contracts, allocation of monetary benefits (tax evasion, subsidies, etc.), speed up government's granting of permits to carry out legal activities and influence outcomes of legal and regulatory processes (Batabyal and Yoo, 2007; Carmichael, 1995; Gray and Kaufmann, 1998; Kaufmann and Wei, 1998; Kaufmann, 1997).

For the purposes of this article the Transparency International's (2011a) definition of corruption as, the abuse of entrusted power for private gain, is applied. This broad definition does not preclude private to private sector corruption as indicated by Hess (2009) nor facilitation payments defined as 'according to the rule' corruption (Transparency International, 2011a). Moreover Transparency International (TI) considers bribery to be the key component of corruption and for the purposes of the present article discussion of corruption predominantly deals with issues related to bribery in national and international contexts. This is in line with Dunfee's focus on 'coarse corruption' (i.e. bribery) in a number of his key writings (Hess and Dunfee, 2000; Donaldson and Dunfee, 1999b).

2.2 The nature of bribery

One of the key attributes of a corrupt culture relates to bribery. Transparency International (2009) not only maintains a Corruption Perception Index (CPI) but also a Bribe Payer's Index (BPI). Along with embezzlement and fraud, bribery stands as a key form of unethical practice in considering corrupt business practice, (Goudie and Stasavage, 1998; McEwan, 2001). According to Shaw and Barry (1998, p 354), "Bribery is an obvious conflict of interest. A bribe is remuneration for the performance of an act that's inconsistent with the work contract or the nature of work one has been hired to perform. The remuneration can be money, gifts, entertainment, or preferential treatment." McEwan (2001) defines bribery as illegal or improper benefit gained in exchange for money or other payment that is valued.

Apke (2001) defines bribery as gaining improper advantage for business activities such as gaining orders, applications for regulatory permits, customs, taxation concessions and judicial and legislative rulings. It is also clear that bribery and corruption share a conceptual synergy in definition in terms of unethical behaviour to derive personal gain. Ampratwum (2008, p.76) states that corruption is 'usually defined as the transgression of formal rules governing the allocation of public resources by officials in response to offers of financial gain or political support'. Alatas (1999, p.6) concurs citing Wertheim's (1965) description of corruption as 'a public servant who accepts gifts bestowed by a private person with the object of inducing him to give special consideration to the interests of the donor'. He also suggests that extortion, or the expectation or demand for gifts or favours in the execution of public duty also constitutes a form of corruption.

2.3 Corruption: Developed and developing economies

There is general agreement that corruption exists in most societies but at different levels of severity and impact (Transparency International, 2009). Furthermore most developing and transition economies are more prone to corruption than developed ones (Goldsmith, 1995; Ksenia 2008). This assertion is supported to some extent by Transparency International (2009) which argues that national economies that are open and integrated with world markets, combined with robust political, social and legal systems appear less prone to corruption than those which are not. The 2009 Transparency International (TI) corruption index also lends support with results for the three least corrupt countries identified as New Zealand, Denmark and Singapore all considered as developed economies with robust political-social legal systems, whilst the most corrupt were identified as Myanmar, Afghanistan and Somalia (Transparency International, 2009).

Within Australia corruption and bribery is recognized as existing and becoming an increasing problem (KPMG, 2008). This is despite the fact that Australia scored better than all members of the G8 and better than the majority of OECD countries in the Transparency International indexes and has done so consistently for a number of years (Transparency International, 2006, 2007, 2010). According to the most recent Transparency International index, Australia ranks as equal 8th out of the 180 countries with a score of 8.7 out of 10 (Transparency International, 2010). However, recent research by Bowman and Gilligan (2007) found that a substantial majority of respondents agreed that corruption was damaging, inevitable, and increasing in Australia.

2.4 Potential causes of corruption

The World Bank (1997) identifies the causes of corruption as poorly designed economic policies, underdeveloped civil society, low levels of education, and weak accountability of public institutions. These are all characteristics of developing and transitioning economies and perhaps provide insight into why they experience corruption (Ksenia, 2008). Gray and Kaufmann (1998) and Alatas (1999) assert that corruption is widespread most amongst developing economies which are typically characterised by an ineffective regulatory system, a high degree of internal political competition, where individual civil liberties and political freedoms are restricted, the majority of the population are in lower socio-economic brackets and poverty is common and accountability is weak. Other factors influencing corruption include the standard of education, income per capita, low and uneven economic growth along with the level of competition and greed (Beets, 2004; Davis and Ruhe, 2003; Feng, 2000; Oskooee, Goswami, & Gour, 2005; Welsch, 2004). Corruption often remains due to the fact it has become institutionalised and essentially becomes accepted (United Nations Development Programme, 2008).

Evidence suggests that factors such as international trade barriers, limited freedom of the press along with the policies applied across the banking sector can cause a higher degree of corruption (Mauro, 1995).. Andenas (1995) argues that significant structural changes to political and economic systems can also be a major contributing factor to the prevalence of corruption. He notes that this appears to be a major problem in former communist countries whose economies are in transition, largely due to an absence of experience with the co-existence of a private and public sector. The privatisation or transfer of public enterprises or public assets to the competitive private sector which introduces competition to an inexperienced sector can also stimulate bribery..

A large proportion of the civil service in these underdeveloped or transitioning economies are significantly underpaid relative to the economic growth and wealth generation that often occurs due to the liberalisation of the economy and the privatisation of assets. 'Underpaid public servants see a chance to take part in the conspicuous consumption becoming a part of their societies, or at least to maintain living standards in a period where the purchasing power of public sector salaries is radically reduced in relative terms (Andenas, 1995 p. 60). However, the issue of potential for corruption is not limited to developing countries alone. Ampratwum (2008) notes that US studies show increases in civil service wages do not necessarily result in a reduction of corruption. Therefore, other influences are very powerful. The recent UK Politicians expense claims scandal presented a series of corrupt practices by several politicians from both sides of politics in that country (MacDonald and Fidler, 2009).

2.5 The normalisation of corruption in organizations as managerial practice

Much literature exists relating the political and economical characteristics of countries to the primary forces driving corruption. It is important to note that corporations also *'choose'* to pay bribes to do business, which contributes to the normalisation of corruption in these countries. Carmichael (1995) identifies three reasons why corporations may take part in such forms of corruption:

1. They perceive bribery as the business norm in the country in order to get successful business transactions.
2. Even though they may identify the act (bribery) as morally wrong, they do it because other corporations also do it.
3. Corporations desperate for business and under pressure may choose unethical practices to obtain business for financial success.

Ashford and Anand (2003) lay out a process for the normalization of corruption behaviour within an organization. They assume that all organizations have the potential for corrupt or unethical practices as opportunities exist both internally and externally which if accepted can result in the normalisation of the practice for managers. They define normalization as behaviour that has become embedded and internalized by organizational members, who see it as permissible and even desirable behaviour. These practices are then passed on to successive generations of members under the guise of normal practice. The authors identify some factors , such as culture and organizational memory within an organisational context, that can encourage their proposed process of an initial corrupt act, leading to embedding, and repetition,. They primarily focus on how an environment develops that promotes corruption, once the acts have already been carried out, not what inspires the corrupt acts in the first place. Similarly Brief, Buttram and Dukerich (2001) have identified the processes under which corruption becomes a collective practice in organizations. Once the key elements of a corrupt organisational climate are established through goal emphasis, means emphasis and rewards orientation and supported by organisational elements of structure, roles and norms, corrupt behaviours become a collective corporate practice (Brief, et al. 2001)

A second aspect to the normalisation process which involves rationalisation of corrupt practice. Rationalizations capitalize on the complexity ambiguity and dynamism of the situation. Actions that appear corrupt in hindsight may have been taken on an adhoc basis, under pressure or with incomplete information. Once initial acts of corruption occur they tend to gain momentum, as the organization tends to count on the rewards of the action (Li and Quang, 2007). With the decision already made, it becomes easier to perpetuate the acts rather than to stop them. According to Ashford and Anand (2003) there are a range of factors that individuals use to rationalise corrupt behaviour. The denial of responsibility involves the actors engaged in corrupt behaviours perceiving that they have no other choice than to participate in such activities, that it is a necessary aspect of their activities. Further individuals rationalize that they are entitled to indulge in corrupt behaviours because of their accrued credits (time and effort) in their jobs for which they are not directly financially renumerated.

When a corrupt practice is embedded in an organisation, Anand, Ashforth, and Joshi, (2005) suggest that the desire for group acceptance reduces individual concerns, which leads to acceptance of and the development of a social cocoon. Once formed, corruption may be facilitated through the following stages:

(1) The organization's leadership and longer term staff (veterans), role model the corrupt behaviour.

(2) Individuals are encouraged to affiliate, bond with and develop desires to identify with, emulate, and please veterans and leaders.

(3) Strong and consistent information and ideological statements are made so that corrupt acts are seen in a positive light.

(4) Individuals are encouraged to attribute any misgivings they may have to their own shortcomings (particularly naiveté) rather than to what is being asked of them.

Systematic corruption was linked to the collective processes of organisations reflected in the structure, culture and social practices of the organisation (Palmer 2008). Spicer (2009) in an analysis of the literature on normalisation of corruption affirms the research of Palmer (2008) and Ashford and Anand (2003) amongst others that organisational systems, culture and socialisation processes support the take up and embededness of corrupt practices in organisations.

In terms of managers exercising individualist ethical practices against corrupt collective organisational practices, this would be difficult to maintain given the pressures to demonstrate behavioural norms and also to secure business through these corrupt methods. The issue of whistle blowing (Donaldson & Werhane, 1999; Shaw & Barry, 1998; Trevino & Nelson, 1999) also becomes an issue for managers. Whistleblowers may experience dissonance between their personal values and what is expected of them from organisational cultural and systemic norms of business practice (Spicer, 2009). Experience suggests that the protection offered to the whistle blower in outing corrupt business practice may be totally inadequate (Lewis, 2008).

There is a confluence of potential factors acting on modern managers that may result in corrupt practice inclusive of accepting or issuing bribes (Vogl, 1998). They are present at the micro level of the individual manager and his/her propensity towards corrupt influence, at the meso level of the organization itself in terms of the cultural practices and norms of corporate behaviours and finally at the macro level of external influences that may press for illicit favours or bribes.

3.0 Research method and purpose of the study

A survey instrument was developed to analyse the attitudes of mid level managers to concepts in business ethics and issues related to corruption and in particular practices of bribery. Following University ethics approval the survey forms were distributed to the selected sample of mid level managers and the anonymous returned surveys became the sample data set (Sarantakos, 1993). The survey instrument was designed with closed questions, open ended qualitative questions and a series of five point likert scale questions to surface attitudes to the following:

- awareness of unethical practices in your organisations;
- attitudes to concepts such as honesty, integrity, fairness and the ability to make ethical decisions;
- views on bribery and corruption;
- reaction to being offered a bribe;
- reaction to being asked for a bribe;
- what you would do if aware of unethical practices in your organisation;
- If you were asked to undertake unethical practices and it became public, what would you expect your organisation or manager to do;
- What is your view about the role of Governments in controlling bribery and corruption.

A total of 112 managers from a diverse range of private and public companies located in Australia and operating trans-nationally represented the population for the survey. A response rate of 60% was achieved. The following section of the paper presents the key findings to the issue of what managers know and do in relation to bribery in particular and their attitudes towards the larger context issues of corruption and concepts underpinning ethics in business.

4.0 Discussion and findings

From a population of 112 managers 67 respondents completed an anonymous on line survey form covering issues on business ethics practices, experience of bribery and attitudes towards corruption as outlined in section 2 above. Reviewing the responses the following results were obtained.

Matrix 4.1 Question Stem Concepts such as honesty, integrity, fairness and the ability to make ethical decisions	Response Strongly Agree	Response Agree	Response Neither Agree Nor Disagree	Response Disagree	Response Strongly Disagree
- are not necessary and a possible impediment to effective business decision making.	11.1%	9.5%	27.8%	32.8%	18.8%
- are learned early in life and cannot be changed in adulthood.	12%	11.9%	31.3%	41.9%	2.9%
- are an important managerial capability that most managers have already developed.	10.5%	41.9%	23.8%	17.9%	5.9%
- are important managerial capabilities that need to be learned and understood.	73.6%	14.8%	5.9%	2.8%	2.9%

To the question "Have you ever been aware of unethical practices in your organisation?" Seventy eight per cent of respondents confirmed that they had experienced unethical practices, whilst 22% responded that they had no experience of unethical practice in their organization. Although the nature of type of practice and consistency/regularity of practice was not accounted for, with a further open ended question in the survey to identify degree of the unethical practice, the high response to experience of the practice is of concern. This would indicate that for this sample unethical practice is a common feature encountered in most contemporary organisations by mid level practising managers.

Matrix 4.1 outlines responses to the next series of questions regarding attitudes to concepts of honesty, integrity, fairness and the ability to make ethical decisions. Analysing the responses in Matrix 4.1, over 50% of respondents disagreed or strongly disagreed with the statement that, *concepts such as honesty, integrity, fairness and the ability to make ethical decisions are not necessary and a possible impediment to effective business decision making*. Again about 62% of respondents agreed or strongly agreed that the concepts *were an important capability that most managers have already developed*. This is an interesting response given that 77% of the respondents were *aware of unethical practices in their own organisations*. This calls into question the level of understanding of ethical business practice and level of sophistication of practice in the organisational setting beyond minimum codes (Donaldson & Werhane, 1999; Shaw & Barry, 1998).

In the next response over 85% of respondents agreed or strongly agreed that the concepts of honesty, integrity, fairness and the ability to make ethical decisions *are important managerial capabilities and need to be learned and understood.* Clearly the from the indication of experience of unethical practice and the response here there appears to be considerable need to develop understanding of business ethics concepts and practice.

Matrix 4.2 Question Stem Which statement best describes your views on bribery and corruption	Response to Strongly Agree	Response to Agree	Response to Neither Agree Nor Disagree	Response to Disagree	Response to Strongly Disagree
- a business practice that whilst undesirable is necessary in many situations	76.5%	12.3%	2.9%	1.4%	6.9%
- a practice that is wrong and adds cost to the organisation	23.3%	51.8%	7.5%	2.9%	14.5%
- a practice that is **not part** of normal business practice in **my country** but **necessary in others**	22.1%	20.0%	16.4%	17.9%	23.6%
- a matter of choice for managers and business	11.9%	7.4%	26.8%	17.9%	36.0%
- a practice that exposes individual managers to risk	33.3%	30.3%	18.2%	9.1%	9.1%

Matrix 4.2 outlines responses to a series of questions on bribery and corruption. Nearly 90% of respondents agreed or strongly agreed with the statement that bribery and corruption is *a business practice whilst undesirable is necessary in many situations*. This would imply that respondents consider bribery and corruption as, 'necessary evils' in given situations, as opposed to rejecting the concepts outright. The level of response would confirm the rationale for corporations taking part in corrupt practices posited by Carmichael (1995). This also affirms the earlier findings of Bowman and Gilligan (2007) that a substantial majority of respondents to their survey agreed that corruption was damaging, was also inevitable, and increasing in Australia.

The next response is an interesting contrast with the first response. Nearly 75% of respondents agreed that bribery and corruption are *wrong and add costs to the organisation*. The responses confirm awareness by managers that the practices are 'wrong'. Forty two percent of respondents agreed or strongly agreed that the issue *is not part of normal business practice in my country but necessary in others*. Forty two per cent also disagreed/strongly disagreed with the statement. This may imply that for these managers their view towards bribery and corruption is that such practices are not part of normal business practice at home nor are they necessarily part of business practice abroad.

The next response group indicated that 19% of respondents agreed that *bribery and corruption were a matter of choice for managers and business*, whereas 54% disagreed that it was a matter of choice. Clearly the managers in this sample view the practice of bribery and corruption as more of an expectation imposed upon them to pursue acts of bribery and corruption rather than exercise their own choice in such matters. This has some connection to the work of Ashford and Anand (2003) in rationalising the processes of corruption and bribery. Interestingly for the final response group 64% of respondents agree that bribery and corruption is a practice that exposes individual managers to risk. The managers are therefore are aware that these practices entail 'risk'.

From this group of responses the majority of managers in this sample are aware that bribery and corruption are practices that are wrong, place managers at risk, are undesirable but necessary sometimes and managers had little choice in engaging in these practices. This to some extent is confirmed by research into the normalisation of corruption in organisations (Spicer, 2009; Palmer, 2008; Ashford and Anand, 2003) which indicates that corrupt practices can become behavioural norms within the culture and systems of an organisation over time.

Matrix 4.3 Question Stem Which statement best describes how you would react to being offered a bribe	Response to Strongly Agree	Response to Agree	Response to Neither Agree Nor Disagree	Response to Disagree	Response to Strongly Disagree
I would politely decline indicating that it was not necessary	76.5%	12.3%	2.9%	1.4%	6.9%
I would seek advice from my manager/organisation as to the appropriate action	23.3%	51.8%	7.5%	2.9%	14.5%
If the bribe were of minimal value I would accept so as to not offend.	6.1%	3.3%	28.4%	8.9%	53.3%
I would accept the bribe if refusing were to jeopardize gaining the business	30.3%	10.0%	7.0%	24.0%	28.7%
I would accept the bribe if refusing were to jeopardize gaining the business and report it to my organisation.	8.0%	8.6%	26.7%	23.1%	33.6%

Matrix 4.3 considers behaviours of managers in relation to being offered a bribe. The first group of responses indicated that 89% of the respondents agreed/strongly agreed that they *would politely decline indicating that it was not necessary*. Some 8% of respondents though indicate that they disagree with the statement of reaction to being offered a bribe as *I would politely decline indicating that it was not necessary*. The situation changes with the next response group. 74% of the respondents agreed/strongly agreed that on being offered a bribe that they *would seek advice from my manager/organisation as to the appropriate action.* With the previous response in which the manager alone makes the choice to *politely decline the bribe* 77% strongly agreed with the statement, yet only 24% of managers strongly agree with *seeking advice from a manager or the organisation as to the appropriate action*. It seems that managers are more comfortable determining refusal of a bribe than referring the bribe to their manager or organisation by a ratio of 3 to 1. In the next response group the interesting feature to the question to accept a bribe, *If the bribe were of minimal value I would accept so as to not offend,* the interesting result was not so much the 53% who strongly disagreed as was the 29% who neither agreed nor disagreed. This would indicate some equivocation regarding the nature of the bribe – perhaps the *minimal value* and *not offending* aspects highlighted in the statement. Cultural

issues such as eastern face saving sensitivities and western embarrassment may impact responses here (Hofstede, 2001; Hofstede & Hofstede, 2005).

The last two response groups display an interesting outcome. 40% of respondents agree they would *accept the bribe if it were to jeopardize gaining the business,* yet only 17% of respondents agree they *would accept the bribe if it were to jeopardize gaining the business and report it to my organisation.* The implication here is that some respondents would accept a bribe *if it were to jeopardize gaining the business* but are not comfortable reporting it to their business. Again the level of neither agree nor disagree responses to declaring the bribe to the business rose to 27% from 7% for the previous question an almost fourfold increase. Again managers seem uncomfortable with declaring/discussing the bribery activity with their organisation. One contention might be the managers distrust the actions of organisation due to the propensity for corruption by members within the organisation.

Matrix 4.4 Question Stem Which statement best describes how you would react to being asked for a bribe	**Response to Strongly Agree**	**Response to Agree**	**Response to Neither Agree Nor Disagree**	**Response to Disagree**	**Response to Strongly Disagree**
I would decline on a personal basis believing bribery to be wrong	78.1%	7.8%	7.8%	1.6%	4.7%
I would decline if my company had a strict policy on bribery	24.3%	39.4%	15.2%	7.5%	13.6%
I would offer a bribe if it was of minimal value and would facilitate the process	10.3%	1.5%	17.6%	23.5%	47.1%
I would consult with my manager and follow his/her advice	24.7%	16.1%	24.7%	28.4%	9.9%
I would find a way to not pay the bribe directly such as arranging for an intermediary to handle such matters and have them invoice my organisation for administration/management fees	16.4%	6.0%	17.9%	25.4%	34.3%

Matrix 4.4 deals with questions relating to managers views on offering or being asked to provide bribes. To the statement *I would decline on a personal basis believing bribery to be wrong,* 86% of respondents agreed. To the second statement *I would decline if my company had a strict policy on bribery,* presents a shift in responses 64% agreed with the statement whilst the disagreed/strongly disagreed response of 21% was four times the response rate to the previous statement regarding *decline on a personal basis believing bribery to be wrong.* It would appear that managers value their own personal ethics above company policies on matters of corruption. Some 12% of managers agreed or strongly agreed that they *would offer a bribe if it was of minimal value and would facilitate the process.* This is consistent with the response of 10% agreed or strongly agreed to the Matrix 4.3 statement regarding accepting bribes - *If the bribe were of minimal value I would accept so as to not offend.* It would seem that about 10% of the managers in this sample are prepared to receive a bribe of minimal value and offer a bribe of minimal value. It should be noted that 71% disagreed or strongly disagreed with the proposition that they *would offer a bribe if it was of minimal value and would facilitate the process*.

The statement *I would consult with my manager and follow his/her advice* on being asked for a bribe throws up considerable changes to previous responses. Forty one per cent of respondents agreed or strongly agreed to the statement, 25% neither agreed nor disagreed, and 38% disagreed or strongly disagreed. Again as with the final question in Matrix 4.3 on advising the organisation of the bribery offer, alters the dynamic of the situation. The results imply mixed perceptions regarding consulting with a manager.

For the final statement in matrix 4.4 *I would find a way to not pay the bribe directly such as arranging for an intermediary to handle such matters and have them invoice my organisation for administration/management fees,* 16% of respondents indicated strongly agree, 6% indicated agree, 18% neither agree nor disagree, 26% disagree and 34% strongly disagree with the statement. Sixty per cent of the managers are in disagreement with this process however 24% do agree or strongly agree with the process. Although a majority of respondents reject the third party approach to delivering the bribe a quarter of respondents as a reasonable reaction to being asked for a bribe.

Matrix 4.5 Question Stem If you were aware of unethical practices in your organisation would you:	**Response to Strongly Agree**	**Response to Agree**	**Response to Neither Agree Nor Disagree**	**Response to Disagree**	**Response to Strongly Disagree**
Do nothing	13.9%	11.1%	15.3%	12.5%	47.2%
Report the action to my manager or superior irrespective of an anonymous reporting system	56.2%	15.1%	10.9%	9.6%	8.2%
Report the action ONLY if the organisation has an anonymous reporting system	23.5%	30.9%	20.6%	8.8%	16.2%
Report the action to an external body such as an Ombudsperson or Government Commission against corruption	15.5%	26.2%	23.8%	20.2%	14.3%
Report the matter anonymously to a newspaper or TV journalist	10.3%	4.4%	7.4%	25.0%	52.9%

Referring to responses in matrix 4.5, about 60% of respondents disagree or strongly disagree with the proposition that *If you were aware of unethical practices in your organisation they would do nothing.* However, 25% of respondents agree or strongly agree that *Do nothing* is the preferred course of action. This would imply that for some managers the issue of alerting senior management to unethical practices in an organisation remains a sensitive issue. Lewis (2008) found that in the UK over a ten year period protection for whistle blowers was inadequate.

For the next response statement, *Report the action to my manager or superior irrespective of an anonymous reporting system* 71% of respondents agreed or strongly agreed with the statement whilst 18% disagreed or strongly disagreed with it. In respect of the next statement *Report the action ONLY if the organisation has an anonymous reporting system* 54% agreed or strongly agreed whilst 25% disagreed or strongly disagreed with it. Analysing the responses to these last two statements together, there would seem to be a counterintuitive situation here. Fewer respondents confirmed that they would report the unethical practice ONLY if an anonymous reporting system operated compared to directing the report straight to a manager or supervisor irrespective of an anonymous reporting system. Again there could be a lack of trust with the organisation's systems and processes to be anonymous. The higher proportion of respondents indicated disagree or strongly disagree at 25% and neither agree nor disagree at 20% would indicate that more managers perceived an anonymous reporting system less attractive than reporting directly to their manager or supervisor.

With reference to external reporting of the unethical organisational practices, 42% agreed or strongly agreed that reporting *the action to an external body such as an Ombudsperson or Government Commission against corruption* was a correct course of action whereas 24% neither agreed nor disagreed with the proposition and 34% disagreed or strongly disagreed with the course of action. It would appear that managers prefer to report unethical practices internally to managers and supervisors

(71% of respondents agreed/strongly agreed) than reporting to external corruption authorities (42% of respondents agreed/strongly agreed).

Faith in external reportage by newspaper or TV journalists was also low as a medium to report corruption by the manager sample group. 78% of respondents disagreed or strongly disagreed with the proposition to *Report the matter anonymously to a newspaper or TV journalist.* Only 15% of respondents agreed or strongly agreed that this was a preferable course of action.

Matrix 4.6 Question Stem If you were asked to undertake unethical practices and it became public, would your organisation or manager:	**Response to Strongly Agree**	**Response to Agree**	**Response to Neither Agree Nor Disagree**	**Response to Disagree**	**Response to Strongly Disagree**
Support my actions and assume responsibility	19.1%	13.2%	16.2%	5.9%	45.6%
Publicly acknowledge that I was directed to undertake the action	14.9%	13.4%	19.4%	29.9%	22.4%
Privately acknowledge that I was directed to undertake the action and provide assistance	25.0%	13.2%	30.9%	17.7%	13.2%
Deny any knowledge of my actions	28.4%	26.9%	8.9%	16.4%	19.4%
Most likely to ask me to resign or dismiss me	47.1%	11.8%	10.3%	13.2%	17.6%

The final matrix 4.6 refers to managers perceptions of how their organisation would respond to if unethical practices which the organisation had instructed the managers to participate in became public. Responses to the first statement that the organisation or manager would *Support my actions and assume responsibility* indicated that 19% of respondents strongly agreed and 13% agreed with the statement, 16% neither agreed nor disagreed, 6% disagreed and 46% strongly disagreed with the statement. Managers seemed to disagree more with the statement with a significant level of strong disagreement. This would indicate a perceived lack of trust in their supervisor to take responsibility for instructing the manager to act unethically. For the next statement *Publicly acknowledge that I was directed to undertake the action* 15% strongly agreed and 13% agreed with the statement, 20% neither agreed nor disagreed, 30% disagreed and 23% strongly disagreed with the statement. 53% of managers disagreed that their organisation or manager would publicly acknowledge that they as a manager were directed to undertake the unethical actions. Again for the majority of managers there is little trust in the organisation supporting the individual manager.

To the next statement there is some change to the responses in that the admission by the organisation is private and the organisation offers support. To the statement, *Privately acknowledge that I was directed to undertake the action and provide assistance,* 25% of respondents strongly agreed, 13% agreed, 31% neither agreed nor disagreed with the statement, 18% disagreed and 13% strongly agreed with the statement. There is no clear indication of preference 38% agree/strongly agree, 31% are ambivalent and 31% disagree/strongly disagree with managing the situation internally. Again there may be issues of a lack of trust within a corrupt practising organisation in how the internal assistance will be managed.

The next statement is very clear in its responses; 55% of respondents strongly agree or agree that the manager's organisation or manager would, *Deny any knowledge of my actions.* Only 9% neither agree nor disagree, 16% disagree and 20% strongly disagree with the statement. A significant proportion of managers perceive that their organisation or manager would sacrifice them even though the unethical action was sanctioned by the organisation. Responses for the final statement *Most likely to ask me to resign or dismiss me* indicated that 47% of respondents strongly agreed and 12% agreed with the statement, 10% neither agreed nor disagreed, 13% disagreed and 18% strongly disagreed with the statement. A high proportion of managers (59%) expect to be dismissed are asked to resign under circumstances where the unethical action was dictated by senior management. Thirty one per cent, however, disagree or strongly disagree with the proposition that an organisationally orchestrated unethical situation should lead to the individual manager's resignation or dismissal.

5.0 Conclusion

This paper has presented a review of literature that suggests that the causes of bribery and corruption are numerous and that organisations can be prone to development of collective cultures in which corruption may become normalized. Given the opportunities for corrupt behaviour to infiltrate organizations particularly through, processes of rationalization, socialization and institutionalization (Ashforth and Anand, 2003; Spicer, 2009), the findings from this survey indicating awareness of and propensity for unethical business practice are not surprising. The further literature in the field of corruption and bribery applied in the discussion of findings for the present article established a stark frame against which the primary data from the survey results was contrasted and assessed.

Based on the survey responses from a sample of mid level managers, the following conclusions have been be drawn:

- Managers have a confused and conflicting awareness of critical concepts in business ethics and ethics per se.
- Managers continue to be confronted with ethical dilemmas in their business practice.
- Managers appear to distrust external agencies and the broader internal organizational systems to address organisational unethical transgressions but show a greater propensity to trust their internal senior management for advice and support.
- Managers remain ill equipped to resolve potential and actual bribery issues in their industries.
- Based upon the responses from this sample of managers, there appears to be evidence that organisations though not wholly corrupt certainly display evidence of unethical practices. A high proportion of managers (78%) indicated that they had experienced unethical practices in their organization. Clearly, there is still much work in developing business ethics in applied practice within the corporate environment.

Further research issues are clearly raised by this paper. In particular some of the research questions could be refined to gain a deeper level of insight. Qualitative face to face semi structured interviews to supplement the surveys could provide greater insight to manager perceptions and practices. Stratified sampling of the data by gender and nationalities could provide further dimensionality to the responses and insights from them into current business ethics practice in modern organizational settings. The issue of managerial trust in organisations to develop a transparent culture to surface unethical practice as well as support ethical practice is also are worthy of research effort.

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Latest Developments in Officers' Duties of SMEs

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Abstract

This paper examines the balance between officers' and directors' duties in the context of modern regulatory reform. The onus that falls on all directors, from a legal point of view, is applied irrespective of the size and complexity of the corporation. Thus, a small (micro-business) with a single director has the same legal obligation under the common law, the equitable fiduciary duties and the statutory obligations under the *Corporations Act* as Australia's largest entity, BHP Billiton. The current Federal Government is attempting to reduce the burden of red tape on business to help the economy. The regulators, in particular ASIC, are pursuing cases to enforce the law and increase compliance. There has been recent case law which helps explain the key statutory provisions and the underlying complexity of the law. The major defence and protection for officers' duties, is the so called "business judgement rule," but it does not seem to be very effective and good quality insurance cover is probably much more useful in the commercial world.

Keywords Officers' duties, SMEs, corporate law

Introduction

The last twenty years has seen the rise of a new Federal regulator, the Australian Securities and Investments Commission (ASIC) to promote and enforce the major legislation – the *Corporations Act 2001* (Cth). In that period, 1991 until 2011, the regulator, ASIC, has had a mixed level of success in the area of enforcement, both against corporate bodies and the individual officers and directors.[7] This paper examines the impact of the regulator on officers' (directors') duties as applied across all companies (including small to medium size enterprises). In particular, ASIC and the Commonwealth Director of Public Prosecutions (CDPP) have always claimed a high success rate in litigation.[8] However, where the litigation, whether civil, civil penalty or criminal has been contested, the results have not been so positive. In fact, ASIC has in the last 12 months lost three very high profile cases. The losses have undermined the confidence in the regulator. It is worth noting that officers' duties are the same laws for all companies, irrespective of the size and complexity of the company. Obviously, if a corporation is also listed on a securities exchange, such as the Australian Securities Exchange (ASX), there are additional legal responsibilities for officers.

It is worth noting that legal term "officer" is defined in s 9 (Dictionary) *Corporations Act* 2001 (Cth) as:

(a) a director or secretary of the corporation; or
(b) a person:

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6 Professor Michael Adams is the Head of School of Law at the University of Western Sydney and any comments may be emailed to: Michael.Adams@uws.edu.au This article is derived from a paper delivered at the 2nd *Small Business Forum*, hosted by Victoria University in Melbourne on 15th April 2011.

7 For a detailed discussion of the regulation of small corporations, see Michael Adams "20 year snap-shot of the developments in the regulation of small corporations" (2009) 4(4) *Journal of Business Systems, Governance and Ethics* 7.

8 ASIC has increased its rate from 81% to 91% over 20 years – see Table 3 below.

(i) who makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the corporation; or
(ii) who has the capacity to affect significantly the corporation's financial standing.

In most cases the majority of officers of a corporation are the directors, but it does include the chief executive officer (CEO) and possibly the chief financial officer (CFO) and other senior executives, depending upon the size and structure of the corporation. In a small corporation it is likely to only have a director who is also the CEO. The 2003 Royal Commission into the collapse of HIH Insurance recommended the change of definition of "officer" from "executives" to this more functional approach.[9]

The *Corporations Act* also has a definition of "director", which is also found in s 9 (Dictionary) a

(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.

In 99% of cases, it is very clear who is an officer of a company, as it includes all the directors and the company secretary (if appointed). In small corporations, the CEO or managing director is nearly always a registered director, but even if he or she is not, they would be deemed to be an officer of the company and thus bound by the same laws.

The officers of a company have very well defined legal obligations and there is a clear link to the role of corporate governance in all entities.[10] Over the last decade corporate governance and, in particular, the role of officers' duties has closely come under the microscope of the Australian courts in all jurisdictions.[11] No director, company secretary, general counsel or chief financial officer could argue they did not know what is expected of them in terms of the basic legal duties owed to the company. The HIH Insurance Royal Commissioner, the Hon Justice Neville Owen, in May 2008, re-stated the need for a commitment to education on the fiduciary principle and for greater professionalism in governance.

This article builds on some earlier published work on directors and officers' duties.[12] The Federal Minister responsible for developments in this area of law has noted that a review into the Safe Harbour Rule (known as the Business Judgment Rule[13]) in the *Review of Sanctions in Corporate Law* (2007)[14]

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9 *Report of the HIH Royal Commission* , http://www.hihroyalcom.gov.au/finalreport/index.htm (viewed 10 August 2011).

10 Alice Klettner, Thomas Clarke, and Michael Adams, "Balancing act – tightrope of corporate governance reform" (2007) 59 (11) *Keeping Good Companies* 648.

11 Alice Klettner, Thomas Clarke and Michael Adams "Corporate governance reform: An empirical study of the changing role and responsibilities of Australian Boards and Directors" (2010) vol 24(2) *Australian Journal of Corporate Law* 148.

12 Michael Adams "Are all directors created equal? Reassessing the role of the chair in the light of ASIC v Rich" (2003) 55 *Keeping Good Companies* 204, Michael Adams "Officers' duties under the microscope" (2005) 57 *Keeping Good Companies* 516 and Michael Adams "Officers' duties –are we keeping up with the changes?" (2008) 60 *Keeping Good Companies* 344.

13 Section 180(2) *Corporations Act* 2001 (Cth)

14 http://www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=1182 (viewed 10 August 2011)

paper, did not expect any quick changes at the moment. This is very true statement, as there has been no change to this officers' defence and few directors have ever been able to successfully rely upon it as a defence. The details of the business judgment rule are discussed below.

It is fair to say that any lay person might feel confused over the state of Australian corporate law. This is sharply brought into focus for directors and company officers that have an increasingly high expectations imposed upon them by a number of stakeholders.

As the author has previously identified the following statement by Sir Anthony Mason CJ wrote in 1992 that "Oscar Wilde described fox-hunting as "the unspeakable in full pursuit of the uneatable". Oscar Wilde, the supreme stylist, would have regarded our modern *Corporations Law* not only as uneatable but also as indigestible and incomprehensible."[15]

Background

ASIC[16] has been the primary regulator for corporations since the inception of the national legislation in 1991. The ASIC *Annual Reports* provide some useful data for comparative purposes and to set a background to the discussion on officers' duties.

Table 1: ASIC corporate data from 1991 to 2010

Event	1991	933,652	1998	2001	2006	2010
Total no corps	892,749	82,278	1,088,192	1,224,207	1,480,684	1,768,526
New corporations	n/a	915,437	97,031	76,103	121,298	157,667
Private (Pty)	871,648	n/a	1,070,050	1,188,042	1,392,458	1,738,638
AFSL	n/a	n/a	n/a	35	4,415	4,874
Auditors	n/a	n/a	n/a	7,222	5,848	5,270
Prospectuses	n/a	96	683	2,744	808	880
Takeovers	n/a		76	81	60	73

Table 1 shows there has been a steady increase in the number of companies registered each year and that the total number of proprietary companies (which are mostly classified as small to medium enterprises) make up over 98% of all companies incorporated. It is interesting to note the annual number of companies incorporated (registered) has increased dramatically over the 20 years, whereas the registered auditors, prospectuses and takeovers have remained relatively stable. Small corporations are not required to have auditors, are prohibited from issuing fundraising documents (prospectuses)[17] and are not involved in takeovers (under the *Corporations Act*).

15 Anthony Mason "Corporate law: The challenge of complexity" (1992) 2(1) *Australian Journal of Corporate Law* 1.

16 Originally the regulator was the Australian Securities Commission (ASC) until its jurisdiction for financial services was increased in July 1998 and the name changed to ASIC.

17 Section 113(3) *Corporations Act* 2001 (Cth)

Table 2 shows how the regulator has changed over the two decades. In the last fifteen years operating revenue has doubled while fees have doubled and equity increased twelve fold.One of the key areas of note is the enforcement aspect of ASIC, both directly and in conjunction with the Commonwealth DPP. Table 3 below gives a useful snap-shot.

Table 2: ASIC performance 1995 to 2010

ASIC	1995	1998	2001	2006	2010
Operating rev	$145m	$131m	$144m	$225m	$381m
Fees to Cth	$258m	$335m	$363m	$543	$582m
Total equity	$9.7m	$1.6m	$2.2m	$7m	$117m
Staff (FTE)	1,551	1,152	1,221	1,471	1,932
Searches	n/a	2.2m	7m	45m	61m
Compliance[18]	84%	94%	93%	94%	95%

Table 3: ASIC enforcement record 1995 to 2010

ASIC	1995	1998	2001	2006	2010
Jailed	12	26	25	17	12
Successful	81%	90%	71%	94%	91%
Litigation[19]	74	199	150	386	156
Misconduct	7,287	7,509	6,946	12,075	13,372
Recovered $	n/a	n/a	$121m	$215m	$302m

Table 3: ASIC enforcement record 1995 to 2010

In the last decade, sending corporate officers to jail has been a steady stream averaging 22 directors and officers per year. The ten years from 2000 until 2010 shows 220 officers were sent to jail in Australia. The highest year was in 2000 with 25 jailings and the lowest was in 2004 with 17 jailings. The successful litigation percentage includes contested and uncontested cases, in both civil and criminal cases.

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18 Compliance of lodgements on time with ASIC (the old annual returns, now called "extract of particulars").

19 Both civil and criminal matters that are concluded in a year.

Focus on small corporations

Over the 20 years of ASIC regulation, the Federal Minister who has been responsible has changed from government to government. Currently, the Hon Wayne Swan MP as Commonwealth Treasurer has responsibility for "corporate and securities law". Whereas, within the Department of Treasury, the Hon David Bradbury MP, as Parliamentary Secretary to the Treasurer, is actually responsible for ASIC and corporate governance. Then, the Hon Bill Shorten MP, as Assistant Treasurer and Minister for Financial Services and Superannuation, also has some corporate law responsibilities. However, it is the Hon Nick Sherry, who is the Minister for Small Business and has been recently making a number of announcements on law reform. This appears to be part of the development of corporate law for smaller companies.

Senator Sherry[20] noted that the Department of Finance has been conducting a review to reduce red tape across the business sector. The review has found that of 11,444 regulations that have come under scrutiny 4,214 are in fact redundant! This means 499 regulations can be repealed by government departments and agencies. A further ten statutes and 3,715 provisions can be removed by way of Parliament passing the necessary amendments.

There has been a particular focus on 27 priority areas, which focus on harmonisation of regulations which impact on business between state and federal jurisdictions. It is believed that cutting ten of the 27 areas will result in savings of $3.5 billion across the economy, with $1.8 billion benefiting business. The key success to such reform is the role of the Council of Australian Governments (COAG), which has historically had a mixed result in making such changes. The Federal government has provided up to $550 million to tackle the 27 priority areas including national reform of occupational health and safety (OHS), consumer credit, consumer protection, environmental assessment, rail safety, energy market regulation, national transport and infrastructure reform.

The Small Business website (www.business.gov.au)[21] has been seen as a great success and after 12 months has clocked up over 250,000 downloads of its business guides and templates. This is a useful resource, but does not cover any legal aspects relating to officers' duties (although other laws are generally covered, including OHS and intellectual property).

The Minister for Small Business has noted that Australia has been ranked in the top ten out of 183 economies for starting a business by the World Bank.[22] The report, *Doing Business 2011*[23]actually placed Australia second in the world to start a business due to the short time, low cost and few administrative procedures required. Australia also ranked highly in getting credit and the ease of doing business. But Senator Nick Sherry has noted that the two million small businesses could be helped even more and he sees the COAG National Partnership to deliver a "Seamless National Economy" as a crucial aspect. One practical way has been the government's provision of $42.5 million to 37 Business

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20 Senator Nick Sherry in his capacity as Minister Assisting on Deregulation announced in a Media Release "Repeal of redundant regulations dating back to Treaty of Versailles" on 30 March 2011.

21 Senator Nick Sherry in his capacity as Minister for Small Business in the Media Release "business.gov.au reaches downloads milestone" on 5 April 2011.

22 Nick Sherry "Repeal Address to Australian Chamber of Commerce and Industry General Council" Hotel Intercontinental, Sydney on 31 March 2011.

23 World Bank & International Finance Corporation *Doing Business 2011 Making a difference for entrepreneurs* World Bank, 4 November 2010.

Enterprise Centres to help over 182,000 businesses. The tax benefits for small companies from July 2012 and the instant write-off of assets under $5,000 will also be a great help.

The ‘cutting of red tape’ appears to be the goal of every government, but is always easy to say but much harder to deliver. The initiatives include a focus on simpler national business name registration (with the three year fee moving from $1,000 to just $70) and improved trademark searching. The biggest help is probably the developments in “standard business reporting” (SBR) which has involved the governments with 30 software developers and the acceptance of Auskey for time-saving new digital security certification to transmit data from business to the Government online. It is projected that the full implementation of SBR could save businesses $800 million annually. Other areas of reform for small business are loan and credit reform to cut the cost of capital/finance and the introduction of the *Personal Property Security Act 2009* (Cth) from October 2011. This will make it much easier for businesses to take secured loans and guarantee the repossession of goods where a customer fails to pay. Deloitte Access Economics have predicted that these reforms could cut the cost of small business borrowing in Australia by 3% reduction.

Australian Officers Duties Guides

The *Corporations Act 2001* (Cth) in s 111J contains a “*Small Business Guide*” which outlines in plain English the various legal obligations of setting up and running a company. In Sections 1 and 5 of the *Small Business Guide* informs about the appointment of directors and their basic legal duties. For convenience this is reproduced:

1 **What registration means**

1.8 Directors

The directors of a company are responsible for managing the company's business. It is a replaceable rule (see 1.6) that generally the directors may exercise all the powers of the company except a power that the Corporations Act, a replaceable rule or a provision of the company's constitution (if any) requires the company to exercise in general meeting.

The only director of a company who is also the only shareholder is responsible for managing the company's business and may exercise all of the company's powers.

The Corporations Act sets out rules dealing with the calling and conduct of directors' meetings. Directors must keep a written record (minutes) of their resolutions and meetings.

There are 2 ways that directors may pass resolutions:

- at a meeting; or
- by having all of the directors record and sign their decision.

If a company has only 1 director, the sole director may also pass a resolution by recording and signing their decision.

[sections 198A, 198E, 202C, subsection 202F(1), sections 248A- 248G, 251A]

5 **Company directors and company secretaries**

5.1 Who can be a director

Only an individual who is at least 18 years old can be a director. If a company has only 1 director, they must ordinarily reside in Australia. If a company has more than 1 director, at least 1 of the directors must ordinarily reside in Australia.

A director must consent in writing to holding the position of director. The company must keep the consent and must notify ASIC of the appointment.

In some circumstances, the Corporations Act imposes the duties and obligations of a director on a person who, although not formally appointed as a director of a company, nevertheless acts as a director or gives instructions to the formally appointed directors as to how they should act.

The Court or ASIC may prohibit a person from being a director or from otherwise being involved in the management of a company if, for example, the person has breached the Corporations Act.

A person needs the Court's permission to be a director if the person has been convicted of certain offences or is, in some circumstances, unable to pay their debts as they fall due.

Generally, a director may resign by giving notice of the resignation to the company. A director who resigns may notify ASIC of the resignation. If the director does not do so, the company must notify ASIC of the director's resignation.

[sections 9, 201A, 201B, 201D, 205A, 205B and 206A-206G, 228-230 and 242 and subsection 1317EA(3)]

5.2 Appointment of new directors

It is a replaceable rule (see 1.6) that shareholders may appoint directors by resolution at a general meeting.

[section 201G]

5.3 Duties and liabilities of directors

In managing the business of a company (see 1.7), each of its directors is subject to a wide range of duties under the Corporations Act and other laws. Some of the more important duties are:

- to act in good faith
- to act in the best interests of the company
- to avoid conflicts between the interests of the company and the director's interests
- to act honestly
- to exercise care and diligence
- to prevent the company trading while it is unable to pay its debts
- if the company is being wound up--to report to the liquidator on the affairs of the company
- if the company is being wound up--to help the liquidator (by, for example, giving to the liquidator any records of the company that the director has).

A director who fails to perform their duties:

- may be guilty of a criminal offence with a penalty of $200,000 or imprisonment for up to 5 years, or both; and
- may contravene a civil penalty provision (and the Court may order the person to pay to the Commonwealth an amount of up to $200,000); and
- may be personally liable to compensate the company or others for any loss or damage they suffer; and

- may be prohibited from managing a company.

A director's obligations may continue even after the company has been deregistered.

[Sections 180, 181, 182, 183, 184, 475, 530A, 588G, 596, 601AE, 601AH, 1317H]

The Australian Government's reform body for corporate law, the Corporations and Markets Advisory Committee (CAMAC) in April 2010 published a more detailed guide to directors.[24] This report outlines in detail the challenges for directors and the various guidance to be drawn from legislation, the case law, the regulators and the ASX Corporate Governance Council. It also provides an international comparison with the United Kingdom and North America. The report is a useful resource for public companies and those listed on the ASX rather than smaller entities.

Before examining the recent developments in Australian case law of officers and in particular director's duties, it is valuable to review the existing laws. There is a natural overlap between the legislation imposed by Parliament and the case law developed over the last couple of centuries. Companies have existed since 1600[25] but the modern incorporated (registered) company can be identified since 1844.[26] Australia has mostly followed the corporate laws of the United Kingdom and moved to registered corporations as part of the move in 1991 to a national system, under what is now the *Corporations Act 2001* (Cth).

Overview of Officers and Directors' Duties in Australia

In Australia, the law relating to officers and directors can be divided into three:

- Statutory duties
- Common law duties (such as the duties of care, skill and diligence)
- Equitable fiduciary duties.

The fundamental duties that are imposed on all officers of all companies can be illustrated in a Venn diagram. The overlapping areas represent how the *Corporations Act 2001* in Part 2D.1 reflects parts of the common law and equitable principle.

Some duties are specifically laid out in statute, such as insider trading in s 1043A. Other duties, such as when directors have interests in company contracts, are both statutory (s 191) and fiduciary duties (s 182). Directors must not trade while insolvent by s 588G and have a common law duty to consider creditors in times of financial trouble, as in the High Court of Australia case of *Spies v R* [2000] HCA 43.

Where the three circles (Figure 1) intersect represents s 185 which provides that the duties imposed by legislation are additional to the duties imposed at common law and in equity, rather than exclusive of them. Thus a director could be sued for all three actions rather than just the *Corporations Act* or the common law/equity principles. An example of a director being held liable for all three types of actions occurred in *South Australia State Bank v Clark* [1996] SASC 5499.

A breach of ss 180–183 may result in a civil penalty order under s 1317E but this is not applied under the common law or equity. However, further criminal liability may also arise under s 184 in relation to the types of breaches found in ss 181–183. This is important due to the different remedies that apply to civil, civil penalty and criminal cases.

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24 Corporations and Markets Advisory Committee, *Guidance for Directors Report*, CAMAC 2010

25 The Honourable East India Company, 1600 England

26 *Joint Stock Companies Act* 1844 (UK)

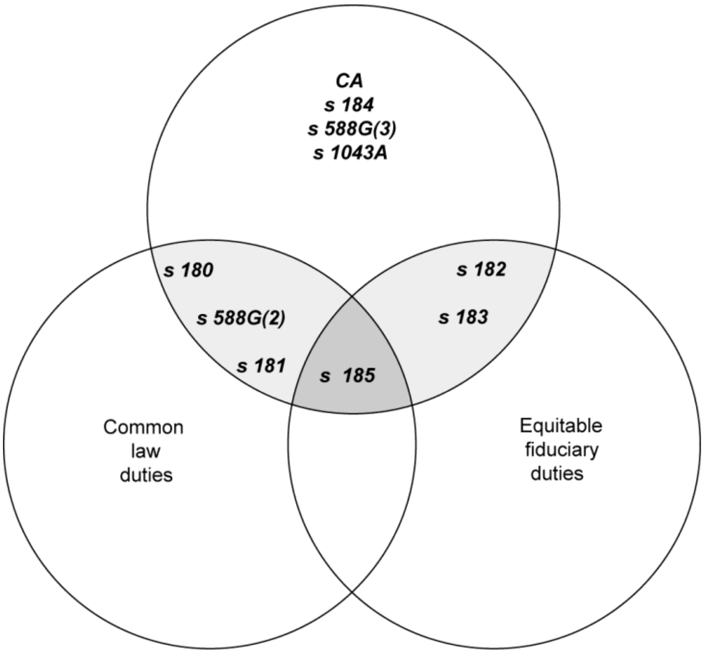

Figure 1: Overview of officers' duties[27] (Adams, 1992 - updated)

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However, it is worth noting that at common law officers are expected to be honest and to take reasonable care in exercising their duties. At the same time, s 181 provides that officers are required to discharge their duties in good faith and for a proper purpose, whilst s 180(1) provides that they must do so with reasonable care and diligence. This can be compared to the tort of negligence that was recognised in the corporate directors context in *ASIC v Adler* [2002] NSWSC 171. Also, the equitable principles of avoiding conflicts of interest and not taking advantage of confidential information are reflected in both ss 182 and 183.

Working professional directors and officers (as well as the many non-executive and part-time directors) have difficulty with keeping up-to-date with the many cases surrounding the same factual circumstances, but deal with different aspects of the law. For example the One.Tel litigation, which is often cited as the *ASIC v Rich* [2003] NSWSC 85 involves many different sub-cases. Obviously, the

27 Jason Harris, Anil Hargovan, Michael Adams, *Australian Corporate Law*, 2nd edition 2009, LexisNexis:Butterworths 439.

HIH litigation and the GIO litigation, all produced many cases surrounding the directors' duties. In the future, the 2007-2008 collapses of Opes Prime brokers' litigation and Centro shopping centres, will produce multiple cases to confuse or possibly enlighten directors and company secretaries.

One of the most significant decisions was the *ASIC v Rich* [2003] NSWSC 85 (known as the "Greaves One.Tel" case) which occurred in 2003, as it examined the precise role of a chairman of the collapsed tele-communications company. Mr Greaves was held to have been a paid non-executive director with finance experience and thus owed a higher duty of care under the common law and statute than other directors by Justice Austin. This original case was a procedural action which was to be struck out, went on to an out-of-court settlement for $20 million, which was paid to the liquidator. This settlement plus an agreed banning order had to be formally certified by Justice White and thus gives legal status to the earlier decision of Justice Austin in the NSW Supreme Court. The final case of Jodee Rich did not work out positively for ASIC in 2009. Before detailing the failed litigation of ASIC, it is important to note the limited success in the James Hardie litigation and other major cases.

The High Court of Australia does not often examine corporate law cases, but one of the many One.Tel cases, *Rich v ASIC* [2004] HCA 42[28] examined the importance of procedures in the area of civil penalties. The HIH Insurance cases around *ASIC v Adler, Williams & Fodera* [2002] NSWSC 171 examines in depth the civil penalty standards of directors' duties. In particular whether Mr Rodney Adler acted honestly (a breach of s181) and taking reasonable care and diligence (a breach of s 180) by Mr Ray Williams and Mr Adler. Unusually, a separate criminal prosecution was launched against Mr Williams[29] and Mr Adler[30], resulting in a conviction and jail sentence. This was followed by the high profile case of Steve Vizard for using confidential information from the boardroom of Telstra for personal gain.[31] This case could have been brought under the insider trading laws, but was in fact brought under the directors' duties provision for misusing confidential information.
Hot on the heels of the HIH Insurance cases was the GIO cases (the hostile takeover by AMP of GIO) which resulted in *ASIC v Vines, Robertson & Fox* [2005] NSWSC 738.[32] This case held the three CFOs of the various GIO companies liable for a breach of their duties as officers of the target company. A higher duty of care had been expected of a chair of a company or even a board audit committee following *Hall v Poolman* [2007] NSWSC 1330.

Thus, after a number of successes against directors in the civil and criminal courts, ASIC potentially hit a wall. The initial highs of the successful 2009 *James Hardie litigation*[33] has resulted in an appellant court over-ruling Justice Gzell in a number of ways and exonerating most of the directors held liable. The case of *Morley v ASIC* [2010] NSWCA 331 and *James Hardie Industries NV v ASIC* [2010] NSWCA 332 was a huge step backwards for the regulator.

The outcome of the appeal was that mixed in that the company (JHL) did make misleading statements to the ASX in June 2002 and failed to comply with continuous disclosure. The CFO at the time, Mr Morley, was in breach of his duty in advising the board and the limited nature of the predicted analysis of compensation. Similarly, the company secretary and general counsel, Mr Shafron, had part of his appeal upheld, but was still in breach of his duty to advise the board. The other non-executive directors, including the chair, Ms Hellicar, were successful with their appeals and breaches of the

28 For a detailed discussion on this case, see Michael Adams "Whether to protect or punish: legal consequences of contravening the *Corporations Act*" (2004) 56 *Keeping Good Companies* 592.

29 *R v Williams* [2005] NSWSC 315.

30 *R v Adler* [2005] NSWSC 274.

31 *ASIC v Vizard* [2005[FCA 1037.

32 For a detailed discussion of this case, see: Michael Adams "Officers' duties under the microscope" (2005) 57 *Keeping Good Companies* 516.

33 *ASIC v MacDonald (No 11)* [2009] NSWSC 287 and penalties imposed at *ASIC v MacDonald (No 12)* [2009] NSWSC 714.

officers' duty in s 180 were removed, in respect of the approved minutes of the board meeting (which became the ASX announcement on asbestos compensation). ASIC was criticised for not calling a particular witness (an external lawyer) who was present at the relevant board meeting of JHL.[34] This case is not yet over, as on 14 January 2011, ASIC applied to the High Court of Australia for special leave to appeal the decision of the NSW Court of Appeal![35]

Losing High Profile Cases

In the last twelve months ASIC has lost a number of high profile cases, including the One.Tel 2009 (Jodee Rich case), the AWB case 2010 (against CEO Andrew Lindberg) and the 2009 Fortescue Metals case (against the CEO Andrew Forrest). As with any current writing, it must be noted that the law does not stand still and there are various levels of appeal occurring for all these cases.

The One.Tel case resulted from the collapse of the tele-communication company in 2004. The final decision was handed down by Justice Austin in the NSW Supreme Court in late 2009, in *ASIC v Rich* [2009] NSWSC 1229. The two managing-directors, Mr Jodee Rich and Mr Mark Silberman were found not to have breached their officers' duties. The cost of the defence was $15 million, which must be paid by ASIC. Two other former directors of One.Tel, Mr Bradley Keeling and Mr John Greaves, settled out of court and thus have bans imposed upon them for ten years and four years respectively.

Probably one of the most important contemporary cases involved the entrepreneur and miner, Mr Andrew 'Twiggy' Forrest and his ASX listed company, Fortescue Metals Group Ltd (FMG). Mr Forrest, on behalf of FMG announced through both media releases and ASX announcements that "binding agreements" with various Chinese state-owned corporations had been made to develop the Pilbara region of Western Australia for iron ore exploration. From August 2004 until November 2004 the share price rose of FMG from 59 cents to $1.93. By March 2005 the share price had reached a high of $5.05 per share. The *Australian Financial Review* newspaper investigated the claims of the so-called binding agreement and the price started to drop (once the agreements were formally disclosed to the ASX). ASIC started proceedings against the company, FMG, for misleading statements and for failing to properly comply with continuous disclosure laws. In addition, Mr Forrest, as an officer of the company, was alleged to have breached his officers' duty of reasonable care under s 180(1) *Corporations Act 2001* (Cth). The Federal Court found that there was no breach of the Act in *ASIC v FMG* [No 5] [2009] FCA 1586.
ASIC decided to appeal the decision of the trial judge, Justice Gilmour and were successful on all counts in *ASIC v Fortescue Metals Group Ltd* [2011] FCAFC 19. The actual penalty imposed on FMG for the breach of misleading conduct (s 1041H) or the continuous disclosure (s 674(2)) or personally for Mr Forrest for the officers' duty of reasonable care (s 180(1)) and involvement with a breach of continuous disclosure (under s 674(2A)) has not yet been determined.[36] There will be an appeal to the High Court oif Australia in 2011.

Business Judgment Rule

The American developments of corporate law have finally refined what is known as the "safe harbour rule" for directors. This means that if a director makes an honest decision, which with the benefit of hindsight appear to be negligent, then the director is protected from legal action by the company or its shareholders (a class action). In Australia this common law principle[37] was deemed to be too vague

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[34] More detailed discussions at Anil Hargovan "Directors' and officers' duty of care following James Hardie" (2009) 61 *Keeping Good Companies* 586 and Richard Head "Directors and officers still in the firing line – a guide to managing risk" (2010) 62 *Keeping Good Companies* 57.

[35] ASIC, "ASIC applies for special leave to appeal James Hardie decision" *ASIC Media Release* 11-07MR (14 January 2011).

[36] The Full Bench of the Federal Court has sent the matter of penalties to a single judge of the Federal Court for determination. There is a possibility that Mr Forrest and FMG may appeal the decision to the High Court!

[37] *Harlowe's Nominees PL v Woodside (Lakes Entrance) Oil NL* [1968] HCA 37

and a statutory formulation was created in what is now s 180(2) and re-named the "business judgment rule".[38]

Section 180(2) states:

> 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.
> 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.

Although this looks like a useful and practical protection for officers and directors, in reality it has been rarely successfully used in any case! The few cases it has been applied, the directors in question have failed the "material personal interest" test.[39] The defence does apply to the statute and equivalent claims under the common law (such as the tort of negligence) and equity.

Conclusion

It is important to note that many of the principles of law discussed above can be derived from the general or basic law duties which were borrowed by way of an analogy of the trustees' duties owed to the beneficiaries, from 1853 in *Re German Mining Co; ex parte Chippendale*.[40] Although the *Corporations Act* in many ways codifies the common law and equitable duties, there is still an overlap and different sections have different outcomes in terms of remedies or sanctions.

ASIC must take risks with litigation, as it is the only way to really test the statutory provisions of the complex *Corporations Act*. However, there is a publicity risk when the regulators lose a major case, but proper case preparation is crucial.

Although many of the cases mentioned in this paper focus on the large ASX listed companies and their officers and directors, the principles are applied to all corporations. The burden of regulation on a director of a small company is huge as they do not normally have the financial resources to fight a big complex case against ASIC or any of the other regulators, such as the Australian Taxation Office or the Australian Competition and Consumer Commission. Good corporate governance principles are valuable for all entities.[41]

It is essential that all officers, in respect of all size of corporations understand the role of insurance (particular the specialist policies for directors and officers insurance known as "D&O" policies). It is D&O insurance that plays a significant role in how directors' cases are run out in the courts. It is critical to remember that insurance does not cover the outcome of a criminal prosecution nor civil penalties, as a matter of public policy and statutory intervention. It may help towards the legal defence costs, but not a penalty for an adverse finding in a case. All officers and directors are advised to keep a careful watching brief on the ever changes currents of litigation. The general duties of honesty and diligence will never change for professional officers for every company in Australia.

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38 Kristyn Briggs and Evan Richards "Time for a new business judgment rule?" (2008) 60 *Keeping Good Companies* 288.

39 *ASIC v Adler* [2002] NSWSC 171; *Gold Ribbon (Accountants) PL v Sheers* [2006] QCA 335 and *ASIC v Rich* [2009] NSWSC 1229.

40 (1853) 3 De GM & G 19

41 Michael Adams "The three pillars of good corporate governance" (2004) *Risk Management* 8 at <http://www.riskmanagementmagazine.com.au/articles/d3/0c03c8d3.asp> viewed 8 April 2011.

Corporate Regulation and Corporate Governance of Small Businesses in Australia

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Abstract
This paper presents the results of a study of small business owner /managers and CEOs of industry associations in relation to corporate regulation and corporate governance for small businesses in Australia. It is part of a larger project investigating regulation and small business governance supported by an Australian Research Council grant and COSBOA. A survey of the CEOs of small business associations and small business owner/managers investigated the corporate governance practices of small businesses, their understanding of their duties as directors, their approach to managing risks and accountability, the regulatory difficulties experienced by small businesses, and the factors that inhibited or promoted the performance of small business.

Kew words
small business, governance, regulation

Introduction
Small Businesses are referred to as the 'engine room of the Australian economy' (Clarke, A., 2007) because of the major role they play in the economic and social wellbeing of Australia. Even though they comprise 96% of all firms, employing more than 5 million people (National Office for the Information Economy, 2007), in the past, their regulatory needs were largely ignored because regulation is aimed at large listed firms. This was particularly true in respect to the Corporations Act. However, the sequence of disasters affecting businesses in Australia, natural disasters such as droughts and floods and economic flow-on from the impacts of the GFC, have drawn attention to the role of small business in stimulating the national economy. One consequence is that governments are increasingly seeking ways of both reducing the burden of regulation on small corporations (Miller, 1010; Deighton-Smith 2008) and using regulation to enhance their efficiency and contribution to the national economy .

This paper presents the results of a study of small business owner /managers and CEOs of industry associations in relation to corporate regulation and corporate governance for small businesses in Australia. It is part of a larger project investigating regulation and small business (Armstrong et al 2004) supported by an Australian Research Council grant.

Definition of Small Business

Regulators and scholars are yet to agree upon a simple definition of a small corporation, however, they do agree that small corporations can include: one person firms, family firms/ businesses (Romano and Smyrnios 1996; Spender 1997), SMEs (small and medium enterprises), and small proprietary companies (Cassidy, 2005). The range of small corporations is therefore numerous and complex. Their legal structure is classified as sole proprietors, partnership or a company. Even though a variety of criteria are employed to define a small business (eg. total net worth, relative size within the industry, number of employees, value of products, annual sales or receipts and net worth), for the purpose of this research we used the definition derived from s 45A(2) *Corporations Act 2001* (Cth). According to this definition:

- Small companies are those with less than 50 shareholders which meet at least two of the following criteria:
  - consolidated revenue of less than $25 million per year;
  - gross assets of less than $12.5 million;
  - fewer than 50 full-time employees.

Regulation

Regulation is defined as a principle rule or law, designed to control or govern (Bank, 2006), and considered an essential component of governing. The OECD (1997)} defines regulation more broadly as "the diverse instruments by which governments set requirements on enterprises and citizens". Regulations include laws, formal and informal orders and subordinate rules issued by all levels of government, and rules issued by non-governmental or self-regulatory bodies to which governments have delegated regulatory powers. In the past, regulation was aimed at large listed firms and the regulatory needs of small businesses were largely ignored. This is particularly true in respect to the Corporations Act. Furthermore, small businesses are also more affected by red tape than large companies. This is because they are less proficient in dealing with regulation because of its complexities and their limited resources. They are unable to spread the costs of compliance across large scale operations (Chittenden et al, 2003) and, due to the fixed-cost nature of the regulation, it creates an environment, where the regulatory costs are disproportionately borne by small businesses (Green, 2002)

Corporate Governance and Small Business

Corporate governance is concerned with internal structures and processes for decision-making, accountability, control and behaviour at the top of organisation (Clarke, A. 2004), and external mechanisms for accountability (Armstrong et al 2011). Therefore corporate governance is mainly about the control and direction of companies, exercised by their directors or those holding power and authority, and any decision making in all those matters which affect the vision, performance and long term sustainability of an organisation.

The Corporations Law refers to a "Director" as those legally appointed and responsible for the duties and responsibilities of directors. However, the owners and managers of small corporations see themselves as owners and managers rather than as directors (Armstrong et al 2011).

When the roles of management and ownership are located in the same person, an agency problem does not emerge. The agency problem refers to the potential conflict of interests between owners and managers (Jensen and Meckling 1976). In large organisations owners provide finance via investment and allocate control to managers who then end up with discretion about how to allocate the investors' funds. Agency theory suggests that the self interest motivating managers can be in conflict with the profit maximising interests of investors. Governance mechanisms, such as an independent board and directors, are seen as a means of separating decision making from the risks of operations and thereby limiting a manger's self serving behaviour (Eisenhardt, 2004; Fama and Jensen 2004).

Many small businesses are managed by only one or two persons, mainly the owners and/or managers, who make all the critical decisions on finance, accounting, personnel, purchasing, processing or servicing, marketing, selling without the aid of internal specialists and with specific knowledge in only one or two areas (Wiltshire Committee, 1971). For them governance is a combination of views of the owners and the manner in which they run the business {Burgess et al, 2009 #132}. Burgess contends that small businesses are concerned with improving their performance and allowing the commensurate benefits to flow to stakeholders such as owners and employees. Many are not interested in economic growth, but rather battle survival on a day to day basis and aim to provide themselves and their employees with a comfortable living (Burgess and Hill, 2004). Others seek a certain life style and autonomy not available when employed in a large organisation.

Governance of small businesses differs significantly from larger corporations in respect of size, resources, level of employment, directors' perceptions of their role, decision making authority, family business structures, independence of board chair and CEO/manager, use of independent directors, diversity and accountability Armstrong et al 2010). Many are family companies that, as they grow in size, face different problems, such as those of succession and minority shareholder rights (Kanpathanat and Armstrong, 2011).

Governance and Regulation

The purpose of regulation of corporate governance is to reduce risk and maintain order and confidence in the corporate capital market and to safeguard the investments of shareholders. These include both direct owners of shares and secondary owners such as those contributing to social and financial institutions such as superannuation funds (Armstrong et al, 2011). The purpose of regulation from a government perspective is to maintain the social order. Regulation of governance includes both internal and external governance mechanisms. Internal mechanisms are the system or structure of rules and relationships, supervision and control of those who exercise the authority, accountability, stewardship, leadership, direction and control which aim to ensure accountability and efficient use of resources in balancing the achievement of goals of corporations, society and individuals (Armstrong 2004).

External governance mechanisms, such as the Corporations Law and rules for listed companies imposed by the Australian Securities Exchange, guide the internal governance of a company. The main differences in the Corporations Law between the regulation of large and small companies are the level of disclosure and the requirement for large companies to produce formal audited accounts (Adams, 2010). Furthermore, an alternative to complying with the main provisions of the Corporations Law were a section in the Act referring to small business and adoption of the Replaceable Rules to guide internal governance mechanisms such as meeting procedures (Francis and Armstrong 2009)..

External governance mechanisms are those imposed from outside the organisation most notably, government regulation. As a result, governance and regulation are intimately related.

Regulation of corporate governance practices in small corporations

In the context of this study, corporate governance refers to the provisions of the Corporations Act, particularly Laws for: Replaceable Rules, simplification for the regulation of small businesses, formation and structure of a board, the appointment and independence of directors and Best practice governance as recommended by the ASX guidelines. Best practice guidelines recommend boards with independent directors, the separation of ownership and control, appropriate skills and diversity of directors, succession plans, a code of conduct ,record keeping and information disclosure.

Adams (2009) describes a major distinction that relates to the level of disclosure required by the regulators and the requirement to produce formal accounts and auditing. A small proprietary company under s 292(2) generally does not have to provide a financial report nor a directors' report unless there is a direction (request) from the shareholders (s 293) or ASIC (s 294). However, all companies, including small proprietary companies have an obligation to keep financial records under s 286 *Corporations Act* 2001 (Cth). The financial records must correctly record and explain all transactions and the financial position of the company and would enable a true and fair financial statement to be prepared. The records must be kept for seven years and it is a strict liability criminal offence to fail to keep such records. This obligation is in addition to any tax law provisions.
Apart from the above, small businesses must also comply with tax regulations, superannuation, health and safety, environmental laws etc.

The purpose of the study

This aim of this paper is to report on a study of corporate regulations and corporate governance in relation to small businesses which investigated the views of small business owner /managers and CEOs of industry associations in relation to corporate regulation and corporate governance for small businesses in Australia. Although previous research had investigated the relevance of the corporate law to small business, there was a gap in the research in relation to the perceptions of and practices of governance in small corporations and the impact of governance regulation on small business performance.
The research questions were:

- What were the corporate governance practices of small businesses? Did they have boards of directors? Did they understand their duties as directors? How did they manage their risks? Were they publicly accountable?
- Were the roles of owners/and managers combined?
- What were the corporate governance and regulatory difficulties experienced by small businesses?
- What factors inhibit or promote the performance of small business?

Methodology

In order to assess the corporate regulations and corporate governance of small businesses, this study employed both quantitative and qualitative techniques. This study was part of a larger study, supported by an Australian Research Council (ARC) grant and COSBOA, that investigated the responsiveness of governance regulation in small businesses in Australia (Armstrong et al. 2011). The sample for this study was twenty one participants consisting of nine owner/managers of small businesses and twelve executive directors of small business industry associations in Victoria.

The sample was a purposive sample selected because of their in-depth knowledge and experience of small business. The majority of the small business respondents in this study were male (77.7%) and 22.2% were female. The highest level of education achieved by the participants was a bachelors degree (33.3%) and 22.2% had post graduate qualifications and a further 22% had secondary education. Over 50% in this sample were technically qualified.

Interviews were conducted using a structured interview schedule containing both closed and open ended questions. The opinions and experiences of respondents were reported on a 1-7 likert scale and responses were probed for in-depth explanations. This gave participants the opportunity to provide comments as well as raise issues that would be useful in the analysis and provide insight into the issues.Most of the survey was conducted by telephone although a few respondents opted to email or mail their responses to the surveys. The quantitative data were analysed using SPSS to produce descriptive statistics and qualitative data were content analysed. The following section will discuss the results of the analysis.

Results

Respondents Views of Corporate Governance Practices of Small Corporations

Constitutions and Replaceable rules

The replaceable rules are a model set of internal arrangements to follow if a corporation does not have its own constitution. Two thirds of the small businesses had their own constitution. Three used the Replaceable Rules. However, in general, respondents were not familiar with the Rules and left all governance matters to their accountants.

Board Structure

The results showed that few of the small businesses operated with a board and sub-committees were rare.

Furthermore, they did not have any independent directors and little separation of the management and board. For many small businesses, a board was reported as ‘not applicable’ or not necessary. A board became necessary when a company had more than one shareholder or grew to the stage of appointing a separate manager.

Six of the CEOs of Industry associations reported that less than a quarter of their members have a board of directors. Only one association, the largest, reported that all their members had a board in place. Three estimated between 25% to 49%, of their members have a board of directors. One respondents disclosed that more than 50% of their members have a board of directors. Of the 9 small businesses, 3 had a board of directors and the other 6 had no board. Two of the respondents whose corporation had a board which had 3 directors and 1 reported that they had 1 director.

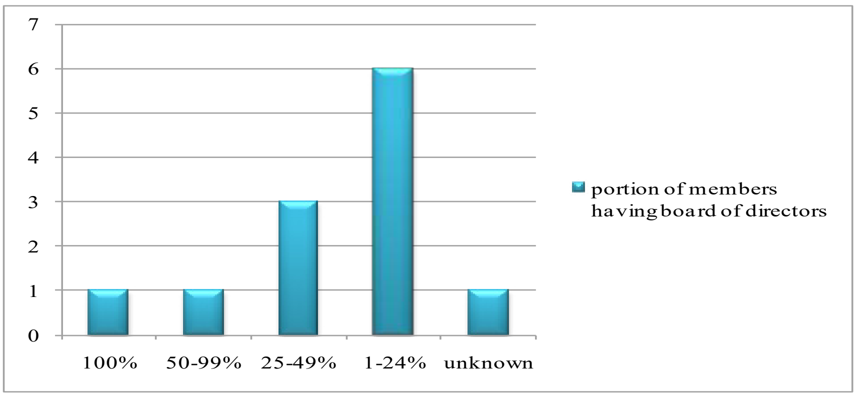

Figure 1: Proportion of companies having a board of directors

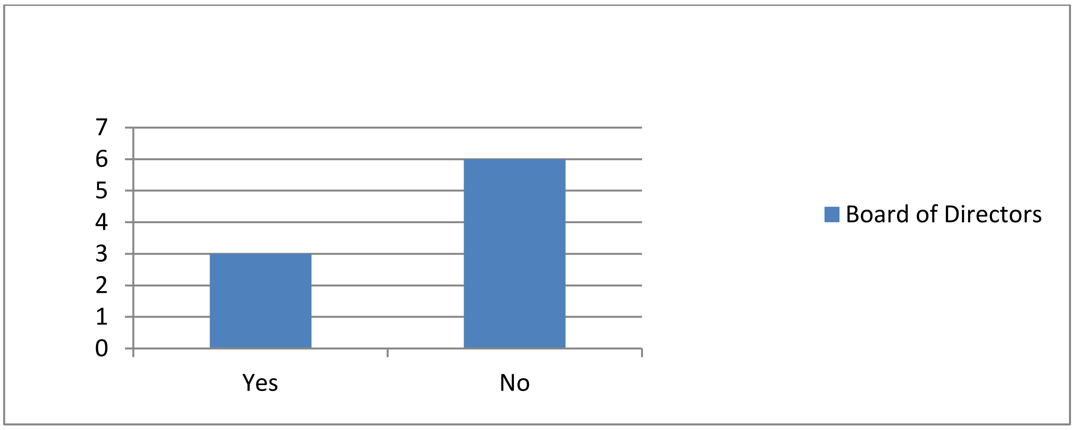

Figure 2: Proportion of small Businesses having board of directors

Directors

The small business owners did not appear to recognise that as the single 'owner/manager' they were also the 'Director' responsible under the Corporations Law.

Qualifications of directors

The qualifications of CEOs of the small business associations and small business owner/managers varied. Several of the Association CEOs had tertiary qualifications. Among the small business respondents, two had professional qualifications but most relied upon business or commercial experience.

Diversity

There were no female respondents and only one respondent saw any value in ethnic or gender diversity on boards.

Succession plans

Less than 25% of small business members have a succession plan. Where there was one, the plan was most likely to be directed towards the senior management or the owner manager position.

Monitoring performance

Two areas that could (a) promote good governance and (b) monitor results are a code of conduct and independent auditing. Half of the small businesses were reported to have a code of conduct.Only two of the twenty one respondents reported that their entities were audited.

Disclosure

Small corporations keep disclosure of their financial performance private and provide information to their accountants to meet taxation and financial requirements.

Respondents' views on governance related difficulties experienced by small businesses

The study explored what SMEs perceived to be their duties in relations to compliance with aspects of the Corporations Law and issues raised by good governance practices that included board structures, succession planning, monitoring and disclosing performance.

Corporate registration

Compliance with the corporate regulations for small businesses was in many cases left to accountants, due to the difficulties encountered by small businesses. They reported that the time frames for reporting were "too short" and that the penalties were disproportionate compared with an offence. ASIC was seen as too inflexible for small business management. The respondents felt that the language used by ASIC and ACCC was confused and convoluted. Further, that ASIC provided poor phone advice and was not tune with modern IT. In contrast, the Australian Taxation Office was now more "customer friendly".

Directors Duties

Directors of small businesses reported difficulties in relation to directors' duties. They reported Rules for the directors were difficult to understand but in most cases the responses indicated a lack of awareness of directors duties by owner/managers'. A good deal of concern was expressed about the level of liability/criminal sanctions regarding directors, ASIC assumptions that directors understand their responsibilities, too much accountability requirements. Although most reported that a board of directors was unnecessary, respondents pointed out that in any case their limited ability to fund directors could hardly attract high quality directors.

As a result, they proposed that the government should clarify and simplify their rules with regards to the directors' duties and educate the directors. Funding the industry associations could provide training to directors.

Regulation

Respondents reported several difficulties in relation to compliance with the regulation of small businesses.The main difficulty was that they lacked knowledge and understanding of the regulations, lack of appreciation of the difference between the owner/manager and the company as a separate entity, lack of understanding of what it means not to comply with directors duties and governance regulations. They respondents felt that because of a lack of skills in dealing with regulators, they were reliant on accountants or lawyers and the subsequently costs were involved.

Difficulties that were reported by the regulators were inappropriateness of regulation to small business, lack of understanding by ASIC of small business points of view resulting from poor communication, resulting in poor compliance, Failure of government to communicate efficiently with small corporations about corporate governance, the regulation and corporate governance requirements are intertwined and the difficulty by small businesses to capture the latest requirements.

Some of the solutions suggested were for the Government regulators to streamline registrations and invest in a regime to assist small business. Previous processes for change have never resulted in improvement, due to the fact that the government efforts are misplaced. They also said the ABR Blog looks good- lots of money has been thrown at it- but take up seems to be very low. Therefore there appeared to be a need for developing specific programs suitable for small businesses.

They also proposed that the law needs to be stabilised and consistent. For example, labour law and health and safety regulations are changing so frequently that it is very difficult for industry associations to keep up. They stated that there should be unified requirements between the States such as adoption of unified definitions in legislation, adoption of standard business reporting, and adoption of uniform hours among the states. Furthermore, they proposed streamlining the requirements of tax administration and other reporting requirements. They suggested that the Governments should improve communication with the industry and small businesses.

Record Keeping

Small businesses considered financial record keeping complex to understand and follow as well as time consuming, especially due to their lack of skills for preparing financial documents. As a result this task was left to their accountants, which was a cost.

They proposed to simplify the requirements of record keeping for small businesses and facilitate training of small businesses with techniques suitable for them to use for compliance purposes. They also proposed that the government should fund small business industry associations or professional associations to communicate the changes of regulations rather than letting small businesses bear the cost of keeping up to date or of non-compliance. They also suggested greater flexibility for small businesses when it comes to auditing issues, because reporting is not their core business.

Difficulties incurred with different regulatory regimes

Respondents reported that small businesses have major difficulties in regards to access to finance, tax administration, interest rates and anticompetitive practices. They also identified difficulties in relation to labour relations.

The respondents proposed that the federal government should provide more supportive export grants, State government should ease the paper work and employee superannuation and parental leave management could be handled through the tax office.

Factors which inhibit or promote the performance of small business

The respondents of this study reported factors that would inhibit or promote the performance of small Businesses. They stated that the performance of small business is impacted by various external factors that include taxation, the direction of regulation of utilities, and access to finance. They also reported internal factors that could promote performance were high levels of skills and knowledge by owner/manager/directors, their expertise in the use of information and communications technology (ICT), and ability to obtain information and advice. In addition to the above, emerging issues that will be important in the future were the environment, social networking and social responsibility.

Conclusion

Due to the importance of small businesses in the Australian economy, this study was conducted to understand the corporate governance and corporate regulation for small businesses. The views of the respondents were that there was a general agreement among the CEOs of small business associations that small business owner/managers were not aware of their legal obligations in regard to governance. For this reason they reported few difficulties with the regulation.

Compliance with legal obligations were managed by accountants and lawyers. Small businesses were apathetic in regard to complying with best practice governance. Corporate governance legislation that applied to all businesses was written with big business in mind, in language that was directed to accountants and lawyers and not understood by the small businesses. Therefore they found it difficult to understand corporate governance legislation.

Several people sought more stability and less change in regulation, and, if there were changes, they wanted to be consulted and notified what the changes were. It was felt that the government should streamline the regulation in regard to small business and that previous efforts for change had been unsuccessful because the efforts were misdirected and resulted in few improvements.

The major problems with governance regulation which were identified by small business were their lack of ability to influence government by small business, lack of knowledge of the regulations by small business, lack of understanding of the regulations by small business, lack of appreciation of the difference between the owner/manager and the company as a separate entity, lack of understanding of what it means not to comply with directors duties and governance regulations, lack of skills in dealing with regulators and reliance on accountants or lawyers and the costs involved.

Furthermore, regulation was inappropriate for small businesses due to lack of understanding by ASIC of small business resulting in poor communication and poor compliance, The regulation requirements need to be stabile and consistent, unified between the States (i.e. adoption of similar definitions in legislation, standard business reporting, and uniform hours among the states), streamlining the requirements of tax administration and other reporting requirements. Despite the lack of knowledge, or because of it, respondents wanted government regulators to improve communication with the industry associations and small businesses.
The study confirmed that agency theory, the traditional theory used to justify the introduction of good corporate governance practices, was not necessarily appropriate for small corporations. Further research is required to develop a more relevant, better suited explanation to justify the appropriate regulation of the sector. Such regulation needs to bear in mind the following points:

- The fact that small corporations are time and resource stretched;
- They are often family based
- The potential role of peak bodies and associations as 'go- betweens between firm and regulator;-and
- Determining how the optimal regulatory model can best be communicated to small corporations.

These important questions are the subject of ongoing and further research. In essence, the critical question is how in the 21st century can there be a cooperative partnership style approach underpin the work of the key stakeholders (firm, peak body, the public and the regulator) in the regulated market?

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Agency Costs, Ownership Structure and Corporate Governance Mechanisms: A Case Study in New Zealand Unlisted Small Companies

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Abstract

This study investigates the linkage between agency costs, ownership structure and corporate governance in small business. Eleven years of data for 100 unlisted small businesses, are collected and 1099 observations are analysed using as dynamic panel GMM estimation. Various diagnostic tests are utilised to check for stationary and convergence of variables. The results indicate that ownership concentration has the most significant governance effect and also has the largest impact on corporate governance. Moreover, this study finds U-shape relationship between internal ownership and performance, which under that agency proxy. Agency costs vary with leverage the life of the business and with its size.

Keywords

Corporate Governance, agency problems, ownership structure, debt, small business

Introduction

This paper investigates the linkage between agency costs, ownership structure and corporate governance in small business. Governance is generally considered be important in contributing to owners' rights and benefits and through strategic policies enhancing performance and creating wealth. However, shareholder value-add has predominantly been investigated for listed public companies, and discussion of governance in the domain of small business has largely been concerned with the lack of professional directors and the lack of division between owners, board and management.

Corporate governance is currently a major issue, attracting considerable attention from policymakers, lawmakers, company executives, shareholders, banks, investors and financial professionals. However, most of this attention has focused on large listed corporations (Gabrielsson and Huse 2004;Hart 1995) and little empirical work relates to how governance impacts agency costs for smaller business.

Small businesses take many forms, include sole proprietorships, family businesses, partnership, private companies, joint ventures, unlisted companies and the terminology may vary from country to country. Most small businesses are owned and controlled by single individuals (founders) or the founder's family. In many cases, owners play a significant direct role in management. The complex interaction between the family and the firm creates several difficult governance issues. The lack of reflexibility among policymakers, lawmakers and other government institutions and the adoption of generic strategies for businesses may be detrimental to small businesses and consequently long-term economic growth.

Corporate governance contributes to the decision making process, procedures, and attitudes that assist a business in achieving its objectives. As the small business seeks to improve the professionalism and sustainability of its activities, it needs to give greater thought to issues of governance. However, small businesses lack the resources to assist themselves in making important decisions about governance. Also, the legal form of ownership and reality might differ. An example, is showing a husband and wife as shareholders and directors where the reality may be that she is a silent "partner" who is neither actively involved in the day-to-day operation of the business nor its governance.

The establishment of an effective governance framework promotes the small firm's continuity and success beyond the effort of one person, allows for businesses to grow in size and maturity, and succession beyond the working life of the founder. Good governance should improve the decision making and strategic vision of the business, making it easier to monitor and manage the various risks, especially as it grows and matures.

An important issue for small businesses is finance. Smaller firms are often reluctant to try to raise capital from banks and other financial institutions tending to rely on owners' contributing loan funds, which are in essence quasi-equity. Recent research finds debt is one of the most effective mechanisms for improving corporate governance in family firms through mitigating the expropriation of minority shareholders wealth by family founders (Setia-Atmaja, Tanewski and Skully, 2009).

This study extends the current literature on corporate governance practices in several ways. First it addresses issues relating to corporate governance in unlisted firms in different organisational contexts, ownership structure, leverage, the stage within the firm's life cycle, size and industry of the firm. Second it is considers both the principal-agent (PA) and principal-principal (PP) agency costs in these context. Third, the econometric analysis is more robust than prior research due to the use of GMM dynamic panel technique to control the endogeneity effect of insider ownership and reverse causality impact of agency costs. The majority of recent studies ignore the endogeneity effect of insider ownership even though they used a 2SLS regression technique. This paper finds a U-shape relationship between internal ownership and agency costs proxies indicative of managerial entrenchment.

The next section reviews prior research and develops the hypotheses and is followed by data, variables, methodology and procedures used for this empirical study. The results and conclusion then follows.

Literature review

The efficiency of corporate governance mechanisms associated with publicly listed companies is the subject of extensive ongoing research in the literature (McKnight and Weir 2009; Singh and Davidson 2001; Ward and Filatotchev 2009). However, there is a paucity of prior research addressing the issues as they relate to small and medium enterprises and more specifically the small to micro business sectors.

Limited data availability for research on corporate governance in smaller firms undoubtedly has contributed to the limited literature concerning governance in smaller firms. Prior research to corporate governance in small firms has tended to focus specifically on the role of boards (Daily et al. 2003; Finkelstein and Mooney 2003; Gabrielson 2003; Heuvel et al. 2006; Huse 2000). The board of directors is only one aspect of corporate governance, especially for smaller firms, where most do not have formal boards and when they do, they may contribute very little. There is a need to consider more than just one board structure and function as defining corporate governance in smaller firms. Survey results of Hessels and High (2006) show that for Dutch SMEs with between 1 and 99 employees only 3 percent have boards of directors. Uhlaner et al. (2007) adopt a broader perspective of corporate governance in privately held firms in the Netherlands, considering the roles of owner, financial reporting and auditing, and executive remuneration as other governance mechanisms in small firms. They also consider privately held firms in different life-cycle stages and their respective governance structures and mechanisms.

A fundamental plank for a corporate governance system is to address the agency issue. As cited by Cheffins and Bank (2009), the foundation of agency theory was established in 1932 when Berle and Means (1932) first discussed the notion of the separation of firm owners (principals) and firm management (agents). As the concentration of ownership becomes more dispersed, the gap tends to widen between the control of the company being with the owners and control being with those appointed to manage the firm. Principal to Principal (PP) agency theory is based upon the conflict between different shareholders (principals) of the firm, more specifically between majority shareholders and minority shareholders. This conflict arises due to the different aims of the owners, which results in a consequential expropriation of profits (Ward and Filatotchev 2009). In small unlisted businesses the owners or founding families tend to hold considerable and undiversified equity positions in their firms. Also, in many cases, owners or members of founding families are directly involved in top management or supervisory board activities. The management-shareholder conflict appears to reduce or disappear in small unlisted businesses.

Randoy and Goel (2003) argue that founding leadership is an alternative corporate governance mechanism that can effectively be used as a monitoring mechanism for small businesses. A study of 68 SMEs in Norway indicates that direct monitoring by owners is a guide to lower agency costs in small businesses. McConaughy et al. (2001) support this perspective, suggesting that founding family control is a key to reduce agency costs and to attain superior firm financial performance.

However, Hessels and High (2006) explain that due to asymmetric information and conflict of owners' interest agency problems are likely in smaller firms. In more recent times, a number of studies show that even though traditional agency costs appear to be reduced in smaller firms, there are other small-firm-specific agency problems that arise. These agency threats can arise because the interests of the executive may not necessarily coincide with those of the extended family; the lack of separation between ownership and control leads to reduced formal safeguards; family involvement leads to adverse selection of employees; and altruism towards family members can lead to inefficiencies (Anderson and Reeb 2003; Gomez-Mejia et al. 2001; Schulze et al. 2001, 2003; Smith 2008). Further, Uhlaner et al. (2007) examine owner commitment to the firm and other ownership characteristics concerning relational governance of unlisted privately held firms. An investigation of 233 directors of Dutch firms with at least 10 employees, finds support for stewardship theory. In an Australian SME context, Fleming et al. (2004) test the relationship of ownership and agency cost finding a positive relationship between equity agency costs and ownership separation.

However, the existing literature fails to identify an optimal figure for insider ownership. The discussions have issued the impact of an endogeneity effect with ownership structure. Demsetz and Lehn (1985) suggest that ownership structure of the companies is determined by firm size, stock price volatility, industry affiliation etc. According to their suggestions insider ownership may have endogeneity effect. The following hypotheses are postulated in regarding the insider ownership and corporate agency costs proxies in unlisted businesses.

H_{1a}: Having taken account of endogeneity of insider ownership, there will be statistically significant relationship between insider ownership and PA costs in unlisted companies

H_{1b}: Having taken account of endogeneity of insider ownership, there will be statistically significant relationship between insider ownership and PP costs in unlisted companies

Highly concentrated insider ownership may expropriate company wealth and give issue to a high free-rider problem. Families and individuals are capable of expropriating wealth from the firm through excessive compensation, related-party transactions, or special dividends (Anderson and Reeb 2003). A number of studies find non-linear relationship between internal ownership and agency costs (Morck et al. 1988; Park and Jang 2010; Weir et al. 2002). However, Park and Jang (2010) explain that until an optimal breakpoint is reached the convergence of interest with insider ownership increases firm performance and managerial entrenchment will decrease firm performance after the optimal point. This is in line with that, McConnell and Servaes (1990) and Morck et al. (1988) who find an inverse U-shape relationship between insider ownership and firm performance. This is an accord with the existence of managerial entrenchment above a critical level of ownership. The next hypotheses are postulated as entrenchment prediction:

H_{2a}: The insider ownership has U-shape relationship with PA agency costs

H_{2b}: The insider ownership has U-shape relationship with PP agency costs

Jensen and Meckling (1976) argue that debt is an important influence on agency costs. Firms with higher levels of debt are more closely monitored by debt holders and thus managers have fewer opportunities to pursue non-value maximising activities. Jensen and Meckling (1976) also indicate that debt reduces agency costs by reducing the available free cash flow from which managers can draw benefits. Yuk-Chow (2005) using small business data finds that the overall effect of bank monitoring has a negative affect on small business. He explains that the benefits of bank monitoring may need to be weighed against the associated "hold-up costs" for small businesses. Vos and Forlong (1998) find that debt has a negative agency advantage (defined as reducing agency costs of equity) for small businesses, a significant but minor advantage at the IPO stage, and a significant advantage at the mature listed stage. Furthermore, Harvey et al. (2004) conduct tests to determine whether debt can mitigate the effects of agency problems, focusing on emerging market companies for which pyramid ownership structures create potentially extreme managerial agency costs. The results show that the incremental benefit of debt is concentrated in firms with high expected managerial agency costs. These firms are also most likely to have over-investment problems, resulting from high levels of assets in place and/or limited future growth opportunities. The, next hypotheses are formulated regarding corporate governance, agency costs and firm leverage in unlisted businesses.

H_{3a}: PA agency costs will be lower the higher the level of firm leverage

H_{3a}: PP agency costs will be lower the higher the level of firm leverage

Four variables are included in this study as control variables, namely firm size, firm performance, firm age and industry type. Firm size is considered one of the important factors or variables in organisational studies. Dean et al. (1998) show firm size is related to industry sunk costs, concentration, vertical integration and overall industry profitability. According to official figures (SMEs in New Zealand: Structure and Dynamics 2009) in New Zealand, the percentage of small business start-ups surviving increases with the number of employees. There is a 40 percent survival rate for sole traders, 55 percent for the 1-5 employees group, 62 percent for the 6-9 employees group, increasing to 80 percent of the 50-99 employees group. Guillen (2000) posits that the size of the firm has a positive affect on the quality of corporate governance as larger firms have comprehensive resources to adopt quality governance system vis a versa. However, Woodward and Alchian (1988) use fortune 500 firms and find that firm size is negatively correlated with the agency cost of the firm.

Storey (1994) notes that, younger firms have higher death rates and faster growth rates than mature firms. In New Zealand, figures suggest that 53 percent of small to medium-sized enterprises (SME) fail within the first three years (Mason 2010). As the firm matures, technology adaptation, degree of diversification and expertise in the management team gradually increase (Campa and Kedia 2002). These factors may increase firm financial performance. Conversely, older firms may be less efficient when compared to their younger counterparts due to high costs, dropping profitability, aging assets, slow growth, and decline in R & D investments. It is still unclear whether maturity helps businesses prosper.

Survival of small business may also depend on the sensitivity of certain industries to change in the microeconomic factors. SMEs in New Zealand: Structure and Dynamics (2009) shows there is a noticeable industry effect, on the survival rates in unlisted New Zealand businesses over five years conspicuously lower in mining, education and training, health care and social assistance industries.

Data

This study uses secondary data for unlisted small businesses regarding ownership structure and financial indicators for the period 1998 to 2008 inclusive, and was made available by the Management Research Centre of the University of Waikato. The random sample is drawn from accounting practices that prepare end of year financial returns for small businesses. This approach avoids the selection bias of using bank related data or figures from those businesses that submit survey responses to government agencies. Eleven years of data for each business are used and, given the high attrition rate for SMEs, the result is an unbalanced panel dataset. Firms included in the study come from a range of industries. A zero equity agency costs benchmark (in terms of expense ratio, assets utilisation ratio and income ratio) is synthesised for sole proprietorship. The final sample comprises 100 firms with 1099 firm-year observations over an eleven years period.

Method

Panel data analysis is the most efficient statistical method (Madalla. 2001). The panel data set consists of cross sectional and time series data. The panel data structure allows for taking into account the unobservable and consistent heterogeneity, which are specific features of each selected company. The OLS form of panel regression requires that ownership and other control variables are strictly orthogonal to the errors, and that the errors are independently and identically normally distributed with a mean of zero and variance equal to σ^2. The existence of at least one source of endogenity (dynamic endogenity, simultaneity and unobservable heterogeneity) in the data generating process will cause the estimates to be biased and inefficient. The direction of causality of ownership and agency costs can be determined by characteristics of the firm or its agency costs.

The early ownership and agency costs literature assumed ownership is an exogenous factor to firm agency costs (Fleming et al. 2004; Singh and Davidson 2001). However, McKnight and Weir (2009) treated the endogenous problem in ownership and agency perspectives using instrumental variables.

In the presence of endogenity, the panel OLS estimation approaches will produce biased parameter estimates. To obtain robust estimates, a GMM panel estimator is used to estimate the relationship between ownership and agency costs. Using the GMM method builds instrumental variables for potentially endogenous variables.

In particular, it is important to determine whether there is an endogenity effect present in the ownership variable. Durbin-Wu-Hausman (DWH) test is applied to check the endogenity of agency proxies and other variables. The results for the DWH confirm endogeneity effect in insider ownership. This finding confirms that OLS coefficient-estimates are unreliable and biased. The result of the DWH test for endogenity points to the need to use a dynamic panel GMM estimator. The GMM panel estimator was introduced by Holtz-Eakin et al. (1988) and Arellano and Bond (1991) and further developed Arellano and Bover (1995) and Blundell and Bond (1998).

The basic GMM estimation consists of two steps. First, a dynamic model with first-differenced form. This first differencing eliminates potential bias that can arise from unobservable heterogeneity.

Arellano and Bover (1995) and Blundell and Bond (1998) improve the GMM estimator by including equations in levels also known as stacks, in the estimation procedure. This uses lagged differences as instruments for the equation in levels and these in turn to become instruments for the first-difference equations. This GMM estimation enables efficient estimators to be obtained while maintaining all the essential elements of controlling for unobserved heterogeneity and simultaneous and dynamic endogenity.

Further, Arellano-Bond (AR1) and (AR2) indicates no auto correlation in the dynamic GMM estimation and Hansen/Sargan J-statistics, indicates that the null hypothesis that the moment conditions are correctly specified cannot be rejected at all significant level for dynamic GMM model.

PA and PP regressions

Following Ang et al., (2000) the first proxy for agency costs is the ratio of operating expenses to annual sales as a measure of operating expenses. Second PA proxy is the ratio of annual sales to total assets which is a measure of assets utilisation. Faccio et al. (2000) propose measuring PP costs using dividend payout. In the case of small businesses, dividends may not necessarily be appropriate, e.g. for a non-company structured firm, so an alternative profit distribution metric is necessary. The independent variables, which are either continuous or binary, fall into one of three categories relating to corporate structure, external monitoring and control variables. Corporate structure variables are: working owner 0% group (Nil), working owner 0%-25% (Low), working owner 25%-50% (Medium), working owner 50%-75% (High) and, working owner >= to 75% (Highest). As indicated by Ang et al (2000), 100% ownership forms used as no-agency costs base case firms for comparison. Further variables are: leverage (leverage), natural log of number of staff (lnstaff), natural log of firm age (lnage and includes 4 industry dummies representing primary (Industry1), energy (Industry2), goods (Industry3) and services industries (Industry4). Appendix provides a summary of the variables along with definitions.

Results

Table 1 reports the descriptive statistics for the data. The approximation of mean value for insider ownership is 42.11, the highest percentage of insider ownership is 100 percent in unlisted small businesses and the lowest insider ownership representation is 0 percent. This highlights the existence of insider ownership in unlisted business in New Zealand. Number of staff varies in between 0 to 196 with mean value of 8 staff members. The sample consists with young firms with an average 8.1 years and age ranging between 1 year to 25 year.

PA agency costs

The regression analysis is undertaken in five steps using the panel data. These five steps involve regressing the ratio of operating expenses to annual sales on each of the variables while controlling for managerial ownership variables (nil, low, medium and high and highest). Table 2 presents the results for the operating expenses to sales measure of agency costs. Columns 2-6 of Table 2 present OLS results and columns 7-11 present dynamic panel GMM results. The second group of regression analysis follows a similar five stage process using the ratio of sales to assets as the dependent variable. Table 3 presents the results for the sales to assets measure of agency costs and these are discussed below under findings. An examination of the results in Table 2 and Table 3 reveals that endogenity is a significant concern of ownership.

The findings suggests that corporate governance in smaller firms relates to governance in different organisational contexts (ownership context of the firm, the stage within the firm's life cycle, industrial sector and size of the firm) which is consistent with PA and PP agency theory. The sign on the coefficients is important in terms of whether the explanatory variables make a positive or negative contribution to PA cost. The finding in terms of expense ratio and working ownership percentage, calculated as the proportion of working owners to total fulltime staff are shown in Table 4. Firms with the lowest working ownership (0%) have the highest expense ratio. However, firms with the highest working ownership (>=75%) have again high expense ratio, suggesting private expenses are probably channelled through the business.

The relationship between asset utilisation and working ownership percentage are shown in Table 3. It is apparent that agency cost is highest when there is >=75 percent working ownership and lowest working ownership (0 percent) proportions. These figures are consistent with the view that high levels of managerial ownership in small businesses exploit the business. The majority shareholders/owners, or family members as managers, use their position to deprive the non-family members or family not in the inner circle or minority shareholders of influence over majority decisions and expropriate business assets for their personal gain. Results show U-shape relationship with working ownership and equity agency costs. This is in line with McConnell and Servaes (1990) and Schooley and Barney (1994) agency costs decline with increases in managerial ownership to a certain point, however, after that entrenchment occurs, agency costs grow with increased managerial ownership.

The expense ratio is significantly positively related to a firm's debt-to-assets ratio. In part, the accounting conventions result in measurement problems for debts and assets in small businesses. The adoption of international financial reporting standards (IFRS) in most countries, except the USA, will assist in ensuring debt and asset measures are market based. It is noted that IFRS will be very watered down when it comes to small business but there may still be an improvement in information transparency where countries mandate a standard. The difficulty caused by historical cost assets having low written down values and debt being at market value distorts the numbers and introduces an ageing bias. Asymmetric information is often stated as the cause of understand the relationship between bank and small business. This is confirmed by Han et al. (2009) who investigated US small business and argue that "high type" entrepreneurs, who transfer secure and transparent information, enjoy preferential advantages with their bank obtaining lower interest rates than entrepreneurs who transfer weak information to the bank. The evidence suggest that, in contrast with larger listed firms, debt is not an appropriate external corporate governance mechanism for smaller unlisted businesses in terms of an expense ratio.

The sign-on debt in the expense ratio regression indicates an increase in debt is associated with an increase in PA agency costs. However, the sign-on debt in the assets utilisation regression indicates an increase debt is associated with a decrease PA costs. The extent to which debt holders will monitor the performance of small business remains an open question. Quasi-equity, i.e., loans from the owner(s), can represent a significant portion of debt (Cosh and Hughes, 1994). There is evidence to suggest that information asymmetry often leads to frustration with small business (Ang 1992; Gregory et al. 2005). Similarly, Garc´ıa-Teruel and Mart´ınez-Solano (2008), note that SMEs suffer more information asymmetry than their larger counter parts giving rise to more agency conflicts from debts than larger companies in Spain.

Results indicate that log of staff number; proxy for firm size is significantly correlated with the expense ratio (assets utilisation ratio). This finding is consistent with Fleming et al. (2004) in an Australian SME context. Further findings suggest corporate governance in smaller businesses relates to the industrial sector within which a firm finds itself. Consistent with Huse (2007) and Zahra and Pearce (1989), there are variations across industrial sectors with respect to technologies, ownership patterns, resources configurations and environment. These factors have different influences on the corporate governance in small business.

PA and the maturity of the firm is statistically significant in higher insider ownership groups, indicating that assets utilisation decreases with the age of the firm. Older firms are seen as less efficient, because company aging increases organisational rigidness and rent-seeking behaviour. Consistently, Table 2 shows positive relationship in between expense ratio and maturity of the firm with lowest and highest insider ownership groups, indicating agency costs is increase with the age of the firm. This suggests that the governance mechanism of small businesses is related to the life cycle of the firm.

PP agency costs

Proxy for the proposed dividend payout metric of Faccio et al. (2000) is necessary as many small businesses do not use dividends as a method of distributing profit. The PP proxy, net income/number of working owners divided by total sales, is regressed against ownership structure, industry, and control variables. The regression analysis follows a five step process similar to that used in the PA analysis above. Table 4 presents the results for the profit per owner ratio measure of PP costs, and these are discussed below under findings. Table 4 columns 2-6 represent panel OLS results and column 7-11 represent dynamic panel GMM estimator results.

Table 1. Descriptive statistics

Variable	Obs	Mean	Stan. Dev	Min	Max
lnopexsal	1100	-2.103062	.7991096	-4.494563	.2651079
lnsalass	1100	.8948383	.9497011	-2.802817	12.66509
divsal	1100	.134667	.1889433	-.3948126	3.232396
ownership	1100	42.117	33.10633	0	1
low1	1100	.0363636	.1872784	0	1
low2	1100	.3345455	.4720459	0	1
low3	1100	.4154545	.4930244	0	1
low4	1100	.04	.1960483	0	1
low5	1100	.1736364	.3789688	0	1
Staff	1100	8.214991	17.2089	0	196
lnstaff	909	1.45306	1.293682	-2.995732	5.278115
leverage	1100	.8838016	1.608701	0	36.04424
Age	1099	8.105551	3.975306	1	25
lnage	1099	1.935046	.624655	0	3.218876

PP agency cost is found to be correlated with variables noted in previous studies. In Table 4 the figures indicate that the working ownership percentage is inversely correlated with the PP agency cost proxy. Firms with the lowest working ownership (0%) and highest working ownership percentage (>=75%) have the highest PP agency costs, higher managerial ownership is positively correlated with PP agency costs consistent with higher managerial ownership using its position to deny the minority shareholders of influence over the distribution of business earnings. Similar to PA the U-shape relationship exists between PP agency costs and working ownership percentage.

The size of the business is negatively correlated with PP, as reflected in Table 4, indicating that as firms grow there is a reduction in the potential for PP costs. Next it is noted that industry factors play an important role, with some industries being more prone to PP costs than others, which is similar to the observation of (Chrisman et al. 2003). As profitability declines and the surpluses diminish, the opportunity to divert relatively more resources to the major owners decreases. The maturity of the business is negatively correlated with PP cost, suggesting that longer-life businesses are not only profitable in a sustainability sense but exploitation by senior owner(s) is not so apparent.

PP cost has a significant negative correlation with leverage, which is consistent with Setia-Atmaja et al. (2009) who propose that with more debt there is a decrease PP agency cost, noting the measurement issues concerning both debt and equity in small businesses. As the proportion of debt in the capital structure increases so too does the interest expense with associated demand on cash flow, and it appears this situation curtails the likelihood of a major owner diverting additional resources in his or her own direction. Setia-Atmaja et al. (2009), suggest that the governance role of debt in family firms/SMEs is determined by the capital market effectiveness of particular country. They further point out that high transparency of corporate accounts and where highly developed shareholder and creditor rights exist this leads to higher debt levels in family firms mitigating PP problem.

Table 2:Panel data random effects regressions of agency costs and operation expenses to sales ratio

Variables (1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
Number of obs	1099	1099	1099	1099	1099	999	999	999	999	999
Number of groups=100 Regressor	OLS 1	OLS 2	OLS 3	OLS 4	OLS 5	Dynamic GMM-1	Dynamic GMM-2	Dynamic GMM-3	Dynamic GMM-4	Dynamic GMM-5
Lnopexal L1						- 0072508 (015642)	- 0140891 (0176852)	0066975 (0207688)	0458443 (0217879)	0380113*** (0202377)
Corporate Structure variables Percentage of working owners =0(nil)	5041206*** (1149557)					682813*** (0422832)				
Percentage of working owners (0> & <25)(low)		- 2136475 * (0495955)					- 1994073*** (0347893)			
Percentage of working owners (>=25 & <50)(medium)			1246827 (04409)					- 1520446*** (0237046)		
Percentage of working owners (>=50 & <75)(High)				- 0311801 (1067793)					0105602* (0503113)	
Percentage of working owners>=75 (highest)					- 3903341*** (0574056)					4280199*** (0333839)
External monitoring variables Leverage (bkdbtass)	0404461 *** (0128967)	0394107 *** (0129074)	0389042*** (0130027)	0399089*** (0130228)	0348508 *** (0127559)	0258178*** (0086831)	0221883*** (0065622)	0258896*** (0084719)	0358938*** (0051233)	0232137*** (0060882)
Control variables Log number of staff (lnstaff)	- 0062652*** (001315)	- 0027879** (0013909)	- 0060081 *** (001338)	- 005098 *** (001304)	- 0033981*** (0012936)	- 0074051*** (0005749)	- 0030723*** (000599)	- 0066934*** (0006307)	- 0058932*** (000397)	- 0028433*** (0006564)
Log number of years of operations (lage)	0664183* (0357192)	059702* (0357356)	0636104* (0359391)	0634152* (0360638)	0582873** (0352751)	0552775** (0290636)	- 0176279 (0288341)	- 0292814 (0284795)	0317609 (0305987)	0576167** (026021)
Industry1	- 0499826 (1513258)	- 0727315 (1502968)	- 0681107 (1469689)	- 069936 (1507032)	- 073362 (1507982)	- 4988945*** (2125679)	- 365983 (3172383)	- 1776589 (2447585)	- 3791728 (3042369)	- 4323009 (3221827)
Industry2	- 0668654 (1513201)	- 0804759 (1502911)	- 0866815 (1469492)	- 0888832 (1506739)	- 0756618 (1507925)	-1 188022*** (1404046)	- 6541657** (3443736)	- 1123104 (2192434)	- 3104862 (3592372)	0967077 (3672809)
Industry3	- 0857834 (1512735)	- 1018915 (1502707)	- 1015541 (1469399)	- 1020393 (1506593)	- 1090314 (1507762)	-1 034349*** (2220349)	- 4496407 (4178873)	3002047 (2136563)	0063244 (4377651)	1417518 (3154239)
Industry4	0401413 (1512374)	0176488 (1502508)	0274493 (1469121)	0249138 (1506275)	0075873 (150766)	1366106 (2146505)	0636448 (2673522)	1322487 (175853)	- 9014451*** (234132)	1859329 (1899921)
Regression summary statistics R^2	0 4403	0 4261	0 4264	0 3236	0 5926					
Sargan test X^2						66 4742	64 85746	69 14538	73 14023	68 89893
Prob > chi2						0 4952	0 5514	0 4048	0 2836	0 4129

This model provides stranded errors which are in parentheses [a] un balanced panel , * Significant at 10% level, **Significant at 5% level, ** *Significant at 1% level

Table 3:Panel data random effects regressions of agency costs and sales to assets ratio

Variables (1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
Number of obs	1099	1099	1099	1099	1099	999	999	999	999	999
Number of groups=100 Regressor	OLS 1	OLS 2	OLS 3	OLS 4	OLS 5	Dynamic GMM-1	Dynamic GMM-2	Dynamic GMM-3	Dynamic GMM-4	Dynamic GMM-5
Lnopexal L1						075692*** (0113806)	0591294*** (0098631)	0687136*** (0133039)	0345725*** (0128275)	0621132 *** (0141005)
Corporate Structure variables Percentage of working owners =0(nil)	- 022702 (1470368)					- 2868058** (1280744)				
Percentage of working owners (0> & <25)(low)		1587066 *** (0628097)					179271*** (0323235)			
Percentage of working owners (>=25 & <50(medium)			0592439 (0562496)					0213628* (029094)		
Percentage of working owners (>=50 & <75)(High)				- 1479249 (1353967)					- 0259714* (058286)	
Percentage of working owners=75(highest)					- 2698041 *** (073359)					- 1958657*** (0391351)
External monitoring variables Leverage (bkdbtass)	1304817*** (0165002)	1309306 *** (0164495)	1311124*** (0165105)	1303675 *** (0165045)	1342304*** (0164246)	1269599*** (0134482)	1210765*** (0133905)	1187736*** (0153183)	1229173 *** (0152406)	1428935*** (0147106)
Control variables Log number of staff (lnstaff)	0017589 (0016607)	-3 54e-06 (0017543)	002155 (0016786)	0015321 (0016301)	0005296 (0016448)	0032751*** (0004676)	0008956 (000622)	0029932*** (0005788)	0025513 *** (0005799)	0018058* (0007125)
Log number of years of operations (lage)	- 1149013** (0449591)	- 1126131* (0448259)	- 1146578* (0449192)	- 112847* (0449504)	- 1123404* (0446787)	- 0038436 (0427698)	- 0491588 (0340736)	- 0016123 (0396187)	- 0789208* (040132)	- 0878489* (0395591)
Industry1	0902035 (1406925)	0927024 (1405566)	0898993 (1388079)	0945427 (1388348)	0930343 (1404779)	-1 984226*** (3279503)	- 2852472 (4831108)	- 8813882 (5663741)	- 0917392 (2970569)	806424 (5378039)
Industry2	1950628 (1406857)	1894663 (140549)	1947864 (1387772)	1985148 (1387868)	1866038 (1404701)	- 6030565 (3726368)	- 2571939 (413483)	- 3433035 (398954)	- 8772175*** (191831)	5082094 (3323608)
Industry3	1827799 (1406036)	1832037 (1405143)	1831393 (1387618)	1846506 (1387623)	1881034 (1404416)	- 5051468 (4205523)	-1 275342** (5624634)	- 9918065* (5388713)	- 6396815*** (2260904)	0122812 (3342362)
Indsutry4	1662283 (1405406)	1723017 (1404799)	1656885 (1387146)	1668439 (1387068)	1788359 (1404233)	-3 381094*** (3716937)	-2 599025*** (3766505)	-3 025712*** (436754)	-1 880077*** (2218832)	-1 402971*** (3499787)
Regression summary statistics R^2	0 4403	0 4261	0 4264	0 3236	0 5926					

Sargan Test X^2						69 54437	57 62787	61 62078	57 33167	66 43815
Prob > chi2						0 3918	0 7860	0 6627	0 7941	0 4964

This model provides stranded errors which are in parentheses [a] un balanced panel ' * Significant at 10% level, **Significant at 5% level, ** *Significant at 1% level

Table 4:Panel data random effects regressions of agency costs and income ratio

Variables (1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
Number of obs	1099	1099	1099	1099	1099	999	999	999	999	999
Number of groups=100 Regressor	OLS 1	OLS 2	OLS 3	OLS 4	OLS 5	Dynamic GMM-1	Dynamic GMM-2	Dynamic GMM-3	Dynamic GMM-4	Dynamic GMM-5
Lnopexal L1						0203529 ** (0079511)	0304536 *** (0053261)	0181918** (0073441)	048064 *** (0072391)	0335898*** (0068734)
Corporate Structure variables Percentage of working owners =0(nil)	1347186** (0309812)					1096025*** (0155607)				
Percentage of working owners (0> & <25)(low)		- 0825029 (0130034)					- 0830553*** (0061669)			
Percentage of working owners (>=25 & <50)(medium)			- 0465457 *** (011828)					- 0254814*** (0052288)		
Percentage of working owners (>=50 & <75)(High)				- 0164505 (0288241)					- 0014591* (0102538)	
Percentage of working owners=75(highest)					- 1692549 (0145421)					1490128*** (0099218)
External monitoring variables Leverage (bkdbtass)	- 0059112* (0034783)	- 0063449* (0034467)	- 0064424 * (0034901)	- 0060907 * (0035103)	- 0084641* (0033445)	- 0050688*** (0018285)	- 0048975*** (00244)	- 0053192*** (0016703)	- 0055837*** (001928)	- 0072207*** (0020891)

Control variables										
Log number of staff (lnstaff)	- 0013841*** (0003423)	- 0001626*** (0003605)	- 0014402*** (0003462)	- 0010911*** (0003383)	- 0003653 (0003206)	- 0013918*** (000176)	- 0002436 (0002465	- 0011484*** (0002906)	- 0007641*** (0002624)	- 0003539** (000161)
Log number of years of operations (lage)	- 0135105 (009216)	- 0152544* (0091182)	- 0143292 (009196)	- 0140999 (0092833)	- 0146594* (0085968)	- 0533693*** (0049681)	- 0390423*** (006495)	- 0497536*** (0060528)	- 0604445*** (007061)	- 0581217*** (0066151)
Industry1	0110391 (0218553)	0046511 (0213569)	0065627 (021023)	0059193 (0215968)	0044964 (0172199)	4326014*** (0417126)	1698863*** (0283417)	3532856*** (0538034)	2192004*** (0585899)	2586331*** (0458576)
Industry2	- 0181658 (021855)	- 0207719 (0213558)	- 0231626 (0210156)	- 0239184 (0215844)	- 0182164 (0172198)	2662671*** (0383713)	1857602*** (0501169)	208401*** (0812792)	3295743 *** (0528092)	033044 (0640179)
Industry3	- 0077505 (0218315)	- 0119563 (0213463)	- 011917 (0210113)	- 0120383 (0215776)	- 0150779 (0172109)	2101382*** (0353032)	243807 *** (0307845)	2569425 *** (0413316)	5059243*** (055916)	1538101*** (0346174)
Indsutry4	0084531 (0218137)	0016115 (0213364)	0053167 (0209976)	0043811 (0215616)	- 0030966 (0172044)	1463242*** (0455095)	0797376*** (0392418)	2135944*** (0578305)	0822115 (0564272)	1584212*** (046161)
Regression summary statistics R^2	0 4403	0 4261	0 4264	0 3236	0 5926					
Sargan Test X^2						75 25219	63 06929	64 74924	62 08328	65 82192
Prob > chi2						0 2289	0 6135	0 5552	0 6471	0 5178

This model provides stranded errors which are in parentheses [a] un balanced panel , * Significant at 10% level, **Significant at 5% level, ** *Significant at 1% leve

Implications

The research indicates that PA and PP agency costs are present in small business and in many instances these findings are consistent with prior research for listed businesses. Managerial ownership seems to be a primary determinant of corporate governance, though majority owners use their position to deprive the minority owners of influence over decisions and/or distribution of business earnings. As the number of owners change, the potential for one managing owner, or family group to expropriate the profit of other owners, becomes more pronounced. Minority interests could be protected by rules that restrict the powers of majority owners. Effective lock-in rules and squeeze-out regulations could important for promote both share transfers and investment in small businesses. PP cost has received no prior consideration in the small business context and, based on the results, it is of considerable importance.

The well-meaning parents who encourage second generation children to participate and then run the business are subject to both PA and PP cost burdens. The requirement for greater disclosure of financial reporting by all businesses, reducing opacity, could potentially reduce this distortion concerning the effective distribution of scarce capital resources. The analysis indicates there is considerable variability in the burden of agency cost. This raises the potential for regulatory and policy reforms that may enhance the productivity and growth in the sector.

The distortion between equity return and debt return arises due to a preference for quasi-equity (loans to the business by the owners), impacting the productive base and affecting the pricing of risk. The common requirement for personal guarantees from the owners to support business loans similarly distorts operational efficiency. As personal risk is increased through granting guarantees, in the absence of a gambling mentality, overall risk taking is reduced and there will be a propensity to ignore potential favourable projects. This adverse selection issue will lower growth and when consider in aggregate lower national living standard increases. The result also tends to be an unnecessary overhead loading and higher bankruptcy costs, which in turn are impounded into the cost of capital. The personal commitments, in terms of guarantees, can lead to the leverage levels of small businesses being misinterpreted where it would be more accurate to include owners' personal loans as equity in the balance sheet. The role leverage plays in shaping corporate governance in small business, is important.

A mis-pricing of risk can potentially distort the market. Given the high bankruptcy cost for small business, around 45 percent of net assets, and the low survival rates, it is rational for lenders to apply high hurdles for loan applicants (SMEs in New Zealand: Structure and Dynamics 2009). Businesses will rationally respond by being less than candid about their financial affairs. This climate of moral hazard will be eased the presence of independent directors. The PP problem increases in the climate of close control of information and one owner being the primary manager/owner. These owners are relatively more aware of the risks inherent in the businesses and they may make decisions subject to adverse selection pressures and expropriate profit to give a fairer return to them, given the risk level of the business as they know it.

The analysis undertaken clearly establishes the existence of PA and PP agency cost. The potential for improvement in such contexts appears limited. Furthermore, the regulatory environment, tax anomalies and the cost of information do not encourage an evolvement toward better governance in smaller businesses. There is a need to develop a corporate governance code for smaller firms that is flexible enough to take account of the different types of governance needs of firms at different stages in their life cycle and the nature of the business.

Limitations

Notwithstanding the findings, the current study does have limitations, which point to potentially fruitful further research opportunities. First, the current study used one aspect of ownership structure (insider ownership). Further studies could consider other aspects of ownership structure and corporate governance variables, such as ownership concentration, ownership type etc. Second the findings are based on research in a single country and may not be generalisable. Further studies in both mature and emerging markets will be helpful in terms of international comparability.

APPENDIX

APPENDIX: Variable definition

Variable name	Definition
Agency Costs	
Operating expenses to sales (Opexsal)	This ratio is calculated as operating expenses divided by annual sales. Operating expenses exclude the labour related expenses such as corporate wages, salaries and so on, and interest expense, rent, leasing and hiring expenses, purchases, depreciation and bad debts written off (%)
Log of Opexsal (lnopexsal)	Natural log of Opexsal
Sales to assets ratio (Salass)	This ratio is calculated as total sales divided by total assets.
Log of salass (lnsalass)	Natural log of Salass
Income ratio (Incratio)	This ratio is calculated as net income/number of working owners divided by total sales
Ownership percentage	This ratio is calculated as number of working owners divided by total staff plus number of working owners
Nil	Percentage of working owners=0
Low	Percentage of working owners >0 and <25
Medium	Percentage of working owners ≥25 and <50
High	Percentage of working owners≥ 50 and <75
Highest	Percentage of working owners≥75
External monitoring	
Leverage (bkdbtass)	This ratio is calculated as total debt divided by total assets
Control variables	
lnstaff	Logarithm of number of staff
lnage	Logarithm of number of years operating in the industry
Industry 1	Dummy variable 1, if the industry is equal to primary
Industry 2	Dummy variable 2, if the industry is equal to energy
Industry 3	Dummy variable 3, if the industry is equal to good
Industry 4	Dummy variable 4, if the industry is equal to services

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