Before outlining the benefits of corporate governance, one might note some possible shortcomings that emanate from misdirected corporate governance. It is important that there should not be a concentration on form rather than substance. If corporate governance is seen only in terms of ticking boxes on forms, writing reports and establishing committees, then the results are likely to be of little value. In practice, such activities could be counterproductive.

Boards already spend a considerable amount of time protecting themselves from legislative and regulatory imposts which cut into the time they might spend endeavouring to enhance shareholders' wealth. Attention to inconsequential corporate governance issues would only worsen this situation. A serious shortcoming is that shareholders could be lulled into a false sense of security just because the form gave the company an apparent clean bill of health.

Changing conditions, scale, arrogance and greed can variously contribute to an entrepreneur's failure. There are a number of benefits to be derived from good corporate governance. The interests of all shareholders can be safeguarded. There might be the avoidance of a misallocation of resources. Management might be improved and more focused. A better market perception regarding the company will lead to a higher market price and a lower cost of capital. Supportive shareholders can make it easier for a company's long-term planning. In recent years some North American surveys have claimed that actual or threatened corporate governance activity in respect of underperforming companies has brought above-market returns to those companies. This is cited as one justification for taking such action.

Let me look at some of the ways in which supposed good corporate governance is determined. Committees comprising the great and the good such as the Cadbury Committee or the Bosch Report might be established. At another level, investment managers might get together to agree on something like the Australian Investment Managers' Association guidelines. Such guidelines serve a useful purpose. However, it is important to recognise that they are just guidelines and not immutable rules. Variations may be appropriate in a number of circumstances where that is the wish of the investors involved. After all, it is for the investors to decide the risk-reward outcome they are prepared to wear.

Let me give a couple of examples. It is now being recognised throughout the
English-speaking world that care needs to be taken if the chairman and chief executive are the same person. Current thinking in Australia and the UK is that it is best for these positions to be separated, and a growing number in the US are moving to this view.

However, it can be readily demonstrated that some of the most successful corporations are, or have been, ones where the chief executive and chairman have been the same person. Of course, this is not to say that these same companies could not have been just as successful if the roles had been separated. However, the argument can be forcefully put that there will be certain stages in a corporation's life when such a combination of roles is appropriate or even necessary.

The founder/promoter is typically in this position and the thrust and drive that is required to rapidly grow a company can be assisted if the one person has almost total control. The risks inherent in such a course of action should be obvious to all.

Another time in a corporation's life when it may be appropriate to combine the roles is when the company has gone into difficulty. There are occasions when the chief executive is dismissed and it is necessary for the chairman to take control for a period. At other times, the major investors or creditors may wish to see such changes brought about that they would prefer to see a “company doctor” brought in to take charge for a period. On the other hand, some of you can no doubt cite instances where a non-executive chairman has unreasonably constrained a most able chief executive to the detriment of the company.

Another example might be the case of differential voting rights such as non-voting shares or super shares. Typically, the reason for doing something like this is to entrench the control over the company by the current controllers. Many investors would oppose such an arrangement, especially when the effects would continue long after the present controllers are no longer effective managers.

It is useful to have sensible guidelines which are generally agreed by corporations, investors and fund managers as a benchmark. It allows a point of reference for both the investor and the company. Each knows what is the accepted conventional norm, and each can then determine whether variations are appropriate in the particular circumstances. It is particularly helpful for the corporation, which can conform to the standard and know it is unlikely to be criticised. Alternatively, it can attempt to convince its shareholders that they should permit a variation.

On the other hand, if the corporation goes on to do something outside the guidelines without proper explanation, it should not be surprised if some of its shareholders object. The guidelines will also assist the trustee and the clients of the investment manager to understand the likely approach that will be taken by the manager.

How will the parties become aware of a corporate governance issue? Often it will be all too apparent. However, there is a very large number of public companies. It is difficult and expensive to ensure that emerging issues are promptly recognised. Just reviewing all the meeting notices during the company meeting season is a massive task. It can be very easy to miss the possible implications of a resolution being put to shareholders.

For my part, I welcome the introduction of services such as ISS. The service can, in a timely manner, reassemble the facts in a comprehensible way, note the conformity or otherwise with published guidelines and highlight the relevant issues. Even though we at AMP Investments have very considerable resources to review the annual meeting and other material, it is very comforting to know that some dedicated professionals are also doing the task.

It is important to realise that the investment manager does not blindly endorse or follow the outside advice. Rather, the information is used to ensure that the investment manager has considered all of the issues before a decision is reached or a recommendation made to the trustees.

The processes by which corporate governance aspects might be raised with the company vary enormously. At one extreme, there is the quiet, polite chat initiated by the investment manager which might result in an acceptable explanation or an amendment. At the other extreme, which normally occurs when investors are so concerned that they are seeking to constrain or reduce the actual or sought-after power of one or more of the incumbents, much more than a quiet chat is involved.

In the latter case, the time spent can be considerable indeed. There will be meetings with the company, with its directors, with fellow shareholders, with professional consultants, with directorial candidates and, of course, the mandatory “no comment” to the press.

As an aside, nearly all participants are in agreement that it is better to conduct affairs in a civilised manner away from the full glare of publicity. While some will argue that it is unacceptable for private deals to be brokered, the unfortunate reality is that once matters get into the public realm there is a tendency for all participants to polarise and for the issues to escalate, even to matters separate from the original dispute. On the other hand, the Fourth Estate does a
remarkable job in bringing a range of corporate governance issues into public gaze. It would not be an overstatement that such publicity can often good otherwise apathetic shareholders into action.

Exercising the vote is relatively easy. Sure, there may be some inconvenience in handling the necessary paperwork. There may be little or no notice of one’s voting intentions if there is the late lodgement of a proxy or the attendance at the meeting by means of an undirected proxy holder or representative. In the case of AMP Investments, we try to give the subject company as much notice as possible, together with our reasons for so doing.

However, it is when proactivity is required that the investment manager is forced to have a strong resolve and be prepared to commit considerable resources. An interesting aspect is the consideration of whether a proactive move should be taken when it cannot be deemed certain to succeed. It can be an issue of principle versus pragmatism.

In the more public proactive issues, it is not unusual for a whole raft of very senior people in the investment institution to be involved, including not just the investment manager but the chief executive, the chairman and often the board. Accordingly, the cost of such a depth of involvement should be recognised as being very considerable indeed.

Who has the obligation to be taking the corporate governance initiative? Is it the ultimate beneficiary, is it the trustee looking after the beneficiary’s interest, or is it the investment manager who is actually managing the investment? In every instance where corporate governance action is required, one of these parties should have the obligation to take appropriate corporate governance activity.

This obligation for the trustee arises because of the fiduciary relationship with the investor or beneficiary whose money it is. The obligation for the investment manager will be as a result of needing to secure optimum long-term returns in accordance with the investment mandate. The answer as to who has the obligation will depend on the legalities – the fiduciary duties and the contractual arrangements.

Some investment managers might argue that they are in the best position to determine these matters because they will be most aware of the commercial implications. Where a quick response is required, the investment manager is most likely to be best able to act. In addition, the investment manager, of course, is usually free to buy or sell the holding with impunity and without reference.

Merely voting the stock would seem to be a much less drastic action than selling the complete holding.

For those of you who might think that involvement in corporate governance is a lot of fun, let me assure you that it is not an ego trip undertaken by power-mad, publicity-seeking investment managers. There really is little in it for them. Occasionally, an important reason for them becoming involved in certain corporate governance actions is to provide a warning to others who might similarly wish to misuse shareholders’ funds. Often, the gain in a particular episode is much less than the pain borne (in terms of time, cost, personal criticism and possible commercial disadvantage).

It should also be re-emphasised that proper corporate governance of itself will not necessarily lead to increased shareholder value. In some circumstances, it may avoid a further erosion of shareholder value. Ultimately, it is good management that will lead to increased shareholder wealth. Good corporate governance can provide the appropriate corporate climate in which good management can flourish.

Finally, I wish to bring you to the point which may bring tears to your eyes. As you know, investment managers are paid a modest amount to manage funds and those margins are subject to quite an amount of downward pressure. The not inconsiderable cost of being involved in a corporate governance action comes out of the investment manager’s return. It is a direct reduction of his or her profit. While the benefits of the action will go to the clients, the cost is borne by the manager.

In my view, the real dilemma lies with the representatives of the beneficiaries. I believe that they have an obligation to ensure that their investment managers, whether they be index managers or active managers, do all that they can to provide increased wealth for the beneficiaries. However, they can only be expected to do so if they are given both the mandate and the resources.

Otherwise, it will be more sensible for the investment manager to burden the fund with the transaction costs of doing the Wall Street Walk rather than cut into the investment manager’s margins in bearing the cost of corporate governance activity. For me, this is a good point to stop because I am handing the problem over to you. However, you must realise that there is no such thing as a free lunch and to acquire a benefit there will be a cost.