Codes of good corporate governance can mislead investors in two ways. The first is that the word “code” has connotations of law, ethics and righteousness. This is reinforced by describing a code as “good” or “best practice” and having it sponsored by prestigious institutions such as the OECD, the International Corporate Governance Network, or a national institution like a stock exchange.

However, even if a company follows current codes, there is no assurance for shareholders that the business is either a good investment or ethical. There are compelling arguments that existing codes accept fundamentally flawed practices. The ritual chant of “good” and “best practice” becomes double-speak denying reality to mislead investors. The patch-up nature of current codes should be recognised by them being described not as “codes” but as “minimum acceptable practice”. In this way investors would be alerted to the possibility of better practices.

The second and more important reason why most codes mislead investors is that they specify the need for “independent” directors to hire, direct, monitor, remunerate and retire management. However, when external directors have no recent commercial association with the company, so as to meet a code criterion for being independent, they must rely on the information provided by management to monitor, remunerate and control management. In this way, external directors become dependent on management and so lose their independence.

Modern law courts would require independent collaboration of any information provided by a source, which could be self-serving. Indeed, it is difficult to understand how external directors can properly carry out their fiduciary duties with due diligence and vigilance while lacking independent sources of information. Independent directors must by their nature lack intimate firm-specific and perhaps even industry-specific knowledge. Industry investment analysts can be, and often are, better informed.

Investors who lost money from relying on so called “independent” directors to protect their interests might well have grounds for taking legal action. The description of any director as being “independent” under the existing system of corporate governance in Australia could be judged to be “misleading or deceptive or likely to mislead or deceive” pursuant to the Trade Practices Act or the Fair Trading Act.
Shareholders have a right to expect that external directors will have processes by which to monitor management with information independent of management. Such processes can also support management and add to shareholder value. The best way to obtain independent value-adding information is to establish advisory boards of people who have a vested operating interest in the business combined with intimate business-specific knowledge. These are the customers, employees and suppliers, including the host community. Because no business can exist without them, they are strategic stakeholders. To make these boards independent of management, their members need to be elected by stakeholders.

As well as providing inside expert independent information to direct and monitor the business, the process of establishing customer forums, employee councils and supplier panels can add additional value as a method to govern total quality control (TQC), employee participation and just-in-time (JIT) delivery of supplies. It also makes good business sense to establish the closest possible relations with those people on whom the business depends for its existence.

Harvard’s Professor Michael Porter recommended in his 1992 report to the US Competitive Council that US companies should follow the example of German and Japanese firms and involve their strategic stakeholders in their ownership and control architecture. Current governance practices in Anglo countries are in conflict with these recommendations and so are deficient in making firms competitive.

While stakeholder boards can provide information independent of management, this is not sufficient to make external directors independent. Directors also need the will, the power and the capability to act in the interest of shareholders as a whole, rather than just for the management and/or control group. About 20% of the Fortune top-500 companies have a control group; higher percentages exist outside the US where founding entrepreneurs and conglomerate groups more frequently maintain control of publicly traded corporations.

Even if stakeholder boards were established by companies like News Corporation or Microsoft, which are controlled by their founders, independent sources of information may not be fully effective in protecting the interests of the company as a whole. This is because the external directors would not have the power or capability to act independently of the founder or control group.

Because external directors usually hold their board position at the grace and favour of a control group, they are unlikely to bite the hand that feeds them with money, perceived influence and status.

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To provide a process to motivate, empower and enable external directors to act for the company as a whole, when this objective is not aligned with a control group, two other measures are required. One is for shareholders to appoint a “watchdog board”, “corporate governance board” (CGB) or “senate” elected by one vote per investor so that its membership is not subject to any control group, even a parent company. The second measure is to elect directors by proportional (cumulative) voting so that there are a least some directors who do not hold their position at the grace and favour of a control group. They can then obtain the will to act to “blow the whistle” privately to the CGB, which can take remedial action before the horse bolts with the money of investors.

**Codes according to CLERP**

Codes of conduct have an important role in the regulatory framework arising from the federal government’s Corporate Law Economic Reform Program, according to the business advisory firm KPMG.

Commenting on the reforms announced in CLERP6, the latest phase in the government’s implementation of the recommendations of the Wallis financial system inquiry, KPMG said participants in the financial markets should be encouraged to develop new codes of conduct or modify existing codes.

The role of codes of conduct would be to establish best practice standards for meeting the requirements of the Corporations Law. “Codes may also be developed that establish best practice in areas not covered by the law,” KPMG said.

The firm noted the part to be played by the Australian Securities and Investment Commission. “ASIC will have the power to approve a code as being consistent with the law and should be consulted in the development or modification of codes of conduct,” it said. However, it would not be mandatory for an industry participant to be party to a code.

KPMG associate director Peter Hutley said the impact of the CLERP6 provisions would be “enormous”, affecting licensing, conduct and disclosure for almost every sector of the financial services industry.

Hutley was announcing the launch of an Internet site providing information about CLERP6 and enabling users to comment on regulatory issues.

The CLERP6 reforms were expected to create a single regulatory environment, replacing provisions in various different pieces of legislation, he said.

“The reforms will cap an approach to regulation that stresses transparency and consistency,” he said.

Virtually no financial services provider would be exempt from the need to re-examine their business processes in order to comply with the new regulatory requirements. Affected areas of the market included banking, insurance, superannuation, managed investments, stock and securities markets, clearing and settlement facilities, a broad range of securities dealing activities and various types of financial advice.
A fundamental flaw in the Anglo tradition of a unitary board is that directors have absolute power in managing their own conflicts of self-interest. It is widely recognised that power corrupts and absolute power corrupts absolutely. The solution is a division of power to minimise the corruption of either corporate officers or corporate performance. None of the corrupting powers of a unitary board set out in Table 1 are required to add value. However, they can all be used to extract value, power, prestige and influence away from the company. The payment of excessive remuneration, director benefits and equity rewards are but one consequence.

It is very much in the self-interest of ethical directors to see to be so by insisting on a division of power. This also reduces their exposure to personal liabilities. The most onerous responsibilities and tasks of directors on a unitary board are managing their conformance duties. The decomposition of decision-making into two or more boards provides a way to reduce directors’ workload and allow them to focus on performance duties rather than conformance obligations. Only rogue directors and opportunists, who utilise power for their self-interest, would resist a division of power.

The solution provided by corporate governance codes to manage conflicts of self-interest is to establish remuneration, nomination and audit subcommittees. However, these arrangements do not remove the conflicts and provide false assurances when directors do not have the information, will, power and capability to act independently of management and/or a control group.

A CGB need only have very limited conformance powers to mediate conflicts of interests, control meetings of members, the interests, control meetings of members, the conformance powers to mediate conflicts of self-interest. It is widely recognised that power corrupts and absolute power corrupts absolutely. The solution is a division of power to minimise the corruption of either corporate officers or corporate performance. None of the corrupting powers of a unitary board set out in Table 1 are required to add value. However, they can all be used to extract value, power, prestige and influence away from the company. The payment of excessive remuneration, director benefits and equity rewards are but one consequence.

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CONCLUSION
Valuation of a stock is hugely dependent on assumptions of its growth rate. For example, it could be valued at (say) $1, $2 or $4 billion, if earnings growth rates for the next 20 years are assumed to be 30%, 50%, or 80% respectively. Theoretically, the net present value of a "hypergrowing" firm may not have a finite figure, if its net earnings growth never slows. Therefore, changing market consensus on large or open-ended growth rates makes a big difference to valuations of hypergrowing firms. As a Merrill Lynch Internet analyst said, investors are buying a vision of the far future.

It must be emphasised that the 17 valuation methods explained above do not establish absolute valuations, because growth assumptions are so subjective or arbitrary. Rather, they seek to measure businesses in ways that can be used in comparisons with industry peers. This can frustrate valuers used to traditional securities. There is no right answer, and valuation conventions will change as growth rates change in each sub-industry.

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created by the ability of a control group to unilaterally obtain benefits not available to other shareholders. A control group could still overturn any limitations on their ability to extract private benefits by obtaining approval at a shareholders' meeting where voting is by one-share-one-vote. However, this would make public the conflict of interest and jeopardise the reputation of the control group if it also used its shares to vote for private benefits.

The division of power created by a CGB removes the most contentious conflicts of director self-interest to significantly reduce their exposure to personal liability and potential damage to their reputation. It provides a win-win outcome for directors and shareholders. Without a division of power it is not possible to introduce meaningful self-regulation to reduce the complexity of corporate laws and stock exchange rules. The introduction of a CGB with stakeholder councils as envisaged in Table 2 provides a basis for replacing government regulation with self-regulation and self-governance. It would greatly simplify various codes of allegedly "best practice" and eliminate the need to justify non-conformance in the situations where conformance is not relevant, desirable or practical.

Stakeholder boards empower external directors with independent information on which to act. Cumulative voting provides some directors with the will to act by having an independent power base. A CGB provides external directors with the power and capability to stop problems of insider dealing before they occur. Government regulators and the common law can provide remedies only after a problem occurs. Corporate governance codes may not even be relevant and when they are, they offer problematical protection.

Governments can no longer protect the interests of both corporations and the public with regulations because business has become too diverse, complex and dynamic. One set of regulations cannot be appropriate for all types of companies, or even for one type of company all the time. Only through prescribing self-governing processes can governments enhance investor and stakeholder protection while allowing business greater flexibility.

### TABLE 2 Competitive advantages in decomposition of decision-making

<table>
<thead>
<tr>
<th>Activity</th>
<th>Anglo practice</th>
<th>Competitive practice</th>
</tr>
</thead>
<tbody>
<tr>
<td>Select, direct, control, remunerate and retire management</td>
<td>Board</td>
<td>Board with advice and consent of CGB</td>
</tr>
<tr>
<td>Nominate directors</td>
<td>Board</td>
<td>Shareholders with advice of CGB</td>
</tr>
<tr>
<td>Appoint directors</td>
<td>Board</td>
<td>Shareholders</td>
</tr>
<tr>
<td>Remunerate management and directors</td>
<td>Board</td>
<td>CGB using performance indicators established by stakeholder councils</td>
</tr>
<tr>
<td>Retire directors</td>
<td>Board</td>
<td>CGB with advice from stakeholders</td>
</tr>
<tr>
<td>Appoint auditor</td>
<td>Board</td>
<td>Shareholders, CGB</td>
</tr>
<tr>
<td>Control auditor</td>
<td>Board</td>
<td>CGB</td>
</tr>
<tr>
<td>Determine accounting practices</td>
<td>Board</td>
<td>CGB</td>
</tr>
<tr>
<td>Evaluate business</td>
<td>Board</td>
<td>Board with advice from stakeholders</td>
</tr>
<tr>
<td>Monitor management</td>
<td>Board</td>
<td>Board with advice from stakeholders</td>
</tr>
<tr>
<td>Appoint specialist advisers</td>
<td>Board</td>
<td>CGB with advice from board</td>
</tr>
<tr>
<td>Control specialist advisers</td>
<td>Board</td>
<td>CGB</td>
</tr>
<tr>
<td>Remunerate CGB members</td>
<td>Not applicable</td>
<td>Shareholders (percentage of dividend)</td>
</tr>
<tr>
<td>Remunerate stakeholder representatives</td>
<td>Not applicable</td>
<td>No remuneration</td>
</tr>
</tbody>
</table>