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Speech Notes

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Ladies and gentleman

Thank you for inviting me to address you today on the subject "There is no silver bullet for Governance".

The Local Government Managers Australia Association, like all professional associations, is vital when it comes to corporate governance, whether it is in corporate world or the world of local government.

I know corporate governance is as important to local government as it has become to the private sector.

In fact, one of the interesting aspects of corporate governance is that the private sector is now expected to have standards at least as high as the public sector when it comes to ethical regulation.

Shareholders and depositors now rank protection at least equal to, if not more than, Australia's voters with their elected representatives and public servants.

I, as Managing Director of a bank, will obviously be speaking of corporate governance from the perspective of the corporate sector.

But many, if not all, of the issues transcend private or public sector to be relevant to all of us who hold office in either government or a corporation.

So, while I am going to speak on Corporate Governance, I do not intend to go into the details of the ASX guidelines, CLERP 9, or even the US Sarbanes Oxley Act.

I am sure you're all quite happy about that.

Corporate Governance is, in fact, the topic which has raged throughout the business world in Australia, and overseas, over the last 18 months.

Once again, its prominence within the political and wider communities has come about due to some appalling corporate collapses, and a culture within society which looks for someone, or something, to blame.

Corporate Governance in Australia has raised its head due to collapses in Ansett, HIH and OneTel, while in the US it has been Enron and Worldcom and even the subsequent fall out of Andersens.

Like all changes which affect legislation, regulation and company culture, it has been controversial.

Interestingly, the report into the HIH collapse found it was incompetence and not corruption which led to the collapse of the insurance giant.

Which highlights the issue I wish to raise today.

Can you ever legislate or regulate to end incompetence and/or unethical behaviour?

Now, don't get me wrong, I am a staunch and public advocate of good corporate governance.

I also believe that, unfortunately, we do need some guidelines in this area because, it seems, common sense is not enough.

But, and you knew there would be a but, anyone who believes legislation will solve the issues surrounding corporate governance, is naïve at best.

Corruption and unethical behaviour is cultural.

As we have seen in our political and law enforcement industries over the years, corruption can only exist where the culture of the entity allows it to develop and become embedded – where whistle-blowing becomes necessary because there is no alternative.

Therefore, changes to corporate governance must be more than regulatory, they must be cultural.

Good corporate governance is about having an appropriate framework of corporate values in place to protect the shareholders, staff, and other stakeholders who rely on an organisation.

It is about government, and politicians, being forced through the media and shareholder anger to act, and act quickly.

Unfortunately, I believe the true answer to the corporate governance issues we have faced over the last few years has no “quick fix”.

There is no silver bullet, no panacea for the corporate governance issues which infected entities like HIH and Enron.

It is about organisations responding and adapting quickly to business changes required as a result of movements in community standards.

What may have been acceptable practice in the past may not be remotely acceptable now or in the future.

It comes down to fundamental cultural influences like ethics, common sense and integrity.

But you can not regulate ethics.

You can not legislate common sense.

You can not enforce integrity.

It also comes down to the market, and I include analysts, brokers, financiers, investors, the media and our regulators, giving due credit for good corporate governance, sometimes over and above earnings per share and net profit.

That is a big leap for all concerned, and not one which will happen quickly.

But it is one we all must make if we are to truly have a corporate culture where ethics and integrity live hand-in-hand with profit and expense control.

As the former Chief Justice of the United States, and great human rights advocate, Earl Warren once said:

“In civilised life, law floats in a sea of ethics”

When I became Managing Director of the Bank of Queensland two-and-a-half years ago, I instituted a set of five core values. They are:

Passion, Achievement, Courage, Integrity and Teamwork.

Leadership guru Max DePree stated why values for a corporation are so important, he said:

"A corporation's values are its life's blood. Without effective communication, actively practiced, without the art of scrutiny, those values will disappear in a sea of trivial memos and impertinent reports".

In light of that, I include the values in every presentation I make to the staff, in regular staff roadshows, and in fact even have the values as the screen savers on the bank's computers.

It is not enough just to espouse values; they must be believed in, practiced and seen by the staff as important to management if they are to become an integral part of the organisation's culture.

Bank of Queensland espouses and works by these values, and they underpin our entire culture.

In fact, there is no place in our organisation for people who do not believe in and share in these values.

This core value system, combined with the ability to provide direct access of staff to senior management, ensures that inappropriate and unethical behaviour never becomes embedded in our culture.

I address every staff induction, meet all staff in regional and South East Queensland branches during regular roadshows, and conduct a phone-in hotline every two weeks for all staff to contact me, no matter what their level within the Bank.

Just to reinforce my previous message about culture, Justice Neville Owen, who conducted the HIH Royal Commission, told a function earlier this year that, and I quote:

"The climate of fear created by management if mistakes are made must be replaced by a climate of proactive problem-solving"

The federal government's corporate reform program, and other recommendations from inquiries such as the HIH probe, will lead to fundamental shifts in the way we do business here in Australia.

Sadly, not all the regulatory changes by the various levels of government will be undertaken to achieve the right results. Many will be undertaken to achieve the perception of having done the right thing.

Let's remember, that we can not compare ourselves to the US on an apples to apples basis when it comes to corporate governance.

Australia's continuous disclosure laws and our other existing safeguards already put us well ahead of the US.

Already we have seen massive concerns about over-regulating corporate governance following the HIH recommendations.

Everyone from accountants and auditors, to company directors, lawyers and even our own State Government, have taken issue with some of Justice Owen's recommendations.

Then we have seen the issue of how some changes may impact on smaller listed companies, particularly in their areas of compliance cost and the appointment for non-executive directors.

Cost which may force some of those companies to de-list. Is that necessarily a bad thing? Particularly if they do not measure up to what is required in the new age of corporate governance standards.

I read in the Financial Review how the ASX faced a, quote, "corporate governance revolt", particularly from smaller listed companies.

I also read, with interest, how recent research by McKinsey & Company, highlighted the growing issue of corporate governance in the eyes of investors.

McKinseys stated that two-thirds of investors said they would not invest in companies with poor corporate governance.

Importantly, McKinseys also found that companies with good corporate governance traded at a 12 to 14 per cent premium on the market.

I would love to know how they obtained those figures. I do not know how good corporate governance has been measured, or what the criteria the study was based on, but I would love to believe that they were right.

Because it is important to note that ethical behaviour, and the organisations which invest heavily in it, are acknowledged and rewarded if it is to gain true currency.

We can talk and legislate all we like, but unless and until corporations gain true, tangible benefits from stakeholders for good corporate governance, there will always be those who will do it the wrong way.

The question for those who often set the market is, do they look at how a corporation achieved its success, or just at the end results?

Up until now, it has bee a case of the ends justifying the means. If the corporation's results are good, then they must be doing the right thing.

Now, I can speak from some position of strength here because, not only do I believe that Bank of Queensland is a good corporate citizen with a strong culture of corporate governance, but we have also been a financial success story over the last couple of years.

We have been opening branches – 29 in the last 18 months or so, while recording record profits.

Opening new branches and growing staff numbers while increasing profitability is not only smart business, but highlights a social responsibility by the Bank of Queensland, one which has been recognised by the community.

Our share price has risen more than two dollars to record highs in the last 12 months as the market has recognised and understood our strong performances to date.

Some time ago Bank of Queensland constituted a Board-level Corporate Governance committee to ensure we continue to meet our own high standards, as well as those expected by regulators.

The Board has a performance review process to ensure it is functioning well and its performance is constantly improving.

So I will restate the question, do analysts look only at the end result, the outcome, or do they also look at how the company reached that position?

What happened on the way to that outcome? How does the balance shift between ethics and shareholder value? Where is the emphasis now?

The genuine solution to the issue of corporate governance is that, for rapid improvement and a sustainable change in culture, ethical behaviour by management and board must translate into tangible benefits at some point – benefits recognised and acknowledged by analysts and ratings agencies.

What value will the market put on ethical performance compared to financial performance? These “soft issues” in many cases have not been valued by technical or fundamental analysis.

We are talking about an attitudinal shift here, not just more regulation.

An over-reliance on proscriptive measures, without a fundamental shift in ethical standards, will not succeed.

The Australian Shareholders Association has rightly raised the prospect that, unless we see the attitudinal shift I have spoken about, corporate governance will be legislated.

This will create its own issues as legislation must, by its nature, be “one size fits all” and will therefore fail as often as it succeeds.

And over-regulation, as we have seen in the past, can be death to business.

Over-regulation can and will kill the entrepreneurial spirit.

It will crush innovation as more and more resources are shifted towards compliance, and away from staying ahead of the pack.

The Bank already has a list of legislation, codes and standards to which it must comply which runs for three A4 pages. While only taking up one line on the list, some of these items include FSRA and the Privacy Act, which have brought about a massive amount of extra work in order to meet compliance standards.

Our answer now seems to be to try and enforce ethical behaviour through regulation or, God forbid, legislation.

But legislation and even increased regulation, is only part of the solution. As I stated earlier, the answer runs much deeper within our society.

You simply can not enforce ethical behaviour if it has not been imprinted on the individual early in their life.

It must be taught in the home, in our schools, and in the formative years of someone's career.

It must be part of our induction into the business world, our mentoring processes, and our staff promotion and reward structures.

The very nature of unethical behaviour is that an unethical individual will not respond to regulation late in their careers. Particularly if it is that unethical behaviour which has helped them to be successful in the first place.

Ethics and integrity must be part of a corporate culture.

As we have seen with Enron, HIH and even the FBI, it has taken massive corporate collapses or disaffected whistleblowers to expose the irregularities or practices which have brought these organisations to task.

Surely todays corporate and public sectors must endorse a culture which allows, encourages, promotes and rewards ethical behaviour within the corporation so that whistleblowers and expensive inquiries are not necessary.

As I stated earlier, in Bank of Queensland I have the simplest of methods, as an example, of allowing staff from all levels and geographical locations to tell me if they think we are doing something wrong. Once a fortnight I have an open phone line so that any staff, no matter who they are or where they sit in the organisation, can ring me up and speak to me about problems they perceive.

Now, I do get the odd call about the plain biscuits in the coffee room or that someone's chair is unsatisfactory, but I also get some of the best ideas on how to improve our processes and our company from these calls.

Not only is this smart business, but it is also an avenue for issues to be raised before they become serious.

This brings us to the issue of self-regulation.

Business ethics are not undefined and unsubstantiated. In fact, an academic study involving Queensland's own Griffith University Key Centre for Ethics Law, Justice and Governance outlined what was essential for a business to operate ethically and with integrity.

The study, entitled "Business Integrity Systems in Australia" and conducted over 2000 and 2001, deduced and I quote:

"Leadership, clear policy, stability, consistency, a concern for reputation, good staff and communication were regularly identified as key factors which sustained business integrity".

My own inclusion of integrity as one of the five core principals and values of the Bank of Queensland is given some weight by another finding of the study. That finding was, and again I quote:

"Whilst integrity was commonly identified as an important personal attribute, directly related to the character traits of individuals, few organisations directly or consciously incorporated integrity assessment as part of employee selection processes."

This will change as corporations face the issues of corporate governance head-on.

Finally, the same study identified key risk factors, one of which was, and I quote: "a lack of clarity about the values and goals of the organisation".

I couldn't agree more.

Much that I have spoken about today has been about ethics and integrity when it comes to Corporate Governance. I could go into a great more detail about CLERP and the US Sarbanes Oxley Act and how they will impact on Australian corporations doing business overseas.

But, and this has become obvious as I have spoken, I believe many of the issues surrounding Corporate Governance can and will be solved through three key areas:

They are:

1. a stronger ethical standard, both in our general community and, consequently, flowing through to our business and government communities;
2. a tangible reward system for those corporations which act ethically and with integrity and have a strong corporate governance culture, and;
3. flexible corporate self-regulation which identifies problems early, rather than proscriptive legislation designed purely to punish the guilty.

The immediate question is, what does he mean by flexible self-regulation and does that just mean do nothing?

Well, no, it means the opposite.

It means that professionals, managers and directors like me, advisers, analysts, brokers, bankers, ratings agencies and regulators must take a deep breath and support a system which allows for the variety and vagary of corporate Australia.

It will be pointless and extremely detrimental if, in the rush to tick the corporate governance box, legislators and regulators create a system which is unworkable and unsustainable.

The end result will be no system at all as its inability to work will be the excuse to chip away at it so that, in five or ten years, business gets on with ignoring corporate governance until the next disaster like HIH or Quintex.

Already, there have been some changes through CLERP 9 which are, at best, suspect in their approach.

Why, for example, introduce non-binding votes by shareholders on Director and management remuneration?

Either make them binding, in which case you have to wonder at just what role boards play in the future, or leave it how it is where shareholders can question remuneration at shareholder meetings.

It is this kind of ad hoc approach that concerns me.

The ASX approach for corporations of “if not, why not” is the answer. Companies either comply with a reasonable set of corporate governance guidelines, or, where they significantly depart from those guidelines, they tell the market and the public why.

This is the most flexible, and therefore the most sustainable approach.

Rather than setting up an entirely new penalty structure based in legislation for corporations, directors or managers who fail to live up to some hard and fast set of so-called standards, we allow the market itself to punish transgressors.

The key, and I say fundamental, platform for this to work is for the market to be able to identify transgressors BEFORE they collapse in a heap, taking shareholder funds down with them.

Australia's laws allow this to happen, provided that, under the ASX guidelines, corporations are forced to disclose whether they are adopting corporate governance best practice.

And if they are not, well they tell the market why and the market rewards or punishes accordingly.

Of course, best practice itself is not an absolute, and can change from organisation to organisation.

However, the ASX system, like capitalism itself, has some chance of being successful because it relies on a reward system which is easily understandable.

If you are a good corporate citizen with strong governance regime, your share price will be stronger.

Of course, as I stated earlier, this can only work if the market adopted some extra tenets to its triple bottom line.

Nowadays, it is not enough just to have a strong profit.

Even the much-talked about triple bottom line has had a revamp. Now we are looking at annual indices which will rate and rank companies on how they contribute positively to their community.

- Do they support charity?
- Do they support the environment?
- Are they involved in the arts?
- Are they <u>involved</u> in their community?

And finally…….

- Are they an ethical corporate citizen?

While it may make some of our lives more difficult, surely it is better to spend resources on achieving success in the above categories rather than in endless compliance with unworkable legislation.

No, like most things in life, the answer does not lie with State or Federal governments sweeping in like a white knight to save us from ourselves.

The answer lies within each of us. The answer lies in doing the right thing and being rewarded for it.

Personally, I think that is the way it should be……….

Thank you.