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Corporate Governance, Incentives and the Internationalization of Australian
Business, 1975-2000*ⁱ

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Abstract

Australia's increasing involvement in the international economy in the last quarter of the twentieth century have been explained without regard to the motivation of managers. Micro-economic reform has been credited with increasing the level of competitiveness within the economy. Behaviours within firms, a 'black box', are assumed to have been profit-maximizing. However, going abroad required fundamental changes in corporate strategies that imposed additional strains on managers. Using principal-agent theory and the insights of the internationalization process literature this paper argues that the extensive change in the corporation governance system was a necessary but not sufficient condition of that phenomenon.

Section 1: Introduction

There is widespread acceptance of a link between greater competitiveness within the Australian economy and its increased integration into the global economy. Micro-economic reform of the 1980s did promote greater efficiency and accelerated productivity growth. However, agency problems continued to confer considerable autonomy to managers in those circumstances where they faced an ill-informed and dispersed proprietorship. The central issue of corporate governance is aligning the potentially divergent goals of the managers and owners as information asymmetries and incomplete contracting permit the former to engage in moral hazard and adverse selection [Hart, 1995; Fama and Jensen, 1983; Jensen and Meckling, 1976; Jensen, 1993; Milgrom and Roberts, 1992]. In the last quarter of the twentieth century the incentives facing Australian managers altered in ways that made them more responsive to profit maximizing opportunities than had been the case previously. For the largest firms going offshore became an increasingly common corporate strategy [DFAT, 2002]. In many respects it was the most difficult to execute successfully. Substantial alterations in the system of corporate governance were a pre-condition to the creation of an environment in which managers would make the efforts required to internationalize. The transformation of corporate governance was a necessary but not a sufficient condition for the newfound ability of Australian business to compete internationally.

The contention of this paper is that there was a causal connection between changes in the nature of corporate governance and the increased internationalization of Australian business. The rapid transition from a heavily protected regime posed new challenges to managers as they sought to learn about foreign markets [Johanson and Vahle, 1977; Welch and Luostarinen, 1988]. For many, facing foreign competition in domestic markets and seeking opportunities in foreign markets was a new experience [Merrett, 2002a, 2002b, 2007]. The administrative heritage of large Australian firms was that they had developed sources of competitive advantage in domestic markets that could not be easily transferred abroad [Zalan & Lewis 2007]. Moreover, managers lacked the skills to make sense of and operate in a new, more complex and uncertain environment. Initiating

foreign operations involved higher transaction costs in finding counter parties with whom to trade, and posed higher costs in writing, monitoring and enforcing contracts. Information asymmetries between managers and owners increased as the executive's knowledge base of diverse markets and cultures became wider and more specialized. Information processing was carried out by top management teams whose actions and efforts, both subjected to potential adverse selection and moral hazard, were increasingly difficult for directors and shareholders to observe, allowing them to under invest in the higher risk-return activities abroad. In the US, with its strong market-based corporate governance system in place, Sanders and Carpenter's [1998] study of 258 firms from the *Fortune 500* list operating internationally had adapted their governance structures in ways to strengthen monitoring and to align managerial incentives with those of stockholders.

The system of corporate governance has evolved in Australia in ways that strengthened the rights of owners. This process was not the consequence of a premeditated or coherent policy. It was driven by many factors, some of which were unintended by-products of micro-economic reform, whose effects built cumulatively. The various changes, discussed below, combined to modify the system of corporate governance in ways that attenuated opportunistic behaviour by managers, particularly in larger corporations. By 2000 owners were in a far stronger position to reward and punish managers than had been the case in the 1970s. Large corporations, many of whom already had dominant market share, faced constraints on their expansion within the small and mature Australian market. Managers were increasingly prepared to explore and implement policies of internationalization to preserve or increase returns. Strategy reappraisal resulted in significant increases in internationalization by Australian companies [DFAT, 2002; Zalan & Lewis, 2007; Zalan, 2007]. The ratio of exports of goods and services to GDP rose from 15.2 per cent in 1975-79 to 19.3 per cent in 1995-99. This growth in outward trade was greatly exceeded by a rise in foreign direct investment, whose ratio of outward stock of FDI to GDP rose from 7.9 per cent in 1980 to 28.7 per cent in 2000 [Merrett, 2007, Table 2.3, 25].ⁱⁱ

The paper will begin with a discussion of the policy changes that made the Australian economy more responsive to market forces, both at home and internationally. The following section will review the changing nature of the system of corporate governance from the 1970s until the present.

Section 2: Microeconomic Reform and International Competitiveness

Deteriorating macro-economic performance was the motivator for the new policies introduced by the government from the mid-1970s onwards. The oil price shocks of the early and late 1970s stalled growth, and drove up unemployment and inflation in Australia as they did elsewhere [Norton, 1982]. However, these sharp recessions overlaid more deep-seated and longer-term problems. Australia had been sliding down the list of per capita incomes in the OECD group of countries since the end of World War II [Dowrick and Nguyen, 1989]. It had been plagued by a comparatively slow growth of per capita incomes, poor productivity growth and a recurrent balance of payments problem. A widening deficit in the balance of trade resulted from an adverse movement in the terms of trade for Australia's narrow range of resource-based exports. The Keynesian-style mix of fiscal and monetary policies employed since the late 1940s was unable to combat either the rising unemployment or inflation in the 1970s, or to address the increasingly adverse external position.

The Australian Labor Party, under Prime Minister Hawke and Treasurer Keating, embarked on a policy of radical economic reform after taking office in 1983. This thrust was continued by the Liberal-National Coalition government that replaced it at the 1996 election. In brief, most of the protective and regulatory apparatus that had shielded Australian product and factors markets from domestic and international competitive pressures since before World War I were removed. Trade barriers on manufactured imports were reduced from an average 23 per cent, the highest in the world in 1970, to a projected five per cent by 2001 [Anderson and Garnaut, 1987, Table 2.1, 7]. The financial system was deregulated in the early 1980s, with the removal of capital controls and the floating of the Australian dollar occurring in 1983 [Grenville, 1991; Perkins,

1989]. Important reforms also occurred in the labor market. The old system of wages and conditions being determined by tribunals applying awards after hearing submissions from unions, employer peak bodies and governments on an industry-wide and national basis was freed up insofar as workers and employers increasingly bargained at an enterprise level [ACIRRT, 1999; Dawkins, 2000]. Further reform included the sell off of government business enterprises discussed above. Further, successive amendments of trade practices legislation outlawed price fixing and other forms of abuse of market power [Brunt, 1994]. The net effect of these various changes was a marked increase in competitiveness within the economy compared to that of a generation earlier. Resource allocation reflected price signals that emanated from markets that were contestable and competitive.

Section 3: Corporate Governance

Australian governments and their advisors assumed that businesses would adjust to the new environment, taking advantage of lower costs and wider markets, to maximize their profits. The central issue of corporate governance was ignored: problems of agency permit managers to act in ways that may lead to sub-optimal outcomes for the owners of the business. A more robust system of corporate governance was needed to align the objectives of managers and shareholders through a combination of more effective monitoring, the use of performance-linked remuneration and external market disciplines.

Corporate governance systems differ substantially between economies [Kaplan, 1997]. The two leading models are the 'outsider' system where the mediation of agency issues arising from the separation of ownership and control largely takes place through external market discipline and financial incentives to managers. This system is most developed in the United States of America and the United Kingdom. The alternative is the 'insider' system where agency issues are worked through within the firm largely through the board of directors which comprises a number of stakeholders. Such a model is commonplace in Europe and Japan. Australia has a number of characteristics which would suggest that it fits with the 'outsider' model. Our contention is that the system is 'outsider' rather than

‘insider’ and that it has strengthened appreciably over the past 30 years. However, a number of legal scholars have argued recently that it has more in common with the ‘insider’ system [Dignam and Galanis, 2004; Dignam, 2005a; Dignam, 2005b], or that it is a hybrid system that may be transitioning towards an ‘outsider’ system [Cheffins, 2002]. Other researchers from this discipline [Ramsay, Stapledon and Fong, 2000; Stapledon, 1995, 1996a, 1996b, 1998; Stapledon and Lawrence, 1997] have highlighted a number of weaknesses, particularly relating to the composition of boards of directors, that compromise the interests of shareholders. These issues will be considered below.

Monitoring managers

Boards

Australian corporation law reflected British practice. Before the introduction of *Company Act 1961* (Cth) it was permissive allowing directors wide discretions in what information they disclosed to the market other than an annual balance sheet and profit and loss account. However, a string of high profile corporate collapses throughout the 1960s, 1970s and 1980s brought pressure to bear for increased protection of shareholders’ rights [Clarke, Dean and Oliver, 1997]. Parliaments and stock exchanges progressively amended the law and listing requirements in ways that forced greater disclosure of information to investors [Industry Commission, 1991, Appendices G and H]. The pace of regulatory reform accelerated in the 1990s in an attempt to improve the practice of corporate governance [Tomasic and Bottomley, 1993; Hilmer, 1998; Clifford and Evans, 1996; Hughes, 1998; Bosch, 1993]. These more recent changes were motivated in part by the recognition that Australian corporations would be disadvantaged in raising capital in global markets unless the country’s system of corporate governance adopted the standards prevailing in the USA and Britain.

Further pressure for reform in corporate governance came as a result of unprecedented declines in returns to shareholders in the 1970 and 1980s. From the mid-1950s until the mid-1970s the profitability of listed firms, measured as after tax profits divided by shareholder funds, enjoyed a healthy equity premium of an average 3.44 per cent over the

10 year bond yield. However, a combination of excessive wage rises and the across the board tariff cut introduced by the Whitlam government and rising interest rates thereafter resulted in a negative equity premium of an average of -1.61 per cent from 1974 until 1986. [Ville and Merrett, 2006, Table 2]. Australian companies were under pressure to lift returns if they were to continue to raise external funds.

The structure of boards of Australia's largest companies was changing in ways that was consistent with their increasing effectiveness in monitoring managers on behalf of their shareholders. They became larger so increasing the pool of human capital available to provide the strategic advice and oversight over the affairs of more complex organizations. Moreover, the ability of boards to act independently of management was increased by the growing number of non-executive directors. The average size of boards of leading companies rose from 7.5 in 1964 to 10.4 in 1997 [Fleming, Merrett and Ville, 2004, Table 7.6, 197, and Table 7.7, 198]. Two measures of board independence, the ratio of non-executive to executive directors and having a non-executive director as chair, also suggest that the potential of boards to provide effective oversight also improved over time [Fleming, Merrett and Ville, 2004, Table 7.7, 198].

A detailed review of board composition, structure and independence of Australia's largest 100 companies in 1995 by Stapledon and Lawrence offers a more pessimistic view. They found that 45 per cent of these companies had as chairman either an executive director or an 'affiliated' non-executive director [1997, 158-9]. Moreover, they argue that only 384 of the 652 non-executive directors were truly 'independent'. Consequently, the ability of the other 268 non-executive directors to monitor managers effectively was compromised by the fact that they were directly or indirectly a major shareholder [28%], a former employee [22%], or were associated with a significant supplier, customer [19%] or contractor [13%], or were a current or past professional adviser [18%] or some combination of the above [Stapledon and Lawrence, 1997, 167-75].

This type of evidence of board composition and an apparent affiliation of nearly a half of non-executive directors with management rather than all shareholders has led some

scholars to argue that Australia has an ineffective form of corporate governance. Blockholders, an entity holding at least five per cent of voting stock, may not have an incentive to seek the maximization of the wealth of all shareholders... It is inferred that these blockholders align themselves with management and favour the status quo because it provides them with the possibility to ‘systematically transfer wealth from other shareholders by means of ‘intercorporate “perquisites” – financial and product market transactions at favourable terms to the [substantial shareholder]’ [Stapledon and Lawrence, 1997, 169-70]. To protect their privileged position blockholders use their influence, which is magnified through cross directorships, to stifle unwanted hostile takeover bids [Dignam and Galanis, 2004, 639-42; Dignam, 2005b; Stapledon and Lawrence, 1997, 175-79].

One class of blockholders, funds managers, would not seem to have an incentive to engage in the private rent extraction behaviour discussed above. Their rise to prominence in the past decade and a half has significantly altered the system of corporate governance within Australia [Stapledon, 1996a, 25-29 & 157-65]. As most Australian employers became contributors to superannuation funds [Edey & Simon, 1996, Tables, 2, 7 & Fig. 4, 16] competition between funds managers increased. In the battle for custom, funds managers closely monitored the performance of the corporations in which they had invested and based investment decisions on short-term results. The use of analysts by stockbrokers and funds managers improved the quality of the advice guiding their own investments and the advice given to clients. Techniques of evaluation became increasingly sophisticated including less reliance on accounting data and more about cash flows or economic value accounting.

Has the emergence of financial institutions as major blockholders been responsible for strengthening the system of corporate governance in Australia? There have been a number of highly publicized cases where action by individual institutions or the Australian Investment Managers’ Group (AIMG), a grouping of the 40 largest funds, have forced changes in the personnel of boards and at senior executive [Stapledon, 1996a, 189-99]. However, a number of scholars have highlighted a range of issues that

would cause institutions to under invest in monitoring and active intervention in the affairs of companies in which they are key blockholders. These include potential breach of the *Corporations Act*, weaker incentives for the institutions than their clients to act, the high costs of detailed monitoring and of organizing collective action with other institutions and so on [Hill, 1994; Stapledon, 1996a and 1996b, Ramsay, Stapledon and Fong, 2000, 127-34]. These arguments not with standing, it is difficult to believe that having institutional investors on the share register does not concentrate the minds of boards and managers. They are better informed than nearly all other shareholders and hold such large blocks of shares that their actions, by either 'voice' or 'exit', can have a material effect on the value of the stock. Their actions may well be constrained by the issues raised by the commercial lawyers but they provide a powerful presence that was absent a generation earlier.

Market for corporate control

The threat of takeover and loss of office by incumbent managers is a powerful incentive to maximize the financial performance of companies. A market for corporate control that imposes such a discipline has emerged in Australia in recent decades. Mergers and acquisitions were frequent occurrences throughout the 1950s and 1960s [Bushnell, 1961; Stewart, 1977]. However, these were almost without exception friendly affairs. A major impediment to the development of a market for corporate control was the lack of any requirement that companies disclose that they had received a bid. This deficiency was not rectified until the Eggleston Committee's 'takeover code' was incorporated in the *Uniform Companies Act* in 1970. Thereafter corporations were compelled to inform their shareholders of the identity of a bidder, the terms of the bid and to give shareholders a reasonable time in which to make a decision [Maxwell, 1982]. However, despite this improvement one commentator described the regulation of takeover bids in Australia as 'rudimentary' up until the 1980s [Austin, 1993, 144]

The pressure on underperforming companies increased sharply from the 1980s. The traditional defense of rejecting an unwanted bid in secret was no longer an option.

Shareholders were in a position to choose. Moreover, financial institutions were prepared to fund hostile bids taking the assets of the target as collateral. Access to finance transformed the effectiveness of a market for corporate control throughout the 1980s and 1990s. Companies no longer had to rely on a 'war chest' of accumulated reserves as they could borrow. Foreign banks were to play an important role in the growing merger and acquisition movement. Although denied a banking license before 1985 they operated as representative offices and as 'merchant banks'. The latter, in particular, provided funds and acted as advisors for mergers and acquisition [Wallace, 1993]. Deregulation, especially the end of exchange controls, gave local financial institutions and corporations unprecedented access to international debt and equity markets. A merger frenzy occurred in the 1980s as debt laden 'entrepreneurs' mounted raids and counter raids on the country's largest corporations [Sykes, 1994].

Managers have a strong incentive to repay their debts as failure to do so may result in the firm becoming bankrupt. Australian companies became increasingly leveraged in the 1980s [Lowe and Shuetrim, 1992; Dempster, Howe and Lekawski, 1990; Reserve Bank of Australia, 1997, Table 3.27]. However, many of the lenders were unable to monitor the position of their debtors as some of the latter exploited information asymmetries to disguise their true financial position [Lowe and Rohling, 1993]. As the decade progressed a number of the most indebted entrepreneurs were trading in assets rather than generating cash flows from business operations. The break in asset prices after the stock market crash in October 1987 and the collapse in property prices soon after brought distress to many firms who could no longer meet their interest obligations or raise fresh capital. Twenty of the more adventurous debt laden corporations collapsed with total losses of about \$20 billion, while Australian financial institutions wrote off more than \$28 billion in losses resulting from loan defaults up to 1993 [Sykes, 1994, Tables 17.1 and 17.2, 571 and 573]. A consequence of the large loan defaults was that banks, partly in response to pressure from the Reserve Bank of Australia, significantly improved their internal risk assessment and monitoring procedures [Thompson, 1996] as the monetary authorities overhauled their system of prudential regulation in the late 1990s [Gray, 1997]. Moreover, greater information became available about the standing of corporate debtors

through the development of a secondary market for their bonds [Financial System Inquiry Report, 1997, 159-61; Reserve Bank of Australia, 2001a].

The growth in the size and liquidity of the equity market in the 1990s resulted in a major transformation of the Australian system of corporate governance. Companies returned to the equity market while reducing the debt in their balance sheets. Meeting the expectations of increasingly well informed and demanding shareholders placed pressure on managers. The share market was significantly enlarged in the 1990s by the demutualization, including life offices and building societies [Reserve Bank of Australia, 1999] and, more importantly, by a sell off of government owned business enterprises [Reserve Bank of Australia, 1997; Walker and Walker, 2000, Table 2.1, 20-24]. The Reserve Bank estimated that the privatized government businesses generated about ten per cent of the market capitalization of the Australian share market in 1997, and was an important contributory factor in boosting the proportion of persons holding shares from ten to 20 per cent between 1991 and 1997. Over that same period, the ratio of market capitalization of listed equities to GDP had risen from 44 to 87 per cent [Reserve Bank of Australia, 1997, 12].

To what degree has a market for corporate control imposed discipline on managers of Australian firms? The effectiveness of the threat of takeover as a mechanism for aligning the goals of managers and shareholders has been compromised in a number of ways. Using market transactions to align incentives has been discouraged by target firms being able to raise the cost of mounting a hostile bid and increasing the uncertainty of the outcome. For instance, during the 1980s corporations became increasingly adept at preempting or defeating bids. Successful defensive actions included locking in the share register, and issuing misleading information to the market and manipulating share prices. Frequent recourse to the courts, so lengthening proceedings, by firms under attack was designed to increase the costs of acquirers. Bidders responded by also approaching the courts to test the jurisdictional powers of regulatory bodies which were ruling on proceedings [Austin, 1993, 176-8].

The effectiveness of a market for corporate control was reduced from the mid-1980s by regulations designed to reduce the number of mergers [Hutson, 1998]. Firms in some industries receive government protection against possible takeover, particularly banks under the continued operation of the 'Four Pillars' policy. For instance, government regulation of foreign investment both through legislation limiting foreign shareholding in banking and media and more generally through the deliberations of the Foreign Investment Review Board provides a further defense to incumbent managers in a number of industries. Furthermore, the Trade Practices Tribunal, now operating as the Australian Competition and Consumer Commission, has the discretion to block acquisitions that would result in a lessening of competition. As many industries are dominated by a handful of large firms the operation of competition policy limits the possibility of horizontal mergers [Austin, 1993, 148-9].

Critics of the regulations governing the Australian market for corporate control argue that they are amongst the most restrictive in the developed world. The rules are designed to protect the interests of shareholders in target companies above all else, including the mandatory use of expert reports for the target shareholders from 1980 [Bugeja, 2005] and the operation of the Corporations and Securities Panel and its successor, the Takeover Panel [Miller, Campbell and Ramsay, 2005]. Australia sits between countries such as the United Kingdom, France and Germany that have a high control threshold, 30-50 per cent, before a mandatory full bid and countries such as the USA, Canada and Japan that have a low threshold, 5-10 percent, that allow for partial bids thereafter. Australia has a low threshold, 20 per cent, and thereafter requires a full bid to be made. The practice of partial bids in Australia was ended in 1986 through the *Companies and Securities Legislation Amendment Act* [Hutson, 1998, 118]. The requirement to accept all the stock offered by shareholders in the target in response to a bid necessarily increases its cost and discourages takeover offers [Hutson, 2002].

Scholars have drawn different conclusions from the empirical data about the number of takeovers in Australia. Many Australian listed companies were taken over each year, an average of 36 per year between 1975 and 2004 [Lew and Ramsay, 2006, Table 3, 15-17].

Or about one in every 20 listed companies each year. Nearly 70 per cent of bids were successful from 1972 until 1994 [Hutson, 1997, 51]. This might suggest that the level of takeover activity was high enough to act as a deterrent and a correction to under performing managers. However, Stapledon argues that nearly a half of quoted companies in Australia are 'either effectively immune from, or in most circumstances actually immune from ...hostile takeover' [1995, 270]. Moreover, there is little empirical evidence linking the prevention of under performance and hostile bids [Stapledon, 1996b, 14-18]. Taking a similar position, Dignam [2005b] argues that there is no evidence to support the view that directors will behave neutrally and seek to maximize shareholder value when deciding how to respond to a bid. His study of 401 completed mergers and acquisitions undertaken in Australia between 1992 and 2001 found that there were only 75 'hostile' bids, bids that directors advised shareholders to reject. Only 29 of these were successful. In 26 cases the bidder retreated without increasing the offer price and in the remaining 20 cases ownership did change hands at a higher price but to another 'friendly' party. The proportion of completed hostile bids was much higher in the United Kingdom, 20 per cent, and the United States, 21 per cent, over the same period [Dignam, 2005b, 59-60]. He argues that the difference arises from the higher concentration of share ownership in Australia that allows blockholders to thwart unwanted bids, leading him to conclude that 'Australia has a weak market for corporate control' [Dignam, 2005b, 61].

There is no direct evidence of the motives of directors and managers in target companies. However, the price paid for target firms provides a measure of the benefits enjoyed by all the shareholders not just the blockholder minority. Dignam and Stapledon imply that blockholders are able to circumvent market discipline by successfully opposing bids or by only agreeing to 'friendly' mergers that will leave their private rent extraction undisturbed. Such a view is at odds with the findings of scholars from the finance discipline [Bishop, Dodd and Officer, 1987; Hutson, 1997; Brown and Horin, 2001]. Bishop, Dodd and Officer's landmark study calculated the cumulative abnormal returns, over the period six months prior to the bid announcement and one month subsequent, in the shares of both targets and bidding firms in 1310 takeover bids between 1972 and the middle of 1985. The bidding process created substantial gains on average for

shareholders, particularly for those holding shares in target companies [Table 2, 21, Table 10, 46]. A reworking of this data set by Brown and Da Silva Rosa, correcting for size effects and survivorship bias, increased the CAR to successful bidders [Reported in Hutson, 1997, 56]. Hutson concludes her review stating that ‘the Australian evidence is reasonably consistent with the international findings. Takeovers, on average, do create value, although it is unlikely that value is corrected in every case.’[Hutson, 1997, 58] Moreover, Brown and Horin [2001] tested the competitiveness of the Australian market for corporate control by observing the behaviour of competing bidders. Their findings were that the market was competitive in that unsuccessful bidders in 80 per cent of contested takeovers did not match the winner’s bid, inferring that it was fully priced [Brown and Horin, 2001]. This finding is at odds with Dignam’s suggestion that blockholder dominated boards could arrange under-priced bids from friends.

Aligning incentives - executive compensation

In another respect, the system of corporate control has changed. Owners have increasingly sought to align the goals of managers and directors with those of shareholders by offering incentive contracts that link remuneration to performance. The data shown in Table 1 indicates the dramatic changes in the composition of the remuneration packages of CEOs of 49 of Australia’s largest corporations that subscribe to the executive reward database managed by the Hay Group [O’Neill and Iob, 1999, 65-67]. Similar shifts were also evident in the compensation packages of the next two levels of executives. Stock options and employee share plans have become an increasingly common feature of compensation in Australian businesses. Best practice corporate governance requires that independent non-executives chair and dominate the remuneration committee.

Table 1 about here

Has this new form of compensation had a positive impact on performance? The studies of the Australian data present conflicting results. A variety of independent and dependent variables have been employed by researchers and different time periods used which make it difficult to compare the findings. The results range from finding negative or

insignificant relationships between pay and performance [Holland, Dowling and Innes, 2001, 47-53; see review of studies in Stapledon, 2004, 12;] to a strong positive relationship between CEO remuneration and firm performance [Merhebi, Swan and Zhou, 2003]. It is indisputable that the largest Australian companies have moved quickly from a regime where there was no link between pay and performance to the opposite position. While the empirical studies may not have reached a consensus on the nature of the relationship, the media constantly reminds the executives of the expectations of shareholders that there should be a demonstrable link.

Competitive markets

The product markets in which firms compete exercise disciplines on managers. The greater the level of contestability and competition between rivals, the greater the pressure on managers to maximize profits. A strong case can be made that the more markets in Australia face greater competitive pressures at the end of the twentieth-century than in the early 1970s. A dissenting view is expressed by Dignam who argues that 'the competitive environment in which companies operate is not acting as a disciplinary force on management' [2005, 765]. His assertions concerning the lack of rivalry within highly concentrated industries, the wide spread existence of cartels, the prevalence of price fixing and the minimal impact of the reduction in trade barriers on domestic competition are at odds with overwhelming evidence to the contrary [See for instance, Brunt, 1994; Dawkins et al., 1999; Reserve Bank of Australia, 2001b; Productivity Commission, 1998; Australian Bureau of Statistics, 2006].

The sweeping changes in the 'rules' under which Australian businesses have operated in the last 25 years have played an important part in driving the reallocation of resources between industries or structural change. The net result of the various drivers of structural adjustment was that the absolute and comparative advantage enjoyed by Australian producers in a range of industries vis-à-vis the rest of the world shifted in their favor. A

short hand measure of the greater effectiveness with which resources were being used was the prolonged and rapid rise in productivity over the 1980s and 1990s [Gruen, 2001]. Australian companies in some industries found new markets in foreign countries and were better able to compete with foreign firms at home [Dick and Merrett, 2007]. In terms of the schema developed by Rugman and Verbeke [1990], Australian corporations were able to exploit enhanced country-specific advantages (CSAs) of lower costs and increased flexibilities. Within these more competitive domestic markets firms that learnt to develop non-location bound firm-specific advantages (FSAs) could build a sustainable competitive advantage operating abroad.

Section 5: Conclusion

This paper argues that changes in the system of corporate governance operating in Australia increased the incentives to managers to respond more positively than they otherwise might to the opportunities offered by the new environment. The rush of small and medium enterprises, where agency issues were attenuated by the owners managing the businesses, to adopt internationalization strategies suggests an improvement in Australia's comparative advantage in a range of manufacturing and service activities. Going abroad made life more difficult for managers as additional resources and new skills were required, and the foreign environment was more complex and often more turbulent than at home. Agency issues allowed managers discretion in their choices of strategy. These problems were greatest in larger organizations, and those with mutual forms of ownership and those owned by governments. A combination of broader and more powerful market-based disciplines and the wide use of incentive remuneration contracts, together with demutualisation and privatization, moderated agency issues and reasserted ownership rights. With a greater focus on performance and shareholder value, managers were increasingly willing to adopt an internationalization strategy.

This optimistic view, the glass of strengthened corporate governance is half full, is contested in the work of a group of eminent commercial lawyers. For them the glass is half empty at best because the current pattern of board composition and the existence of

impediments to the operation of a market for corporate control and institutional activism combine to perpetuate agency problems. However, agency problems cannot be eliminated. They can be only be attenuated in a world of bounded rationality and opportunism [Williamson, 1985, 64-67]. There is a strong case that the goals of managers and owners are closer now than in the 1970s. Financial markets, institutional managers, venture capital firms, credit rating agencies, analysts and the business press are more judgmental of poor corporate performance today and regulatory changes have provided them with more remedies to discipline under performing managers than had been the case in the past. A number of high profile firms such as Qantas have welcomed their private equity buyouts as a means of escaping regulatory burdens and financial markets pressures for short-term results. In the longer term, corporations need external sources of funds to finance growth. Markets rewarded those well-performing firms with capital at lower cost. While Australian firms had access to international markets in their search for capital they now had to satisfy both foreign and domestic markets that they could generate a sufficient rate of return on the capital employed.

Table 1: CEO remuneration package, 1987-98

Per cent	1987	1990	1998
Fixed pay	90.5	81.7	50.4
Short term incentive	3.2	5.0	14.5
Long term incentive	6.3	13.3	35.2

Source: O'Neill, 1999, Table 2, 11.

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ii Changes in the definition of FDI post 1985, including lowering the threshold of equity holdings that qualify as being FDI from 25 to 10 per cent and valuing equity at market rather than book values, make comparisons before and after 1985 problematic [Australian Bureau of Statistics, 1987, 89-90].