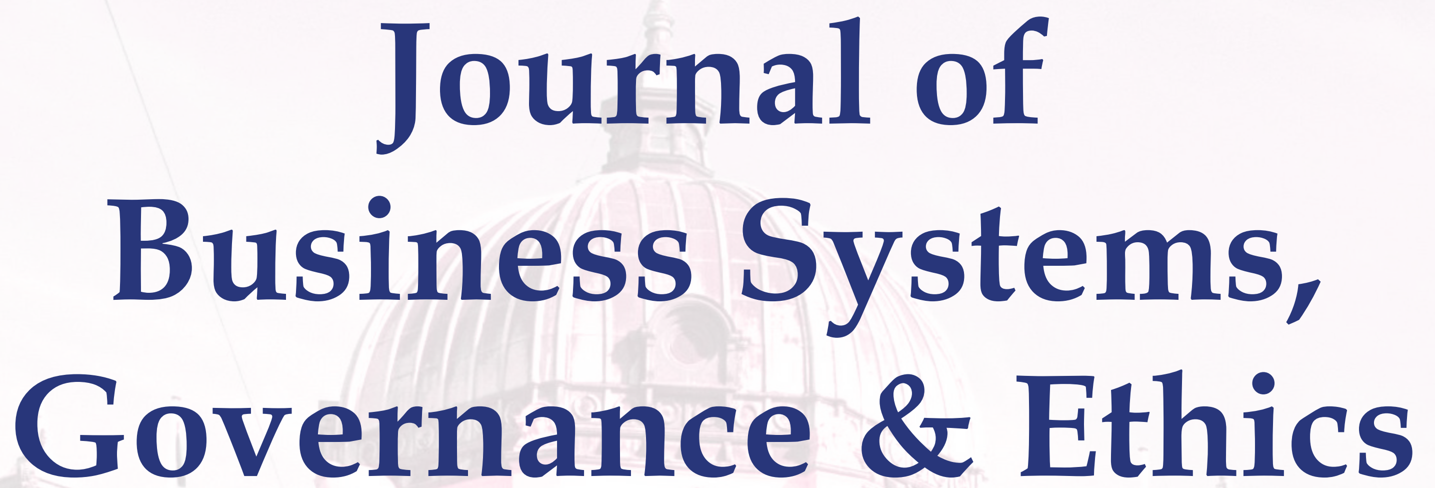

Journal of Business Systems, Governance & Ethics

Special Issue

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Journal of Business Systems, Governance & Ethics

Special Issue

Issues and Future Directions in the Regulation and Technology of Small Business Enterprises

Published By

School of Law
Victoria University

Vol 4, No 4, 2009
ISSN 1833-4318

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The *Journal of Business Systems, Governance and Ethics* is published four times a year by Victoria University in online format for no charge. Printed copies are available, for a fee, upon request.

All articles published in this journal were subject to a process of blind peer review by at least two reviewers before selection for publication by the Editorial Board.

Submissions are welcome for research articles of between about 5,000 and 10,000 words in any area relevant to the journal's coverage. Potential articles should, in the first instance, be sent to: Kumi Heenetigala at the Centre for International Corporate Governance Research: Kumi.Heenetigala@vu.edu.au

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Journal of Business Systems, Governance and Ethics

Vol 4, No 4, 2009

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Guest Editorial
Issues and Future Directions in the Regulation and Technology of Small Business Enterprises

Anona Armstrong
Victoria University

The papers in this edition of the Journal of Business Systems Governance and Ethics were initially presented at a conference that introduced the results of research conducted in two projects by the Governance Research Program of the Victoria Law School, Victoria University, into regulation and the use of information and communications technology (ICT) by small business.

The first project, **Developing a responsive regulatory system for Australia's small corporations** was supported by an Australian Research Council (ARC) Linkage grant in which the partners were the Australian Treasury and the Confederation of Small Business Organisations of Australia (COSBOA).

Australia's small corporations play a vital role in national economic and social wellbeing. They comprise more than 99% of all firms, employing more than 5 million people. Their regulatory needs, however, are largely ignored because regulation is aimed at large listed firms, and it is assumed there will be 'trickle down' compliance by small firms. This project draws together the experiences of small corporation owners/managers, regulators, the Federal Treasury, industry leaders and academic experts. Its prime focus is the regulatory environment of the Corporations Law. The aims of the project are to:

1. Identify and document the organising principles adopted by the regulators of Australian corporations in order to control, govern and regulate small corporations.
2. Identify and distil the particular Federal regulatory requirements relevant to the growth and expansion of small corporations.
3. Develop a map of the most effective regulatory framework to assist and enable optimum performance by small corporations.
4. Link item 3 to a law and policy reform agenda.

The first step in the project was to produce an annotated bibliography of the major studies of small business regulation. This provided a basis for developing a questionnaire to be used to interview a purposive sample of small business leaders on their views of regulation and how it can best be managed. The next stage will be a major survey of small business corporations located across Australia.

The project team brought together Professors Anona Armstrong and Andrew Clarke from Victoria University, Professor Michael Adams, University of Western Sydney, Professor Thomas Clarke, University of Technology, Sydney, Professor Ian Eddie University of the Southern Cross, Professor Dr Alice Richardson and Professor Phil Lewis University of Canberra.

The second project, **The use of Internet Reporting for Small Business** was made possible by the award of their major 2009 grant by the National Institute of Accountants (NIA). The project team were: Professor Anona Armstrong, Ms Kumi Heenetigala, Professor Colin Clark, Associate Professor Arthur Tatnall, Dr. Wei Dai, Professor Ronald Francis, and Professor Andrew Clarke.

The purpose of this study was to determine how accountants could assist small businesses to make better use of emerging web based technologies to communicate with their accountants. The research was supported by a major grant from the National Institute of Accountants. The paper in this volume of the JBSGE reports research in which twenty two accountants and their clients were interviewed to determine the potential adoption and use of web based information and communications technology to provide immediate on-going communication between small businesses and their accountants.

Most businesses now have computer based financial accounting systems. Many use E-Commerce or E-Business to share business information, maintaining business relationships and conducting business transitions by means of internet-based technology. The internet offers a range of services and opportunities including data exchange, mobile telephone, internet, intranet, and email. In the context of this study it specifically refers to two way interactive access by accountants with their small business clients. This mode of communication would enable ongoing monitoring of the small businesses and their performance and the provision of management accounting services to the businesses.

The main interface of small businesses with the regulatory bodies is through their accountants. Hence, how accountants interact and communicate with small business and the role that ITC can play in this is of central interest, not only to accountants and their small business clients but also to government. The research questions addressed in this paper were: What uses do small businesses currently made of ICT? What are some of the new opportunities offered by ICT to accountants? What are the barriers to the use of new technology? What are the benefits to accountants and their small business clients?

In recent times, there have been a number of State and National Government inquiries and reports that have addressed the issue of regulation in small businesses in Australia. Most have reported the difficulties encountered by small businesses in meeting the ‘regulatory burden’. All governments have expressed a need to reduce the amount of regulation. Post the global financial crisis, this is highly unlikely. An alternative approach is to address the question of how can the process of compliance with regulations be reduced.

In Australia the next generation of technologies will be made possible by the roll-out of the national broadband network at an estimated cost of $43 billion. The Australian Government is also investing $4 million in a Standard Business Reporting Program (SBR) based on XBRL. This technology policy initiative aims not only to reduce the administrative burden for business but has a clear set of policy objectives, including participatory democracy, improvements to government efficiency and effectiveness and transparency as a tool for accountability.

It is the above issues that have been the stimulus for the ***Regulation and Technology in Small Business conference*** and the publication of this issue on small business in the Journal of Business Systems, Governance and Ethics.

This issue of six papers begins with a review of government policy in regard to regulation of small business by Mr Geoff Miller, the General Manger Corporations and Financial Services Division, Australian Treasury.

The Corporations Act currently defines a small proprietary company as one that satisfies at least two of the following criteria:

- Consolidated revenue for the financial year of less than $25 million
- Consolidated gross assets at the end of the financial year of less than $12.5 million and
- Fewer than 50 employees at the end of the financial year.

Under this definition, around 98 per cent of Australia’s 1.6 million proprietary companies are classified as small and, with some exceptions, do not have to prepare annual financial statements and lodge them with ASIC. However, there are over 30,000 small and medium companies with must meet the full regulatory requirements.

Mr Miller pointed out that the current corporate governance regulatory environment is too heavily geared to large companies and that governance norms are based on the assumption that there is a separation between the ownership and management of a company, an assumption which is the exception rather than the rule in small corporations. Some government departments such as the Australian Taxation Office and regulatory bodies such as the International Accounting Standards Board have provided assistance or issued specific standards for small businesses that are intended to promote flexibility in small business responses to regulation. Treasury is considering whether similar provisions should be introduced for small businesses.

Mr Miller expects that the research and data from the first of the projects, especially in respect to three areas, (i) tailoring the replaceable rules in the Corporations Act to small corporations, (ii) modifying directors' duties and meeting requirements, and (iii) a draft governance code or other educational instruments, will help to reduce the burden on small business and play a valuable role in future policy development.

Members of the Research Teams are the authors of the remaining papers. Professor Michael Adams presents a review of the historical development of the Corporations Law from the co-operative agreements between the States in the late 1980s to the Corporate Simplification Law introduced in 1997 and the relevance of the Law for small businesses. This includes modification of the definition of 'small business', the introduction of a guide and details of the reporting requirements for small business. He concludes with an analysis and assessment of the impact on directors' duties and the role of governance through civil and criminal law, as applied to small corporations.

Thomas and Klettner in their paper on governance issues for small business discuss the difficulties imposed by the use of various definitions of small business.. These differ not only across different sectors and organisations within Australia but also vary across countries. The paper then explored the particular issues that governance regulations raise for small and medium enterprises (SMEs). The authors noted that the governance regime is designed to protect investors who buy publicly listed shares and is predicted on the assumption of the separation of ownership and management. This led to a discussion of how the structure and nature of SMEs differ from those of large corporations and to the results of their research. They interviewed nineteen directors and /or company secretaries of SMEs on the responses of their businesses to the *Corporate Governance Principles and Recommendatio*ns issued by the Australian Securities Exchange. In particular, they explored SME corporate governance structures and processes, how SMEs had chosen to implement the Principles in relation to appointing independent directors and establishing board committees, and the reasons for their choices. From the results the authors drew some conclusions about whether the ASX governance guidelines were appropriate for SMEs.

Some results from the research conducted on the use of the internet by accountants and small business are presented in the next paper by Kumi Heenetigal and Anona Armstrong. The purpose of this study was to determine how accountants and small businesses could make better use of emerging web based technologies to communicate. Twenty two accountants and their clients were interviewed to determine the potential adoption and use of web based information and communications technology to provide immediate on-going communication between small businesses and their accountants. Accountancy firms used a variety of financial analysis programs including MYOB, Excel, Quick, Books (/quicken and BankLink and electronic lodgement of Government returns (Taxation, BAS, Payroll tax, ASIC returns, WorkCover, etc) was widespread. Three quarters of the Accountants in this sample reported that their firm had a website. All the businesses used IT packages for a variety of tasks including client control, financial plans, receiving and transmitting information, liaising, making appointments, and on-line training. The business respondents identified the practical advantages of ITC as having ease of transfer of information and increased efficiency. The study found that among the barriers to adoption of ICT were cost, compatibility with existing systems and privacy issues.

The final two papers are indicative of the future direction of ITC for SMEs. Dr. Wei Dai describes the potential for new information and communications technology (ITC) to impact on the ways in which SMEs will do business and Professor Andrew Clarke concludes this edition with some suggestions for new approached to regulation policy.

New types of ICT are on the horizon. Dr Wei Dai's paper describes the potential access of SMEs to new types of ICT technology. These combine existing software systems, cloud technology and an application called the Phoenix program developed by the research team at VU. Cloud computing is the term used to describe off-business services delivered via the Internet which can be accessed by SMEs on demand. These services can include repositories, usual business systems or be extended to provide the equivalent of a private network tailored to a specific business need, such as balancing purchases from suppliers with customer needs. Phoenix provides the 'black box" that makes the services available to SMEs irrespective of the software systems used by the SME business. The first advantage of this ICT is that it is interactive; users can access the suite of programs on demand. Second these

sophisticated programs can be very costly to purchase by individual businesses but on-demand means lower costs due to access to a shared and serviced ICT service, and costs are directly attributed to use.

In the final paper Andrew Clarke noted the inherent paradigm conflict between regulators and the regulated. Regulators often are imbued with the objective of maintaining quality standards and perceptions of servicing an industry, while the regulated see regulation as an evil and a cost to doing business. Whilst much of the analysis in this area focuses on the apparently relentless growth of regulation, the corollary is to seek a more simple set of regulatory rules, especially for small, resource constrained firms. The paper presents two case studies that illustrate the problems. They address the questions: what are the contextual imperatives of regulation in Australia? How is regulation set up and what are the political attitudes towards it and theoretical options available? And what lessons can be learned from other countries. The paper concludes by canvassing the possibilities offered by ICT. Clarke states that one of the interesting ideas to be gleaned from regulatory practices is the notion of networks and informal networks. He suggests that if the regulators are using networks and swapping information and collectively gathering information and using it, then this practice may be usefully applied to the regulated market. That is, small businesses should behave more like the regulators and also begin to develop, between themselves, fairly complex and efficient informal networks. The network agencies could be the accountants' associations such as NIA or small business associations such as COSBOA.

In conclusion, regulation of small business sector is an important area of policy reaching across all government and economic activity in Australia. The research teams in both projects are grateful to the sponsors for their interest and support. We hope that this issue of the Journal will add to the knowledge and debate about the issues surrounding small business regulation and the use of ICT technology.

Developing a Small Business Regulatory System

Geoff Miller
The Treasury, Australia

Keywords

Policy, small business, corporations law

Introduction

Thank you for inviting me to share my thoughts on what the government is doing to reduce the burden on small business. I also look forward to hearing the other speakers talk about how to make the regulatory system more responsive and relevant to business needs.

It is more than a year since the fall of Lehman Brothers and the beginning of the Australian Government's response to the global financial crisis.

Today, the Australian economy is showing encouraging signs of recovery. The Government's policy responses have been largely responsible for placing Australia in a better position than most countries around the world.

The *Mid-Year Economic and Fiscal Outlook* (MYEFO) (released earlier this month) showed that the economy is performing much better than was forecast in the last Budget — MYEFO shows that Australia is the only advanced economy to have recorded positive growth through the year to June 2009. MYEFO also upgraded the growth forecasts for the following two years with consequental falls in the expected peak unemployment rate.

Although this is good news, the GFC has clearly affected, and is continuing to impact on, small business.

A number of Australian Chamber of Commerce and Industry surveys have reported large falls in small business confidence and conditions throughout 2008 and early 2009. However, the August *ACCI Small Business Survey* reports that, while conditions for small business are expected to remain challenging, conditions are stabilising.

This good news is supported by the most recent *Commonwealth Bank – ACCI Business Expectations Survey*, which shows that small, medium and large businesses are expecting business conditions to improve significantly during this quarter.

It is true that small businesses succeed or fail on the creativity, ingenuity, innovation and imagination of their owners and staff. It is also true that small businesses are notoriously time poor. When considering ways to improve the regulatory framework for small businesses it is important to weigh up the desire to minimise time spent by businesses on compliance, with maintaining the integrity of the market as a whole.

People in my position rely on people like you with the specific knowledge and expertise in small business matters to make sure that reforms are developed which benefit both the small business sector and the wider economy.

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Small Business Regulatory System

In May 2007, Treasury jointly hosted a symposium on corporate governance for small corporations with the National Institute for Governance at the University of Canberra. This symposium highlighted the complexity of governance arrangements for small businesses using a corporate structure, and raised a number of issues on the benefits of regulatory oversight.

The general view expressed at the symposium was that the current corporate governance regulatory system is too heavily geared to large companies. This is not a new criticism and given that the regulatory framework and governance norms for Australian companies are based on the assumption that there is a separation between the ownership and management of the company, it is not an unfounded criticism.

It is not surprising that the system was developed with the larger corporates in mind as the framework does reflect the reality that larger companies are directly responsible for a high proportion of output and employment.

From the symposium, we learned that in the interests of better targeted regulation and reducing red tape, it was important to improve understanding of how corporate governance requirements can be better tailored to meet the needs of small businesses using a corporate structure.

That is why Treasury is pleased to collaborate with Victoria University and the Council of Small Business of Australia on this project.

The driving factor underpinning any reform should be an economic one. Our focus during this project will be on making sure that corporate governance regulation improves the performance of all corporations, including small corporations, through improved efficiency, quality, accountability and integrity.

We anticipate that his project will examine the adequacy of the current corporate governance framework for small corporations and increase the knowledge base around three important questions.

Firstly, to what extent can the default governance rules, that is, the replaceable rules in the Corporations Act, be tailored to small corporations?

The success of the replaceable rules in the Corporations Act is based on how closely the rules reflect the terms that the parties themselves would most commonly choose. The replaceable rules are intended to save time and money for companies with more straightforward business affairs.

Both government and industry are seeking to close any gaps between the current governance arrangements and the current replaceable rules. It is through projects such as this that the knowledge base needed to identify those gaps can be developed.

Secondly, are there any mandatory governance rules, such as the directors' duties or meeting requirements, that should be modified or removed for small corporations?

While there is a clear case for making mandatory rules that serve a protective or disclosure function with sanctions for non compliance, there is a question as to whether some of these rules may be turned off, moderated or recast as default rules for small corporations. The desire to ease the regulatory burden on small business should be weighed against the need for consistency and certainty.

Thirdly, from a practical standpoint, Treasury would like to find out whether there is a call for guidance materials, such as a draft governance code or other educational instruments, to help reduce the burden on small business.

The setting up of benchmarks for best practice in corporate governance of small corporations is an exercise that has been taken up in other jurisdictions, but which has not been appropriately dealt with in Australia.

Problems occur when parties remain ignorant of rules – until a dispute arises. Small businesses incorporate for a variety of reasons and once incorporated, are subject to the same corporate governance requirements as large incorporated entities. Unfortunately, the level of knowledge of the regulatory obligations is difficult to gauge.

As I said earlier, it is through the development of a better knowledge base that we can gain a better understanding of the policies that will help small business to contribute more to the wellbeing of Australia.

Treasury expects that the research and data from this project, especially in respect to these three areas, will play a valuable role in supporting future policy development.

Financial Reporting

Of course, the regulatory system affecting small business extends beyond corporate governance obligations. Successive governments have been mindful that the Corporations Act's financial reporting requirements can be burdensome to business.

The introduction of the small/large criteria for proprietary companies in the late 1990s was a significant move towards reducing the regulatory burden for such companies. The Corporations Act currently defines a small proprietary company as one that satisfies at least two of the following criteria:

- Consolidated revenue for the financial year of less than $25 million
- Consolidated gross assets at the end of the financial year of less than $12.5 million and
- Fewer than 50 employees at the end of the financial year.

Under this definition, around 98 per cent of Australia's 1.6 million proprietary companies are classified as small and, with some exceptions, do not have to prepare annual financial statements and lodge them with ASIC.

The question is what is being done for the remaining 30,000 or so companies that are required to prepare financial statements and lodge them with ASIC? At present, these companies are required to prepare their financial statements in accordance with the full body of international financial reporting standards or IFRS.

A number of these companies are large listed entities and are required to prepare and lodge financial statements in accordance with IFRS. There are, however, some smaller, non-listed companies, which also have to prepare and lodge full financial statements.

Earlier this year the International Accounting Standards Board issued a standard on financial reporting by small and medium-sized entities that are not publicly accountable. This standard … usually referred to as IFRS for SMEs … seeks to reduce the financial reporting burden for smaller entities through the adoption of simplified recognition and measurement criteria, and a significant reduction in the number of items that must be disclosed in the financial statements.

A number of overseas jurisdictions have already decided to adopt this standard as the basis of financial reporting by their smaller entities.

The Australian Accounting Standards Board is currently looking at whether IFRS for SMEs should be used in Australia or whether we should develop our own SME standard based on the recognition and measurement criteria in the full body of IFRS and the disclosure requirements in IFRS for SMEs.

A paper is expected to be released shortly seeking stakeholder views on these options.

Treasury is also considering a number of other measures designed to reduce the burden the Corporations Act financial reporting requirements place on business. These include the possible introduction of differential reporting requirements for companies limited by guarantee – essentially those with a not-for-profit focus and revised reporting requirements for companies that are parent entities.

The Government will consult with business and the wider community prior to adopting any such measures.

Small Business Tax amendments

The Government has also introduced a number of tax measures to help small businesses in the current economic environment.

Reduction in pay-as-you-go instalments

The Government provided immediate and much needed cash flow relief to eligible small businesses by reducing their pay-as-you-go (PAYG) instalment amount by 20 per cent for the quarter that includes 31 December 2008. Broadly, the reduction applies to small businesses that make four quarterly PAYG instalments using the instalment amount calculated by the Commissioner of Taxation and printed on their Business Activity Statement —the GDP-adjusted notional tax method.

To provide further cash flow relief to small businesses the Government also reduced the PAYG instalment amounts for the 2009-10 income year for all taxpayers who pay quarterly instalments using the GDP-adjusted notional tax method.

Small Business and General Business Tax Break

The Government's *Nation Building and Jobs Plan* included a Small Business and General Business Tax Break to support Australian businesses — in particular small businesses — undertaking capital investment.

As part of the 2009-10 Budget, the Government expanded the Small Business and General Business Tax Break. Small businesses can claim a bonus tax deduction of 50 per cent — up from 30 per cent previously – of the cost of eligible assets acquired between 13 December 2008 and 31 December 2009, and installed by 31 December 2010. The tax break is available for most types of machinery and equipment used in business.

Research and development tax incentive

From 1 July 2010, the Government will replace the complex and outdated research and development or R&D tax concession scheme with a new R&D tax incentive that will cut red tape and provide a better incentive for business to invest in research and development. The new R&D tax incentive includes a 45 per cent Refundable R&D Tax Credit, available to companies with a turnover of less than $20 million — this is equivalent to a tax deduction of 150 per cent.

As an interim measure in the lead up to the new scheme, the Government has increased the expenditure cap for eligibility to the existing R&D tax offset from $1 million to $2 million from 1 July 2009. Lifting the expenditure cap provides a further boost to small pre-profit companies in research intensive industries.

ATO assistance to small business

The Government provided around $100 million to support small businesses experiencing difficulties meeting their tax liabilities as a result of the global recession. Early and tailored assistance from the ATO helped viable but struggling businesses stay in business helping to support Australian jobs.

Further, the Commissioner of Taxation announced new measures to support small businesses owing tax. These include a 12-month interest-free debt repayment arrangement for businesses with turnovers of up to $2 million that are struggling to meet their obligations and an interest-free deferral of the payment due date on activity statement liabilities to help small businesses manage short-term cash flow problems.

Standard Business Reporting

I would also like to talk about the Standard Business Reporting initiative currently being driven by the Treasury, which I expect to have profound practical implications for small businesses.

Under this initiative, reporting by businesses — for example, their Business Activity Statements — to the main government agencies — including ASIC, APRA, ATO, state revenue offices and the ABS will be streamlined. Business-to-government reporting will be simplified by:

- Removing unnecessary information from forms
- Adopting a common reporting language
- Providing business with a single secure online sign-on to the agencies involved
- Utilising software to pre-populate government forms
- Providing an electronic interface to report to government as a by-product of business processes.

This initiative directly attacks compliance costs and is expected to save businesses around $800 million each year following full implementation.

By being able to understand the requirements better, business will be able to self-prepare and lodge their reports easily and quickly. In return, businesses will be better able to access to up-to-date financial information, more readily share financial/accounting data and more comprehensive audit trails.

It is expected that financial statements that result from the use of International Financial Reporting Standards and the SBR taxonomies will be compliant and reliable, providing further benefits to businesses that operate internationally.

Pilot projects to implement SBR are being undertaken with further progress expected in 2010.

Conclusion

Our work in Treasury, and the work of Victoria University in researching policies to reform small business regulation, will augment the work being undertaken by the ATO and other agencies to address the concerns of small business. Allowing small businesses to earn a fairer share from the growth in the economy as the world emerges from the GFC is a significant policy challenge, but one where we think there is a high probability of success.

Twenty-Year Snapshot of the Developments in the Regulation of Small Corporations

Michael Adams
University of Western Sydney, Australia

Abstract

This paper explored the history of the regulation of corporate bodies through State and Commonwealth systems beginning in 1989 that resulted in the development of the legislation impacting on small proprietary company for over 20 years. The introduction of the Corporate Governance Principles for listed companies by the Australian Securities Exchange added another layer of regulation intended to promote transparency and accountability. Research into corporate governance in small companies showed that, in contrast to opinions about the US Legislation, very few Australian companies expressed negative views about corporate governance regulation. The most recent addition to corporate governance regulation has been the expectation that companies have a responsibility for corporate social responsibility. This was illustrated by the James Hardy Industries case.

Keywords

Regulation, small corporations, close corporations, James Hardy Industries

Introduction

When the Australian Constitution was enacted the country's leaders envisaged that company law would be left to the States and it was not a matter for the newly established Commonwealth of Australia to be concerned with at all. In the following years, the various State *Companies Code* statutes worked reasonably well with state corporate affairs departments and a basic national regulator known as the National Companies & Securities Commission. However, by the late 1980s companies were moving across local and state boundaries to national distribution of goods and services. The expansion across state borders meant that companies found the need to register and comply with regulations in each state a source of annoyance and increasing cost. In this environment it was mooted to move to a federal law to govern all companies across Australia. However, the introduction of a federal scheme did not happen smoothly. The history of its development and adoption is described below. Of particular interest is the 'close corporation" model of regulation which could be relevant to small corporations.

Early schemes

Administrative recognition of the need for a uniform law and practice for the regulation of corporations in Australia dates back to the late 1950s. Uniform companies legislation was passed throughout Australia from 1961 to 1963, a result of a cooperative drafting effort using the Companies Act of 1958 (Vic) as a model. Similar, though not identical, Marketable Securities Acts were passed in the states and territories from 1966 to 1971.

Attempts to establish a National Companies Act and Corporations and Exchange Commission, in response to the

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1974 Report of the Senate Select Committee on Securities and Exchange, were frustrated by the prorogation of Commonwealth Parliament on 11 November 1975. However, in 1976 Victoria, New South Wales and Queensland formed the Interstate Corporate Affairs Commission for the uniform administration of corporate legislation. In response to this and other initiatives, a Formal Agreement between the Commonwealth and all states was made on 22 December 1978, whereby Commonwealth legislation would be applied in each of the states and the National Companies and Securities Commission would be empowered to regulate the states' application of the Commonwealth's laws.

Pursuant to the Formal Agreement, the Commonwealth Parliament passed the National Companies and Securities Commission Act 1979 , and the following co-operative scheme Acts:

- Securities Industry Act 1980 , operative 1 July 1981;
- Companies (Acquisition of Shares) Act 1980 , operative 1 July 1981;
- Companies and Securities (Interpretation and Miscellaneous Provisions) Act 1980 ,
- operative 1 July 1981;
- Companies Act 1981 , operative 1 July 1982; and
- Futures Industry Act 1986 , operative 1 July 1986.

Each state and the Northern Territory passed legislation applying the co-operative scheme Acts "to the exclusion of" the existing state legislation. The Acts applied directly to the Australian Capital Territory. The co-operative scheme was thus instituted. Its key features were:

- substantially uniform legislation applied to all jurisdictions;
- a Ministerial Council, comprising federal and state ministers, to review the laws, supervise their administration and request amendments;
- the National Companies and Securities Commission (NCSC), accountable to the Ministerial Council, to administer the laws and review the regulation of the corporations and securities industry;
- the state Corporate Affairs Commissions, continuing as the state delegates of the NCSC, to administer the laws "having regard to the principle of maximum development of a decentralised capacity to interpret and promulgate the uniform policy and administration of the co-operative scheme";
- the Companies and Securities Law Review Committee to research and report on aspects of companies and securities regulation at the request of the Ministerial Council;
- the Accounting Standards Review Board to develop approved accounting standards for use by persons regulated by the scheme;
- the Ministerial Council could request the Commonwealth Parliament to pass amendments to the laws, failing which the states had the power to individually implement the agreed amendments; neither the Commonwealth nor any state could unilaterally introduce amendments.

By 1986, the introduction to the successor to the co-operative system was in train. A timeline of the events that led to the creation of a national corporate law system based on a federal system is provided in table 1.

The legislative package to introduce a national corporations law was first presented to the House of Representatives on 25 May 1988. It was commissioned as a response to many perceived weaknesses in the co-operative scheme, to achieve "for the first time in the nation's history a single and truly national regulatory regime that can guarantee a sound and well-regulated environment for corporate activity": the Attorney-General in parliament on 8 November 1990. The primary difficulties with the co-operative scheme were the inconsistencies and duplications which arose in the provincial administration of laws regulating corporations with national dealings.

However, the States were reluctant to relinquish their ownership of their companies and the revenue derived from registration and three states challenged the power of the Commonwealth to regulate business activities. In response, the High Court in *New South Wales v Commonwealth (Incorporation Case)* (1990) 169 CLR 482 held the provisions for the formation of new companies to be

constitutionally invalid. The Commonwealth's ability to legislate for the regulation of corporations is limited by enumerated heads of power bestowed on it by the Constitution.

Table 1. Events leading to the introduction of national Corporations Law

25 May 1988	The Australian Securities Commission Bill, the Corporations Bill, the Close Corporations Bill introduced to the House of Representatives.
1 July 1989	Parts 2 to 9, 13 and 15 (concerning just ASC itself and court jurisdiction) of the Australian Securities Commission Act proclaimed to commence.
27 June 1989	The Australian Securities Commission Act 1989 receives Royal Assent. Part 1 commenced operation.
1July 1989	Australian Securities Commission Parts 2-9, 13, 15 proclaimed
14 July 1989	Remaining legislation received Royal Assent Preliminary provisions of the corporations Act and Close Corporation 1989 commence operation
August 1989	3 States challenge the constitutional validity of the corporation Act: operative provisions n postponed
8 Feb 1990	The High court in New South Wales v Commonwealth (Incorporation Case) 1990 holds provisions for formation of new companies constitutionally valid
29 June 1990	Commonwealth, state and Northern Territory ministers meet at Alice Springs to overcome the consequences of the High Court decision. Heads of agreement are reached on "Future Corporate Regulation in Australia", comprising the key elements of the national scheme -- another co-operative legislative system administered by the Australian Securities Commission.
14 Nov 1990	The Corporations Legislation Amendment Bill 1990 passed
13 Dec 1990	Senate passes legislation: Act No 110 of 1990
Dec 1990	The Corporations [State] Acts are passed.
1 Jan 1991	Operation commenced
1 Feb 1993	Amendments of the Corporate Law Reform Act set new standards in directors ' duties and civil penalties applied to breaches
23 June 1993	Rules relating to 'voluntary administration" and insolvent trading provisions applied only to directors
17 Oct. 1995	First Corporate Law Simplification Act 1995 (Cwth) receives Royal Assent
9 Dec. 1995	Repeal of the Close Corporations Act 1989 Cwth) and associated legislation
1999	Corporate Law Economic Reform program (CLERP)
15 July 2001	Corporations Act 2001 (Cth) (Corporations Act) and the Australian Securities and Investments Commission Act 2001 (Cth) (ASIC Act)

The dissenting judgment of Deane J extended the placitum power to include the formation of trading and financial corporations on the principle that such a plenary grant of legislative power should be construed liberally to avoid an unacceptably narrow and technical construction of the words. The decision also applied by extension to the Close Corporations Act.

Following the court case the Commonwealth, State and Northern Territory ministers met at Alice Springs agreement was reach on another co-operative legislation system that was ratified in State Parliaments and administered by the Australian Securities Commission. The Corporations ([State]) Acts passed, applying the Corporations Law and ASC Law to the various states were: NSW (Act No 83 of 1990); Victoria (Act No 80 of 1990); Queensland (Act No 98 of 1990); Western Australia (Act No 105 of 1990); South Australia (Act No 66 of 1990); Tasmania (Act No 41 of 1990); Northern Territory (Act No 56 of 1990).

The Corporations Legislation Amendment Bill 1990, implementing the Alice Springs Agreements, was introduced to the House of Representatives. The bill did not deal with the Close Corporations Act, leaving that legislation in constitutional limbo. The bill is passed on 14 November 1990.

Although the new law was in operation the opportunity to revamp and streamline some of the more unwieldy provisions of the superseded Companies Codes had not been taken. This was addressed by the Corporations law Simplification Task Force established by the Commonwealth Attorney-General in 1993. Responsibility for corporate law reform moved from the Federal Attorney-General department to the Commonwealth Treasury department. The Simplification Task Force was replaced in March 1997 by the Corporate Law Economic Reform Program. In 1999 a major overhaul of the Corporations Law was completed with the passage of the Corporate Law Economic Reform Program Act 1999; and in *Re Wakim; Ex parte McNally* (1999) 198 CLR 511; [1999] HCA 27 the High Court found the cross-vesting legislation, which formed the basis of the national scheme, to be constitutionally invalid.

In response to the decision in *Wakim*, New South Wales was the first state to enact a Federal Courts (State Jurisdiction) Act 1999. Other states and territories followed suit with similar legislation. The main purpose of the legislation in each state was:

- to provide that existing ineffective judgments of a federal court in the purported exercise of state jurisdiction are taken to be judgments of the Supreme Court;
- to provide for the transfer of current proceedings before a federal court in relation to state matters to the Supreme Court; and
- to enable state courts to deal with matters that arise under applied law schemes and that would otherwise be dealt with by a federal court.

In November 1999 the Council of Chief Justices of Australia and New Zealand has announced the completion of the project to harmonise the Rules of the Supreme Courts of each state and territory and the Federal Court for proceedings under the Corporations Law. It was a project undertaken with urgency in the aftermath of the High Court's decision in *Wakim*.

Further constitutional uncertainty dogged the national scheme with the High Court decision in *R v Hughes* (2000) 202 CLR 535; [2000] HCA 22. In that case the High Court unanimously upheld the power of the Commonwealth Director of Public Prosecutions (CDPP) to prosecute a person for alleged offences against s 1064(1) of the Corporations Law of Western Australia. The DPP's power was upheld on the ground that the alleged offences fell within the ambit of the Commonwealth's external affairs power and its overseas trade and commerce power. *Hughes* has given rise to great uncertainty as to the CDPP's powers to prosecute for other kinds of offences, and also the exercise of powers and functions by ASIC, under many provisions of the state Corporations Laws.

In his judgment in *Hughes* Kirby J observed:

> *The accused's arguments thus present a challenge to the scheme adopted for the regulation of corporations in Australia, of which the Corporations Law is the centrepiece.*

> *Unless the offences provided in the Corporations Law are valid and may be the subject of prosecution in Western Australia by the CDPP the legislative and administrative scheme for the regulation of corporations in Australia would collapse.*
>
> *Without enforceability, the Corporations Law would be no more than a pious aspiration.*
>
> *This court should be the upholder and not destroyer of lawful cooperation between the organs of government in all of the constituent parts into which the Commonwealth of Australia is divided.*

In the aftermath of *Hughes*, at a special meeting of the joint Standing Committee of Attorneys-General and Ministerial Council for Corporations in Melbourne on 25 August 2000, the states unanimously agreed to make a broad referral of power to the Commonwealth to restore confidence in the national scheme of corporations law. In a joint statement to the media Federal Attorney-General Daryl Williams and Minister for Financial Services and Regulation Joe Hockey welcomed the outcome:

> *... this is an historic agreement that will provide constitutional certainty for corporations law ... this is another step towards Australia positioning itself as a centre for global finance.*

Each state passed a Corporations (Commonwealth Powers) Act 2001 to formally refer the corporations power to the Commonwealth. The federal Corporations Act 2001 (Cth) (Corporations Act) and the Australian Securities and Investments Commission Act 2001 (Cth) (ASIC Act) were both assented to on 28 June 2001. Both statutes were proclaimed to commence on 15 July 2001. The majority of section numbers referred to in the Corporations Law were given the same number and wording in the Corporations Act 2001. There have been many amending statutes since that time, which continue to refine and reform the current *Corporations Act* 2001.

Section 51(xxxvii) of the Federal Constitution is the head of power enabling state governments to refer their power to regulate companies to the Commonwealth. Where amendments to the Law and ASIC Act are necessary, the meeting agreed that the referral should permit amendments relating to the formation of corporations, corporate regulation and the regulation of financial products or services.

The process of amendment is subject to provisions of the Corporations agreement. It was further agreed that the referral should be subject to a sunset clause. It was reviewed and renewed for a further five years, but could be terminated after the additional five years. “The referral can be extended by agreement”, said the joint statement. “The cooperative approach at today’s meeting is evidence that all the states and territories recognise the importance of long term certainty for corporations law in Australia.”

The most observable feature of the new scheme was the operation of the Corporations Act and its national implementation of the Corporations Law. Equally important was the replacement of the National Companies and Securities Commission and its state delegates, the Corporate Affairs Commissions, with the sole entity of the Australian Securities Commission (ASC), now the ASIC. Nevertheless, interpretation of the Commonwealth Constitution prevented the scheme being implemented at a federal level without state collaboration.

The incorporation of a variety of Acts into the Corporations Law was designed to simplify the interpretation and implementation of the substantive law. Also, some significant changes were made to Australia’s corporations and securities legislation. However, the opportunity to revamp and streamline some of the more unwieldy provisions of the superseded Companies Codes had not been taken. Most provisions were transcribed straight from the former legislation. This was being addressed by the Corporations Law Simplification Task Force established by the Commonwealth Attorney-General in 1993.

The referral of power under the Australian Constitution from the states/territory to the Commonwealth was fully effective from 15 July 2001, with the royal assent of both the Corporations Act 2001 (Cth) and the Australian Securities and Investments Commission Act 2001 (Cth). However, there have been a few cases which have challenged the constitutional basis of the corporate statutes and, in particular,

the transitional provisions. The saving provisions between the Corporations Law and the Corporations Act have been tested a number of times. In particular when actual events straddle the operation of the corporations Law (in the first half of 2001) and the technical breaches occurred after 15 July 2001. An example is *ASIC v Macdonald (No 11)* [2009] NSWSC 287 where the James Hardie Industries Limited converted to James Hardie Industries NV during this period. Justice Gzell stated that equivalent law was to be applied for the event in February 2001 (the ASX announcement as to the fully funding the trust fund for asbestos victims) as to the events later in the year when the company transferred to a Netherlands based company.

In the period described above where the corporations Law has emerged from a cooperative agreement between the States to a national law supported by a fully funded regulating authority the numbers of corporations in Australia and the number of cases has grown substantially.

Australian Registered Corporations and the Corporations Law

Over the last 19 years, Australian registered companies have grown from 892,749 to the current figure of 1,700,891. The *Australian Current Law Reporter* produced by LexisNexis classifies case law into discipline categories, of which category 120 is dedicated to “Corporations”. In Table 2 it can be seen that all superior court decisions in Australia are recorded and that any matters relating to corporate law are separately recorded. As you would expect only a few corporate law cases make it all the way to the High Court of Australia.2. Over the 19 year period, 46 HCA cases have been dealt with and mostly relate to Constitutional matters. The Federal Court has grown its corporate jurisdiction but the dominate case load is carried by the various State/Territory4 supreme courts.

The majority of cases which have been recorded (5,852 corporate law cases up until September 2009 since the commencement of the federal corporations law) would relate to private companies rather than public companies. Approximately 90% of the cases are in respect of private companies and two-thirds of all litigation relate to companies in financial trouble (in liquidation or formal administration).

Table 2. LexisNexis Australian Current law Reporter 1991-2009 (Sept).

Year	No. Co’s	All Cases	Total	HC	%Total	FC	%Total	SSC	%Total
1991	892749	4797	275	0	0.36	47	17.09	227	82.55
1992	859678	5019	260	3	1.15	51	19.62	206	79.23
1993	839593	5406	260	3	1.15	67	25.77	190	73.08
1994	885118	5939	290	3	1.03	72	24.83	215	74.14
1995	933652	7835	238	6	2.52	68	28.57	164	68.91
1996	965461	6918	286	1	0.35	92	32.17	193	67.48
1997	1,026206	7544	239	1	0.42	93	38.91	145	60.67
1998	1,088192	7510	295	4	1.36	87	29.49	204	69.15
1999	1,149297	6718	312	4	1.28	69	22.12	239	76.60
2000	1,195851	7397	250	5	2.00	10	4.00	235	94.00
2001	1,224207	8002	341	4	1.17	21	6.16	316	92.67
2002	1,251237	8071	351	1	0.28	49	13.96	301	85.75
2003	1,299985	8109	399	0	0.00	116	29.07	283	70.93
2004	1,359305	7949	375	0	0.00	122	32.53	253	67.47
2005	1,427573	6554	386	1	0.26	96	24.87	289	74.87
2006	1,411421	4504	441	2	0.45	173	39.23	266	60.32
2007	1,572054	4493	324	3	0.93	124	38.27	197	60.80
2008	1,645805	n/a	207	4	1.93	89	43.00	114	55.07
2009	1,700891	n/a	323	1	0.31	107	33.13	215	66.56
TOTAL			**5852**	**46**	**0.67**	**1553**	**21.07**	**4252**	**63.67**

It has been possible to access ASIC data of companies registered in Australia under three classifications: public companies by shares (including ASX listed entities); other public companies, such as by guarantee and proprietary companies (private). Unfortunately, it is not possible to sub-divide proprietary companies into small and large, but they represent consistently over 98% of all registered companies.

Complexity of Corporate Regulation

This has imposed greater duties and responsibilities of officers and directors than ever before in the courts. The complexity of the modern corporate legislation and ever-growing case law, can be quite imposing upon directors with little legal training or education. Before 1991, Australia had a state-based corporate law scheme, as the Australian Constitution provided that commercial law and in particular the regulation of companies was a state-matter. When the Commonwealth of Australia (Federal Government) proposed to shift corporate law to a single act of parliament in 1989, it became law in 1991. Sir Anthony Mason CJ5 wrote in 1992 "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."[1]

By 2009 one would have hoped that the world of corporate law and regulation would be so much simpler! Unfortunately, Justice Graham in *Ku v Song* in 2007 stated "Whoever coined the expression 'as clear as mud' " must have been slaving over the extraordinary, and unnecessarily complex provisions of the Corporations Act and the Corporations Regulations….Gaining an understanding of the relevant law on this subject [share transfers] back in 1961 involved a five minute exercise…Today, it requires hours of study, reference to numerous sections and regulations…Why the law had to be expressed in such an obscure way beggars belief.".[2]

Close Corporations – 1988 Proposal

Today the corporations law describes companies as 'public' or proprietary' but does not distinguish between regulation of small or large corporations. In 1988, as part of the reform of corporate law from the State/Territory system to a national scheme, it was proposed to adopt a "close corporation" system. This would have created three main types of companies, public, private and close. The public companies would attract investment from the public via prospectuses and have the ability to have their shares publicly traded. Private companies (keeping the traditional Australian term "proprietary") would have up to 50 investors, but not be allowed to be listed on an exchange. The close corporation would be limited to only 20 members and would be closer to a limited partnership model.

Close corporations have been successful in South Africa (which the Australian bill was model on) and a number of States in North America. Unfortunately, the Constitutional difficulties relating to the national scheme produced meant that as a political compromise, the close corporation bill was dropped in favour of the single corporations law bill and the single regulator (the Australian Securities Commission).

Small Proprietary Companies

Although the close corporations bill did not create a new entity, the Federal Attorney-General's Department noted the demand for an easier regulation of small to medium sized entities (SMEs). Section 112 *Corporations Act* 2001 (Cth) only provides for the registration of public or proprietary companies. The type of company is not linked to size, but to the ability of the public to make investment and the number of shareholders that a company may have. Proprietary companies are limited to a maximum of 50 shareholders and public companies are unlimited.

In 1995, as part of the *First Corporate Law Simplification Act*, it was proposed that proprietary companies would be divided into small and large. The definition of small proprietary was based on

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1 Anthony Mason, "Corporate law: The challenge of complexity" (1992) Vol 2 (1) Australian Journal of Corporate Law p.1

2 KU v Song [2007] FCA 1189 @[175]. Quoted from Harris, Hargovan & Adams, Australian Corporate Law LexisNexis 2008 p.vii.

satisfying a two-out-of-three criteria in a financial year. The criteria related to consolidated gross revenue of $10 million; the value of consolidated gross assets of $5 million and fewer than 50 full-time employees. If the company was greater than these amounts it was deemed a large proprietary company.

By June 2007 the criteria in s 45A (2) *Corporations Act* 2001 (Cth) for a small proprietary company was increased to:

- consolidated gross revenue of less than $25 million;
- value of consolidated gross assets less than $12.5 million; and
- fewer than 50 full-time equivalent employees.

A large proprietary company is defined in s 45A (3) as greater than the specified amounts for a financial year. It is important to note that a company is not actually registered as small or large; it is a definition that is applied by the regulator, ASIC, based on the information supplied by the extract of particulars (the old annual returns) each year, with the annual renewal fee.

The importance of the distinction relates to disclosure purposes of a company and the requirement to produce formal accounts and auditing. Thus, a large proprietary company has the same reporting requirements of annual accounts (balance sheet, profit & loss etc) and audit requirements as a public company. 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.

One of the other benefits to come out of the *First Corporate Law Simplification Act* 1995 (Cth) was s 111J (Part 1.5 Small business guide) of the *Corporations Act* 2001 (Cth). This was an attempt to summarise in plain English the main provisions of the corporate law statute into a few pages to cover SME corporations. The structure of the *Small business guide* is 12 simple headings with a brief explanation of the law, with cross-references to the exact sections in the *Corporations Act* 2001 (Cth). The headings included:

1. what registration means
2. the company structure for small business
3. setting up a new company
4. continuing obligations after the company is set up
5. company directors and company secretary
6. shares and shareholders
7. signing company documents
8. funding the company's operations
9. returns to shareholders
10. annual financial reports and audit
11. disagreements within the company
12. companies in financial trouble

One of the most useful tables in the *Small business guide* is a list of the notifications required to be sent to the regulator. It is a series of eight statements which start "If..." a company issues shares or changes director etc and then states how many days before the regulator must be notified (28 days or 7 days or whatever) and what is the key section in the *Corporations Act* 2001 (Cth). This particular table is useful to all companies, even large proprietary as well as public companies.

Australian Corporate Governance Research

So as to address the question of corporate governance a research team based at the Centre for Corporate Governance of the University of Technology Sydney, spent three years (2005-2007)

examining the extent to which the Australian corporate governance reforms have caused changes at a practical level within companies. The study, entitled *The Changing Roles and Responsibilities of Company Boards and Directors*, was focused on qualitative changes in thinking and behaviour rather than on quantitative measures of compliance. It can be distinguished from the ASX's annual surveys of corporate governance reporting and provides evidence to support some of the findings of those surveys (ASX, 2007). The research also offers qualitative support for recent corporate governance surveys conducted by Chartered Secretaries Australia (2007) and the BDO *Mid-Cap Corporate Governance Report 2007* which looked at 150 annual reports to determine a "tick a box approach" to governance.

Some of the points relevant to SME corporations are picked up in the research. In light of the changes made by companies, it considers whether Australia has found the right balance in its corporate governance regime. On the basis that both the costs and benefits are difficult to precisely pin down, it is not an easy balancing act to achieve. Nevertheless, Australia appears to be on the right track in terms of developing a useful and well-balanced corporate governance system.

Summary of Australian Research Findings

For most companies, implementation of corporate governance regulation proved a gradual process of formalisation and improvement rather than an outright transformation. Across all sectors of Australian business surveyed there was evidence of intelligent engagement in corporate governance and professionalism in its implementation. To a degree this may have been a reflection of the interest in corporate governance of the companies and interviewees, the majority of whom demonstrated themselves to be highly informed directors, company secretaries and legal counsel.

Engagement with the ASX Principles has proved a positive process in this sample of companies and to a large extent they have tailored their corporate governance structures to fit the needs of the organisation. Risk management systems had an obvious value in improving information flow and promoting better decision-making.

The research clearly revealed that the corporate governance practices appropriate for a company change as the business grows and develops. The governance needs of start-ups and small enterprises are very different from those of mature ASX 100 companies. The role of the board and directors changes over time and board composition ought to reflect the needs of the company rather than conforming to any particular formula.

Rules-Based and Principles-Based Approaches to Reform

The ASX Corporate Governance Principles set out the requirements for best practices in governance expected of Australian listed companies. The Principles and their Guidelines are not mandatory, enshrining the *'if not, why not'* or *'comply or explain'* principle by which companies that do not wish to comply with particular guidelines can explain their reasons for non-compliance to the market. This was first applied in the UK 1992 *Cadbury Report*. This kind of market regulation can be less costly to comply with than prescriptive legislation because it acknowledges that one size does not always fit all. In contrast to black letter law, the ASX Principles are more adaptable to changes in best practice and easier to keep up to date and relevant. Additional advantages include the fact that the Principles were able to be produced relatively quickly and were designed by experts with relevant industry knowledge, who together represented every part of the investment and corporate value chain.

The alternative regulatory approach of using prescriptive law has been adopted historically by the United States. Continuing this legal tradition the *Sarbanes-Oxley Act* of 2002 (SOX) prescribes governance practices that must be followed and which can be enforced by way of penalties for non-compliance.[3] SOX was a direct response to the collapses of Enron and WorldCom and has been

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[3] See e.g. McDonnell B. (2004) 'Sarbanes-Oxley, Fiduciary Duties and the Conduct of Officers and Directors' *University of Minnesota Law School, Legal Studies Research Paper Series*, Research Paper No.04-13

widely criticised as a knee-jerk reaction that imposes unreasonable costs on business. A concern of the rules based approach of SOX is that it has encouraged, both internally and externally, a heavily bureaucratised technical approach to auditing, that makes for inflexible processes and involves significant costs.[4]

In contrast principles-based approaches are not as rigid in implementation, and improvements in standards of practice can be encouraged over time. Principles work to influence a broad set of practices meeting the expectations of the stakeholder community at large.

The Debate on Regulation in Australia

The debate, about the need for regulation on the one hand and on the other hand the burden that regulation imposes is a long running one in Australia and other countries. However, most criticisms of over-regulation encountered in this research were not about corporate governance regulation *per se*. Participants complained about regulation in the areas of occupational health and safety, financial services, food and drug safety, local government planning, accounting standards and money laundering. Indicative of the views about Australian corporate governance regulation was:

> *In Australia, my view is that where we are now is about where we want to be. If we take it a few steps further companies will no longer be in control of themselves – their destiny would be in the regulators' hands, which is not where it should be"*

Interviewees regarded the United States corporate governance regulation as a different matter. All participants who had been affected by SOX, particularly because of a U.S. listing, said that it was out of proportion and very costly. Perhaps the favourable view of the Australian regime is a consequence of the belief that the alternative could be a lot worse. As one respondent said:

> *I don't think Australia's reforms are too bad. SOX is a great overcompensation – the cost has been extraordinary. Certainly its cost us half a million and the ongoing things – internal and external auditors etc.*

The prime reason why SOX is disliked is because companies feel that the costs outweigh the benefits. It is this cost-benefit equation that determines whether regulation is seen as good or bad; whether the company feels regulated or over-regulated. The fact that there was little complaint about the ASX Principles suggests that they have, for the most part, succeeded in finding the right cost-benefit ratio.

The Hon Justice Neville Owen outlined in 2008 his top five directions to lift corporate governance and professionalism, as follows:

1. Commitment to an ethical framework for decision-making;
2. Notion of compliance;
3. Need for education on fiduciary principles and instil ethical values;
4. Performance, not conformance by avoiding just the 'tick boxes' approach; and
5. Critical responsibilities of the legal and accounting professions.

One area of corporate governance over which shareholders seem to have very little control is the annual general meeting (AGM). The Federal Minister for Corporate Governance, Senator Nick Sherry, in late April 2008, stated that a review is necessary but does not expect real changes as there is no systemic problem with Australian corporate governance! However, a proposal is being considered for an overhaul to shareholders meetings to bring them into the 21st century and address the decline in attendance.[5]

Also, Chartered Secretaries Australia (CSA), the Australian Division of the Institute of Chartered Secretaries and Administrators) released a discussion paper[6] in May 2008 entitled "Rethinking the AGM" which followed a roundtable discussion with the law firm Blake Dawson in February 2008.

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4 Branson, D. M., "Too Many Bells? Too Many Whistles? Corporate Governance in the Post Enron, Post WorldCom Era" (February 26, 2006). Available at SSRN: http://ssrn.com/abstract=887176.

5 Patrick Durkim; "Pack 'em in: Plans to get investors back to AGMs" (2008) 21 May, *Australian Financial Review* p 8.

6 Download the paper at <www.CSAust.com>

The CSA issued a *Benchmarking Governance in Practice in Australia* report in April 2008 which showed the cost of a large AGM is AUD$2.08 and $3.31 for a medium size listed company. This amount is paid on top of the share registry costs of $9.32 and $7.31 per shareholder.[7] Only 11.1% of respondents had over 300 people present at their AGM and 41.3% had fewer than 100 shareholders present. This means that for large companies only 1.52% of the membership body attend AGMs in person and 0.7% of medium sized listed companies. The use of webcasting for AGMs has increased from 47% in 2001 to 73.1% for large companies and from 15% to 45% for medium sized companies. Of course, none of these are a real burden to an SME corporation!

Case Study: James Hardie Industries (2009) – movement from corporate governance to corporate social responsibility?

All governance professionals should now be on notice that the principles and concepts on corporate governance (Klettner et al 2007) as expressed in corporate law have now moved towards including more onerous corporate social responsibility concepts. The 23rd April 2009 is not quite an ANZAC Day equivalent, but it can be interpreted as a watershed in the development of Australian corporate law. Justice Gzell handed down a 194 page judgment (broken up into 1313 individual paragraphs) to explain why the James Hardie Industries Group (JHI) of companies and its officers[8] had misled the public and investors as to the funding of future asbestos claims. JHI believed they had "ring fenced" any current or contingent liabilities that might arise out of the asbestos claims arising from their building products over the previous 75 years. [9]

It is worth noting that by 1978 JHI and its subsidiaries had overwhelming evidence of the dangers of asbestos products and as such warning labels were attached to products. The corporate body finally made a decision to stop all production in Australia in 1987. The size of the outstanding liability has been a core contentious issue and the expert actuaries have had to work hard to make accurate "estimates". But it is a fact that approximately 50% of all claims made to the NSW Dust Diseases Tribunal relate to JHI products.

Corporate Governance to Corporate Social Responsibility

By 2001 the management and the board of directors had decided to reorganise themselves to be a Netherlands based company named JHI NV. This was an extremely complex matter for any company to organise as there were so many subsidiary companies spread throughout the world. The only legal methodology that is available under corporate law is known as a scheme of arrangement, and this requires the court's permission as well as the shareholders consent to the changes. A variety of reasons were given for this reorganisation including taxation and business costs (savings) and that the appropriate level of funding for future asbestos victim claims would be met through a trust (Medical Research and Compensation Foundation – MRCF). The true motive behind the reorganisation has never been publicly stated and still remains quite unclear, apart from it was agreed by the board of directors on a business case, but the general community appears to be sceptical as to the corporate body's intention.

In 2001 JHI transferred the value of A$293 million to establish the MRCF and made a very clear statement that this trust was "fully funded" to meet the future Hardie asbestos claims. By the end of 2001 the actuaries estimated that MRCF would in fact need A$574 million and by 2002 liability had grown to A$752 million and by the end of 2003 the estimates sat at an amazing A$1.573 billion.[10] In February 2004, the NSW Government appoints Mr David Jackson QC to conduct a Special

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[7] The ASX Top 200 companies were surveyed and 36% responded. Large means greater than AUD$3 billion market capitalisation and medium means between AUD$500 million to AUD$3 billion. The survey has been conducted in 2002, 2004, 2006, 2007. The average number of shareholders per company surveyed was 104,000.

[8] Officer is defined in s 9 *Corporations Act 2001* (Cth) as "a director or secretary of the corporation"

[9] Mr James Hardie and Mr Andrew Reid (both from Scotland) set up a business partnership in Melbourne in 1895 and Hardie sold his share on retirement in 1911. The company developed asbestos products from the 1930s and JHI was listed on the Australian Stock Exchange in 1951

[10] The figures are quoted from the David Jackson (2004) *Report of the Special Commission of Inquiry into the Medical Research Fund and Compensation Foundation* [online], <www.dpc.nsw.gov.au/publications/publications/publication_list_-_new#11330>.

Commission in the MRCF and by September 2004 he produces the *Final Report of the Special Commission of Inquiry into the Medical Research and Compensation Foundation* showing up a A$2 billion short fall and noting a public statement that "seriously misled" the Trust.

The civil action was commenced in February 2007 by the corporate regulator, the Australian Securities and Investments Commission (ASIC) against the original listed entity (JHI) and its former directors. The major focus of the case was on the media release (as an announcement) to the Australian Securities Exchange (ASX) that JHI had fully funded the MRCF. The media release, which one might call the "smoking gun" in a criminal case, was a single page drafted by a public relations firm, which passed through internal and external lawyers, the senior management and the whole board itself.

ASIC brought the civil action against 12 defendants, being the original company, James Hardie Industries (now with a change of name called ABN 60 Pty Ltd) and the current company (James Hardie Industries NV) with the three executive directors (Peter Macdonald, Peter Shafron and Phillip Morley) and seven non-executive directors.[11] The case is actually named after the first plaintiff and defendant, *ASIC v Macdonald (No 11)* (2009).[12] [13]

At a similar time that ASIC was bringing a civil case, ASIC also made a referral to the Commonwealth Director of Public Prosecutions to bring a criminal prosecution against the company and its executive officers. In September 2008 it was determined that there was insufficient evidence to pursue a criminal prosecution, but the civil case started its 45 days of hearings in the NSW Supreme Court before Justice Gzell. The result of this case, which is explained below in summary[14], is a number of serious breaches of the *Corporations Act* for both the company (old JHI and new JHI NV) as well as all the former non-executives directors and three senior executives of JHI.

A key distinction in this current case is that the decision focuses on a specific behaviour of a corporate body that reorganised itself, using a legal mechanism (the scheme of arrangement) to avoid future liabilities. From a corporate governance perspective, the board and management followed the procedures and believed it was the right thing for the shareholders. However, there does not appear to be evidence of the wider duties and responsibilities being shown to the broader stakeholders – the employees or consumers of JHI products, which have become asbestos victims. This case, as the common law system requires, has a focus on technical aspects of the law, but provides direction to the board over its broader corporate social responsibility duties.

What are the general themes of the case?

There is a general principle that time is crucial in legal cases, as only the relevant law at that time of the event occurring can be applied to a particular legal action. The corporations' legislation has had a long and difficult history from the previous State/Territory versions (the old *Companies Code*) to the Commonwealth version (the 1991-2001 *Corporations Law)* and its more constitutionally stable current form, the *Corporations Act 2001* (Cth) which commenced on 15th July 2001. Thus, the events surrounding the JHI business decision to reorganise as a company based in the Netherlands and comply with a series of detailed documents, court procedures and necessary ASX announcements (the media releases) must be applied to the law at that time and not the current version.

It is also fair to state that business in Australia 2001 was going through a difficult economic period and the largest collapse in our history (HIH Insurance) and icons like One.Tel and the problems of the AMP takeover of GIO, resulted in complex legal problems. The result is a series of officer's cases have arisen, such as Mr Williams and Mr Adler of HIH Insurance, Mr Rich of One.Tel and Mr Vines of GIO, that have enabled the courts to deal with both key directors' duties (Adams, and Nehme 2009) and the transition of provisions from the former *Corporations Law* to the current *Corporations Act*. In substance the words are the same, but the section numbers are different for both the misleading

[11] Michael Brown, Michael Gillfillan, Meredith Hellicar (chair) Martin Koffel, Geoffrey O'Brien, Gregory Terry and Peter Willcox.

[12] 32 [2009] NSWSC 287 (23 April)

[13] In the August 2009 issues of *Keeping Good Companies* there will be a more detailed legal analysis of *ASIC v Macdonald (No 11)* [2009] NSWSC 287 (23 April). [2007] NSWCA 75

[14] Adams, M. & Nelme, M. 2009

conduct provision and the officers' duty of reasonable care and diligence. Justice Gzell handles this point very clearly in the judgment and follows the same line of logic as Justice Austin did in *ASIC v Vines* (2005)[15]

However, it can get confusing when the judgment discusses this former JHI Ltd being held liable for misleading conduct under s 995 *Corporations Law*, but the current JHI NV is found liable under s 1041H *Corporations Act 2001*. Similarly, JHI failed to disclosure to the market that it had a Deed of covenant and Indemnity document which should have been made known to the ASX and as such as a breach of the old s 1001A *Corporations Law* and the current JHI NV breaches s 674 *Corporations Act* for continuous disclosure of the cancellation of partly paid shares in ABN 60 Pty Ltd (the new name for JHI Ltd)!

Table 2: Contraventions of CA2001 per defendant

Position/Capacity	**Corporations Act**	**Contraventions**
Old JHI (now ANB 60 Pty Ltd)	Misleading conduct (s 995) False statement to securities (s 999) Continuous disclosure (s 1001A)	Three Two One
Current JHI NV company	Section 1041H (misleading conduct) Section 1041E (false statement in financial products) Section 674 (continuous disclosure)	One One One
CEO (Peter Macdonald)	Section 180 (duty of care)	Ten
General counsel (Peter Shafron)	Section 180 (duty of care)	Six
CFO (Phillip Morley)	Section 180 (duty of care)	One
Seven non-executive directors (including the chairperson Meredith Hellicar)	Section 180 (duty of care)	One each
12 defendants	Corporations Law and Corporations Act 2001	33 contraventions in total

What are some of the key lessons?

In *ASIC v Macdonald (No 11)* (Table 2) *there were 52 allegations of contraventions of the* Corporations Act brought against the 12 defendants. Companies, JHI (ABN 60 Pty Ltd) and the current entity, JHI NV, as well as the seven non-executive directors and three executives (CEO, general counsel and CFO) were all named. ASIC was successful in proving 33 of the contraventions covering officers' duties (24), misleading and deceptive conduct (4), false statements in relation to securities (3) and breaches of continuous disclosure rules (2).

37 [2009] NSWSC 287 (23 April)

ASIC was unsuccessful (that is not able to prove to the appropriate standard) in 19 alleged breaches of the *Corporations Act* relating to officers' duties, misleading or false statements.

There are some key lessons to be learnt from this case and these are broken into simple headings:

1) Importance of minutes – the judge discusses the adequacy of minutes as evidence in a court of law and notes that it is recorded that the whole board approved the relevant misleading ASX announcement (media statement) in draft on 15 February 2001 and thus the actual ASX announcement

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15 *ASIC v Vines36* (2005) 55 ACSR 617; [2005] NSWSC 171 and upheld on appeal at *Vines v ASIC* (2007) [2007] NSWCA 75

and press conference statement on 16th February. The minutes had not been entered in the official minute book within the requisite 30 days, which caused some legal issues.

2) The boards reliance on the public relations firms, professional advisers including external lawyers, actuaries, accountants, as well as the senior management. The CEO failed to advise the board of the too emphatic language in the draft announcement and the cash flow model prepared by PwC and Access Economics was limited to technical correctness and logical soundness. But ASIC did fail to make out its case for the advice that the "best estimate" in the Trowbridge actuaries report only had a 50% probability of being achieved and was too uncertain as to assessing adequacy of funding.

3) Misleading conduct – one of the most litigated provisions in commercial law is s 52 *Trade Practices Act 1974 (Cth) "A corporation shall not, in trade or commerce, engage in conduct that is misleading or deceptive or is likely to mislead or deceive."* This was very successfully used to prevent the aborted float of the NRMA from a mutual to a listed company in 1995. The famous *NRMA v Fraser*[16] (1995), where the expression "free shares" were deemed to be misleading and prevented the two billion float from proceeding by one simple provision of the TPA. After the NRMA case, financial services (including securities) were removed from the TPA[17] and placed in the *Corporations Act.* However, in the NRMA case the central issue was whether the company has misled its members and not a question of whether the board of directors was responsible. This current decision goes further in that in *ASIC v Macdonald (No 11)* (2009) states that the original company, JHI (now ABN 60 Pty Ltd) and the current company, JHI NV, engaged in misleading and deceptive conduct in respect of financial products through the media release to the ASX on 16th February 2001. More importantly, every individual director and in particular the CEO, Mr Peter Macdonald, was held to have failed to take reasonable care[18] as a corporate officer for the misleading in drafting that media release, as well as other documents.

4) False statements – the judge carefully explains that the former company, JHI, made a false statement in connection to securities for the ASX announcements under the old s 999 *Corporations Law.* As well as the new company, JHI NV, making a false statement in connection to financial services and products (including securities) under s 1041E *Corporations Act* for sending to the ASX PowerPoint slides that had been used in the UK for an investors' road show, which contained the same statements ("fully funded" for asbestos claims).

5) Continuous disclosure – the two corporate defendants managed to be caught for continuous disclosure for failing to disclose in 2001 the Deed of Covenant and Indemnity document in 2001 under s 1001A *Corporations Law* and for failing to inform of the cancellation of partly paid shares in ABN 60 Pty Ltd (the new name for the old JHI) under s 674 *Corporations Act*.[19]

6) Officers' duties – the heart of the action and the distinct feature of this case, is that all the directors and in particular the CEO is held to have breached the most basic of officer's duties. All ten directors, without exception were found to have contravened s 180(1) *Corporations Act* – this section states that a director or officer of a corporation must exercise their power and discharge their duties with the degree of care and diligence that a reasonable person would exercise in those circumstances. This is known as "statutory negligence" and the directors fail to meet the objective standard set out by Parliament in the legislation. In making the original draft ASX announcement (media release) on 15th February 2001, they did not take the necessary care that would have been expected by directors of a public listed company at that time and in those circumstances. This does follow a number of

16 *Fraser v NRMA Holdings Ltd* (1995) FCR 452.

17 Section 51AF *Trade Practices Act 1974* (Cth).

18 40 Section 180 *Corporations Act* 2001 (Cth).

19 Nehme, M, Hyland, M, & Adams, M; "Enforcement of continuous disclosure: The use of infringement notice and alternative sanctions" (2007) 21 *Australian Journal of Corporate Law* 1.

precedents on officers duties including *ASIC v Adler* (2002)[20], *ASIC v Rich43* (2003)[21] and *ASIC v Vines44 (2005)*[22].

The companies involved can only be ordered to pay compensation (civil damages) for their misleading and deceptive conduct. The former officers of the company are in breach of a civil penalty provision and thus could face damages, a penalty (up to $200,000) and a disqualification order from being a director or senior manager of a company for five years. The CEO was required to pay $350,000 and was banned for 15 years and the non-executive directors all received $30,000 penalties and five year disqualifications. JHI NV had a small penalty of $80,000 and the original JHI was protected by statute! Meredith Hellicar has announced her resignation of all other directorships as an immediate consequence of the James Hardie case outcome. The other directors are likely to follow suit. Personal reputations have been closely focussed on throughout this litigation and once indicate a changing tide of public opinion as to corporate greed over corporate social responsibility to a wider audience.

Conclusion

This paper began by exploring the history of the development of the Corporations Law that exists today. It reported that the number of corporations had grown exponentially since the corporations Law was introduced in the early 90s. In many respects the bias in the law towards large corporations has been addressed by a special section directed towards small corporations. The introduction of the Corporate Governance Principles for listed companies by the Australian Securities Exchange added another layer of regulation intended to promote transparency and accountability. Research into corporate governance in small companies showed that, in contrast to opinions about the US Legislation, very few Australian companies expressed negative views about corporate governance regulation.

The most recent addition to corporate governance regulation has been the expectation that companies have a responsibility for corporate social responsibility. This was illustrated by the James hardy Industries case. The broad lesson to be learnt by all governance professionals in small or large corporations is that the small details matter. It is not acceptable to delegate everything to a PR firm or rely upon lawyers and the CEO to make critical decisions. Minutes are used as key evidence in officers' duties case and great care should be taken in recording them accurately. Companies can be held accountable for substantial amounts of money if they are found to have misled investors, their shareholders and the general public. In the 2003 Royal Commission in the collapse of HIH Insurance, Commissioner Justice Neville Owen stated that the Board of Directors has the ultimate responsibility for corporate governance.45 This case probably additionally adds the broader duty of corporate social responsibility being owed to a wider group of stakeholders, including all the employees and consumers, impacted by the activities of a small or large corporation. .

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Governance Issues for SMEs

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Abstract

This paper draws on research into the corporate governance practices of small and medium enterprises (SMEs) listed on the Australian Securities Exchange. Interviews were conducted with the directors and/or company secretaries of 19 SMEs. The aim of the research was to explore not only SME corporate governance structures and processes but how SMEs had chosen to implement the Principles and the reasons for their choices. The paper addresses the issue of whether the ASX Corporate Governance Principles and Recommendations were appropriate for SMEs. It describes the SME responses to the requirements, how these differ from those of larger companies, and how these differences impact on small companies.

Keywords

Small medium enterprises, governance

Introduction

The first task in writing about small to medium enterprises (SMEs) is to define the scope of the term. Most definitions seem to focus on the number of employees as a measure, sometimes also combining this with financial measures such as annual turnover or market capitalisation. In 2000, Huse reviewed research on boards of SMEs in the ten most established European-based SME journals and found a variety of employee-based definitions being used (2000:274). Of the 19 papers "about boards of directors in SMEs during the 1990s", 10 included companies with less than 50 employees, seven included companies with 50-499 employees and one included companies with more than 500 employees. Seven included discussion of SMEs without any size indications.

In its July 2000 SME strategy document the World Bank states:

> *"What is an SME? There is no universal definition. Some analysts use objective standards, classifying firms with fewer than 10 employees as "microenterprises", those with 10 to 100 employees as "small" and those with 100 to 500 as "medium" - or even listing any company with annual turnover below $10 million as an SME. Others prefer to rank companies by their relative size within the local economy, since a large company in Macedonia would likely be considered small in Brazil."*

Ayyagari et al have reviewed SME definitions across the world as part of their work in examining the contribution of the SME sector towards overall economic activity. They chose a cut-off of 250 employees when compiling their data tables but also provided the official SME definition for each of 76 countries. They sum up the difficulties of defining an SME as follows:

"Efforts to compile data on the size of the SME sector across countries have been plagued by several problems of comparability and consistency. Different countries adopt different criteria – such as employment, sales or investment –

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> *for defining small and medium enterprises. Hence different sources of information on SMEs use different criteria in compiling statistics. Even the definition of an SME on the basis of a specific criterion is not uniform across countries. For instance, a specific country may define an SME to be an enterprise with less than 500 employees, while another country may define the cut-off to be 250 employees." (2007:415-416)*

The Australian Bureau of Statistics (ABS) defines a small business as one that employs less than 20 people and a medium business 20 to 200. This is on the small side compared to other countries but of course the definition varies even within each country.

The UK's Institute of Directors (IoD) defines an SME as having less than 250 employees. In their policy papers they use the definition set out by the UK Government's Department for Business, Enterprise and Regulatory Reform (DBERR) which defines micro-firms as having 0-9 employees, small firms as 10-49 employees and medium firms as 50-249 employees. The IoD points out that the European Commission, Companies Act and British Bankers Association all hold different and distinct notions of the characteristics and thresholds that constitute an SME" (Ehmann:2007).

This paper draws on our research into the corporate governance practices of companies listed on the ASX. We conducted interviews with directors and/or company secretaries of 67 listed companies, exploring not only the corporate governance structures and processes that they had chosen to implement but the reasons for their choices. We asked about the costs and benefits of complying with the ASX Principles and explored participants' views on the 'comply or explain' mechanism.

Because our research focused on listed companies, we deal in this paper with 'smaller' companies rather than the 'smallest' companies which of course will not be publicly listed. We categorised companies by market capitalization, with anything outside the ASX 300 being an SME. We did not collect information on employee numbers but in visiting the premises of these companies we could see that most had less than 200 employees. In this paper we discuss the problems faced by small to medium listed companies in complying with a 'one-size fits all" corporate governance regime often said to be better suited to large corporations.

Of course, this is a governance regime designed to protect investors who buy publicly listed shares. It is a regime predicated on the assumption of a separation between ownership and management of the company. That is, a company owned by a large number of dispersed shareholders and managed by a small team of professionals. The corporate governance provisions of the *Corporations Act 2001*, the *ASX Listing Rules* and the ASX *Corporate Governance Principles and Recommendations* are primarily designed to protect shareholders from any self-serving behaviour on the part of management or other major shareholders represented on the board. Thus, formally at least shareholders may elect a board to represent their interests and to monitor management. The law requires that the company establish board structures and disclose certain information in order that shareholders can be confident that their investment is being managed to an acceptable standard.

The issue considered in this paper is whether this corporate governance regime, established with larger listed corporations in mind, is appropriate for SMEs. Firstly, we need to look more closely at what the regime entails for SMEs and whether they are treated any differently from the large companies. Secondly, we draw on our research, as well as surveys completed by the ASX, to see how SMEs have responded to the new regime. We can then explore some of the reasons for the observed responses, and examine how the structure and nature of SMEs differ from larger companies. Finally we examine how these differences may impact upon the ease of implementation of corporate governance regulation. What is the effect of governance regulation on small companies? Is it achieving its purpose or having unintended adverse effects? Could we improve or simplify corporate governance for SMEs and thereby achieve a better balance between economic aims (entrepreneurship and innovation) and protective aims (promotion of investor confidence)? Can we draw on developments overseas to guide us in this process?

Corporate Governance Requirements for SMEs

Recent corporate governance reforms in Australia, at least for listed companies, have centred around a system of 'comply or explain' similar to the UK system. The ASX *Corporate Governance Principles and Recommendations* (the Principles) apply to all listed companies by way of Listing Rule 4.10.3 which requires companies to disclose the extent to which they have adopted each of the 8 principles (recently consolidated from the original 10) and 28 recommendations. If a company has not adopted a particular recommendation it must explain why.

The Principles are described as a reporting framework designed to provide a "practical guide" for companies, investors and the wider market. The foreword to the first edition stated:

> *"The size, complexity and operations of companies differ, and so flexibility must be allowed in the structures adopted to optimise individual performance. That flexibility must, however, be tempered by accountability – the obligation to explain to investors why an alternative approach is adopted – the "if not, why not" obligation."*

There was express recognition when the Principles were introduced that one size does not fit all and hence the Principles are flexible rather than being prescriptive. In a section entitled 'how to approach adoption of the best practice recommendations' (2003:5 and 2007:5) the Principles state:

> *"The Council recognises that the range in size and diversity of companies is significant and that smaller companies may face particular issues in attaining all recommendations from the outset. Performance and effectiveness can be compromised by material change that is not managed sensibly. Where a company is considering widespread structural changes in order to meet best practice, the company is encouraged to prioritise its needs and to set and disclose best practice goals against an indicative timeframe for meeting them."*

This paragraph does not concede that any of the Principles might be inappropriate for a smaller company, only that small companies might need longer to achieve 'best practice' (more recently considered 'good practice'). The only recognition of any disconnect between the Principles and the needs of small companies (or at least small boards) is found in the commentary to the recommendations on board sub-committees:

> *"It is recognised that for smaller boards, the same efficiencies may not be apparent from a formal committee structure."*

This sentence was changed slightly in the second edition of the ASX Principles (2007). It makes it clear that even if there is no formal sub-committee the functions that it would carry out must still be in place.

> *"For smaller boards, the same efficiencies may not be derived from a formal committee structure. Companies without a [nomination, audit or remuneration] committee should have board processes in place which raise the issues that would otherwise be considered by the [nomination, audit or remuneration] committee."*

The only area where the ASX Principles formally distinguish between large and small companies is in the requirements dealing with the composition, operation and responsibility of the audit committee. Listing rule 12.7 requires that companies in the S&P/ASX All Ordinaries Index (top 500) must have an audit committee and those in the top 300 must comply with recommendation 4.2 regarding the composition of that committee. Recommendation 4.2 suggests audit committees should be made up of:

- only non-executive directors
- a majority of independent directors
- an independent chairperson, who is not chairperson of the board
- at least three members.

It was recognised that this would be onerous for SMEs and hence it is only mandatory for the top 300 companies. It is perhaps significant from a policy point of view that, rather than being drafted as an

exemption for small companies, it has been included in the Listing Rules as a mandatory requirement for large companies.

The ASX Principles are not law, and were created by the ASX Corporate Governance Council (CGC). The CGC is made up of representatives from 21 business associations representing the interests of a wide range of groups involved in the investment and governance value chain including shareholders, directors, accountants and superannuation funds. Although most of these associations consulted their members, there was no explanatory memorandum or parliamentary discussion regarding the policy decisions taken.

The ASX set up a body known as the Implementation Review Group (IRG) in mid-2003 to provide an independent review of the industry response to the Principles. The IRG was made up of a panel of senior industry practitioners, representing a cross section of the corporate and investment community, including advisors to and directors of smaller companies. The IRG's first report published in March 2003 confirmed the universal approach:

> *"The IRG received numerous submissions suggesting that particular classes of companies (e.g. small companies) should be exempt from the requirement to report against the Council's Recommendations. The IRG believes however, that the 10 Principles and the requirement to report against the Recommendations should apply to all listed companies, regardless of size or maturity. Exempting any class of listed company from reporting against the Recommendations would be inconsistent with the disclosure-based approach."*

The document went on to explain that making exceptions would be inappropriate because the Principles do not require compliance in any event. Further, if a company has made the decision to raise money from the public it should be obliged to provide sufficient disclosure to investors to enable them to assess the quality of the company's corporate governance procedures. This is hard to argue against. The element of choice involved in listing makes it difficult to justify any sort of exemption.

Rather than recommending any significant alterations to the Principles, the IRG stressed their flexible nature. The IRG provided guidance for SMEs on how to approach some of the Principles, particularly the requirements for a majority of independent directors. It recognised that in the early stages of a company's life cycle, expertise might be more important than independence. It suggested that companies without a majority of independent directors might explain their non-compliance in terms of:

- The value to the company of the knowledge, experience or expertise of its directors given the stage of growth or nature of the company. Your board should consider providing more fulsome disclosure in relation to the skills, experience and abilities of its directors and how the company benefits from this.
- The risk profile of the company and the impact this has on desirable board membership. For example, your board may wish to discuss the entrepreneurial nature of the business.

The IRG took the stance of educating and encouraging SMEs to make use of the option of exception reporting. There was recognition that the optimal balance between objectivity of directors and their value to the company can vary over the life of a company and that certain investors might reasonably expect to have representation on the board.

The IRG's Second Report to the ASX Corporate Governance Council published in February 2005 throws further light on the thinking behind a universal set of principles. The IRG considered that the audit committee rules should not be seen as validating a move towards further exceptions:

> *The IRG is concerned that segmentation of the market involves a shift away from the flexibility of the current disclosure-based approach towards a more prescriptive one. The implication would be that companies above or below a certain size or of a certain business type would be expected to adopt specific Recommendations. Such a change would undermine the current emphasis on promoting 'substance over form' and carries*

the potential to reinforce a 'tick the box' approach. The IRG wishes to avoid any risk of degrading into a 'tick a box' governance environment.

In 2006 the ASX conducted a review of the Principles and in 2007 published a revised second edition. The review involved a consultation paper and opportunity for public submissions. The consultation paper stated:

> *"Since Council released the Principles there has been discussion about whether the Principles should be modified to assist smaller companies by providing "carve-outs" from the Principles. During its review, Council considered the possibility of modifying the Principles and Recommendations for smaller companies and has decided that the Principles and Recommendations should be the same for all listed entities. ASX conducted a market research program among Small to Medium Enterprises (SMEs) and their advisers which found that there was overall support for the Principles, while acknowledging that the independence and audit committee requirements were more difficult for this sector.*
>
> *Council considers that all companies, regardless of size or industry, that have made the decision to raise capital from the public, should provide investors with sufficient disclosure to enable them to assess the quality of the corporate governance policies and processes in place in those companies in which they invest.*
>
> *The revised Principles provide assistance for smaller listed companies which adopt alternative practices from those outlined in the Principles, such as removal of the phrase "best practice". Other changes include recognising that companies may use alternatives to board committees in Principles 2, 4 and 9. Council reminds smaller companies that it is entirely acceptable for them to adopt effective governance practices that differ from the Principles, provided they make appropriate disclosure."*

In its response to public submissions the ASX said the following regarding the issue of SMEs:

> *Those submissions that addressed this issue generally expressed support for Council's decision not to provide a "carve out" from the Revised Principles for SMEs. The rationale for Council's decision is that all listed companies raise funds from the public and there should not be a differential standard of reporting. One submission raised the related point of whether "if not, why not" reporting should be required by this sector where they adopt alternative practices to those set out in the Recommendations. Council has decided not to pursue this suggestion for the reasons referred to above. (ASX, 2007, para 31)*

Blakiston & Crabb lawyers provided the submission referred to above which focused on the issues faced by SME's:

> *"Blakiston & Crabb reviewed the consultative paper, liaised with a number of clients and submitted detailed comments to the ASX Council in early February 2007. Over 100 companies provided letters of support for the Blakiston & Crabb submission.*
>
> *The central theme of the submission was an attempt to improve the application of the Principles and the reporting requirements from the viewpoint of small to medium enterprises." (Zimmel, 2007)*

Blakiston & Crabb have since joined up with Deloittes and ASX Markets Supervision to produce a guide for SMEs in relation to Principle 7 on risk management as this was deemed to be another difficult area for companies at the small end of the listed scale. The introduction states:

> *"ASXMS has identified that small to mid-capitalised ASX-listed entities may experience difficulty in implementing risk management practices which accord with the recommendations in the Principles due to the generally lower level of resources available to such entities. The purpose of this Guide is to allow small to mid-capitalised ASX-listed entities to access information and guidance on the management of material business risks*

in a way that will allow them to report positively against the recommendations in Principle 7."

To conclude, there has been a reluctance, to date, to provide any form of exemption or alternative regime for listed SMEs. The use of a universal but flexible set of principles appears to be fairly established with no SME-specific changes made in the second edition of the ASX Principles. The provision of supplementary guidance, rather than exemptions appears to be the favoured pathway.

SME Response to the Principles

Each year since the first edition of the Principles, the ASX has carried out a review of compliance. Although these reviews have not looked specifically at the issues faced by SMEs they do provide anecdotal evidence of the widely held belief that smaller companies are more likely than larger ones to give 'why not' explanations.

The ASX's 2009 review was the first to be conducted since publication of the second edition of the Principles. At the time of the review only a small proportion of all listed companies (those with their accounting year-end in December rather than June) were reporting against the 2007 edition of the Principles, the majority still reporting against the 2003 edition. The ASX published two separate reviews for each of these sub-sets of companies. In both reviews the main comment regarding SMEs was in relation to Recommendation 2.1 which suggests boards should have a majority of independent directors. It was found that adoption of this recommendation was higher in the top-500 companies than across all companies:

> *The high level of "if not, why not" reporting confirms anecdotal evidence that smaller listed entities are more likely to adopt alternative board and committee structures and report on an "if not, why not" basis. The continued high rate of "if not, why not" reporting is also evidence of the ongoing acceptance and adoption of the corporate governance reporting framework outlined in the ASX Listing Rules and the Revised Principles (ASX, 2009a:16 and 2009b:14)*

One of the common reasons for choosing to give a 'why not' explanation regarding independent directors was that the company or board was too small. Other interconnected reasons included the high cost of independent directors, the limited resources of the company to engage them and/or doubts that the experience and skills of non-independent directors were appropriate for the company. (ASX, 2009a:16) For end-June companies there was also found to be a high level of 'why not' reporting with regard to Recommendation 2.4 which suggests the establishment of a Remuneration Committee:

> *The overall reporting level for Recommendation 2.4 for listed companies saw an increase in 2008 to 98% from 90% in 2007. This result was almost entirely due to an increase in "if not, why not" reporting which rose from 58% in 2007 to 67% in 2008. This result confirms anecdotal evidence that smaller listed entities are more likely to "if not, why not" report in relation to the Recommendations on committee composition and are comfortable with this reporting approach. (ASX 2009a:18)*

This finding, of SMEs choosing not to have the recommended number of board sub-committees and/or independent directors has been consistent across all of the ASX's annual reviews. Our research throws more light on these two areas of the Principles. We will deal with each in turn, first use of board sub-committees and then the issue of independent directors.

Committees

On the issue of board sub-committees responses from the SMEs we interviewed were mixed. As might be expected from the ASX surveys several companies did not have separate nomination and remuneration committees:

> *We don't have a nominations committee because our board is so small it tends to be the whole board.*

> *We didn't see the need for a separate nomination committee. The audit committee can do it or add two more and you have the whole board*
>
> *We had three committees but have now reduced it to two. The audit committee I chair and the nomination and remuneration committees have been combined into one. There was not a lot of work on the nomination side and a fair amount on the remuneration side.*

Others had created these committees but only because it was easy to do so. Here we have evidence of the pressure to conform, even if doing so provides little or no value to the company:

> *We have set one up in order to comply because it's not difficult.*
>
> *The committees are a bit of a farce for us…. The audit and risk committee is necessary, nomination and remuneration is a bit of a farce…*
>
> *Yes, we have the three committees but I don't think they are really very useful for us with a small board. Three of the four directors are on each committee and the other one is generally invited.*

At the other extreme we had several participants who thought the committees were a great thing even if it had taken them a while to appreciate their role:

> *It is fantastic having the committees both in terms of dedicated time and in developing specific expertise. From the point of view of an executive director it is terrific to have that responsibility taken away from you to someone with focus.*
>
> *Yes, the committees are useful. They each met four times this year even though the remuneration and nomination committee is only supposed to meet twice.*
>
> *The board formed the view at the time that there would only be an audit committee even though we were not required for a company of our size. We thought that would be quite sufficient. The last thing you want is more committees. You don't want any to be quite honest. But as we have come along, the board has seen there is a role for them and so we developed the remuneration committee with a standard charter. It has since expanded its role to remuneration and nomination.*

Independent directors

The issue of independence on SME boards is often linked to the nature of the shareholder base. As will be discussed below, many SMEs are tightly held with one or more controlling shareholders who are often represented on the board. Thus, these directors, even if they are non-executives, will not be independent because of their shareholding. The requirements in the ASX Principles regarding independent directors have been one of the more controversial aspects of the Principles. Is independence being held up as more important than competence? Why should a director suddenly lose his or her independence after a certain number of years on the board? The ASX Principles suggest that a majority of board members should be independent. The first edition of the Principles provided what it called a definition of independence in Box 2.1 as follows:

> *"An independent director is a non-executive director (i.e. is not a member of management) and:*
>
> 1. *is not a substantial shareholder of the company or an officer of, or otherwise associated directly with, a substantial shareholder of the company*
> 2. *within the last three years has not been employed in an executive capacity by the company or another group member, or been a director after ceasing to hold any such employment*
> 3. *within the last three years has not been a principal of a material professional adviser or a material consultant to the company or another group member, or an employee materially associated with the service provided*

> 4. *is not a material supplier or customer of the company or other group member, or an officer of or otherwise associated directly or indirectly with a material supplier or customer*
> 5. *has no material contractual relationship with the company or another group member other than as a director of the company*
> 6. *has not served on the board for a period which could, or could reasonably be perceived to, materially interfere with the director's ability to act in the best interests of the company*
> 7. *is free from any interest and any business or other relationship which could, or could reasonably be perceived to, materially interfere with the director's ability to act in the best interests of the company."*

In response to criticism that some of these criteria were too prescriptive, the second edition has softened and removed some of the criteria as well as making it clear that they are designed to give guidance rather than a definition of independence. Box 2.1 now states:

> *When determining the independent status of a director the board should consider whether the director:*
>
> 1. *is a substantial shareholder of the company or an officer of, or otherwise associated directly with, a substantial shareholder of the company*
> 2. *is employed, or has previously been employed in an executive capacity by the company or another group member, and there has not been a period of at least three years between ceasing such employment and serving on the board*
> 3. *has within the last three years been a principal of a material professional adviser or a material consultant to the company or another group member, or an employee materially associated with the service provided*
> 4. *is a material supplier or customer of the company or other group member, or an officer of or otherwise associated directly or indirectly with a material supplier or customer*
> 5. *has a material contractual relationship with the company or another group member other than as a director.*

This may make it easier for SMEs to explain why they consider a particular director to be independent despite not meeting all the criteria. Nevertheless, the ASX surveys show that many SMEs do not have a majority of independent directors. Our research supports this finding and shows that there may be two reasons for this non-compliance. Firstly, when a company first lists its board often includes some of the founding directors and/or representatives of the venture capitalists who do not want to lose control. Secondly, companies can find it hard to attract independent directors with the skills that are going to justify their directors' fees:

> *…for smaller companies it is difficult to comply. Often, I believe, in this sector at least, particularly at the early stages. Of course, the VC wants to keep an eye on things and is not independent and the issue of founding directors can be difficult, particularly for products that they have invented.*
>
> *At the start we would have struggled to get a good person to come in. We had to prove the business model – only then can you go out and get someone who will really add value.*
>
> *We do need another independent non-executive... It's the cost holding us back. They get $35,000 a year for 12 meetings so usually it's better to get a skilled tool-maker.*

However, what was perhaps more surprising was that most participants genuinely seemed to want to change this situation. They could see the value of independent directors and were striving to achieve a majority. The reasons for this will be discussed below as they are closely linked to the issue of whether there is an 'agency gap' in SMEs.

General response

Although the ASX survey identified certain recommendations with a high level of non-compliance, the overall trend was one of widespread adoption of the Principles. Again, our research backed this up. Most SMEs limited their 'why not' explanations to those mentioned above and had complied with the remainder of the Principles.

One would hope that this compliance 'on paper' translates to some meaningful changes within the companies. Unfortunately, however, some of the recently listed participants saw corporate governance as a process of creating a swathe of policies that did not really change much within the business:

> *What you see in the annual report is pretty standard. What was put together at the time of the listing – articles of association, board structures and committees – was designed to tick boxes with the Guidelines.*

An experienced professional director told us that this was common when companies are preparing to list:

> *Governance is just so far down the list in terms of the things needed to be done – road shows, brokers meetings etc that they don't really think about it. Then they find themselves saddled with a load of stuff they've not read and which they don't do. They have just thought, well, we've got to have a statement so let's buy one.*

Some companies, however, were trying hard to break out of that mould and were justifying the time spent on governance as an investment for the future:

> *…although we are only a small business we intend to start the way we want to finish*

> *We wanted to improve corporate governance because we wanted to grow. However I suspect we overdid it because of our big company backgrounds.*

Others took the middle road, accepting that they had to create and implement appropriate policies as part of the listing process:

> *When you move from the small league to the big league there are certain things you've just got to do.*

> *To be listed we had to do it all – create the corporate governance policy, board charter, committee charters etc. We took a fairly vanilla one and then adjusted it to fit our needs.*

> *We've done it all for the first time – the present set of ASX Guidelines were around a year or two before we floated so its just been a matter of bringing the company into that scene. We've had to introduce certain disciplines to the board papers and meetings.*

> *We implement corporate governance as far as we can without incurring cost. Where we struggle is having to do it all ourselves. It gives me more to do. Although the internet and having 100 other companies reporting first is great – the wording for policies is already set up.*

This cost-benefit equation is of course the key to effective regulation and will be discussed further below. Certainly, directors of smaller organisations appear to appreciate the flexibility inherent in the ASX Principles. A submission to the ASX review from Mr Mark Beavis states:

> *As a Director of a medium-size credit union (total assets of $105m), I found value in the actual principles; by way of contrast, I was dismayed and annoyed when APRA released its Prudential Standard on Governance, which effectively imposes a governance structure irrespective (and possibly to the detriment) of a company's unique culture, situation and strategy.*

In a similar vein, the submissions from two companies considering a listing on the ASX in future (Emerging Group Capital and Cubbie Group Limited) both stress:

> *…the practical workability of the final document you produce will be a very important factor in the deliberations a company such as ours will go through in deciding whether or not to proceed to an ASX listing*

Most of the participants in our research project were in favour of the ‘comply or explain regime although there were some concerns over the response of investors to ‘why not’ explanations.

> *I'm a supporter of the ‘if not why not’ approach. As long as investors understand that there are good reason for not complying and the company is not penalised for it (e.g. independence) then I think it is appropriate in the main. If you make it too complex it's just a rod for the back.*

Why Should There be a Different Regime for SMEs?

The regulation and corporate governance for Australian companies is predicated on the assumption that there is a separation between the ownership and management of the company. However, this ‘agency gap’ may not always arise for small companies. The real question is whether, if owners and managers are not entirely separate groups, is there a need to impose a swathe of monitoring processes or can the owners look after themselves? Is there any value for SMEs in complying with the ASX Principles?

Our research focuses on listed companies. Thus even the small companies have offered their shares to the public and there will be some level of gap between ownership and control. However, this gap can be quite different in the newly listed companies as compared to those that are well established. Often, when a company first lists many of the directors will be substantial shareholders, perhaps the original founders of the company or representatives of the venture capitalists. The share capital may be tightly held such that the top twenty shareholders make up a large proportion of the total share capital. These shareholders will be in close contact with management and therefore are likely to have a high level of awareness of the company's activities that is not necessarily enhanced by an annual corporate governance statement. There may be a controlling shareholder who sits on the board or who has great influence over the company's activities.

The theory is that when companies are tightly held like this, with several substantial shareholders, those shareholders will have an incentive to monitor the company closely thus reducing the agency problem associated with more dispersed ownership. In the participants' words:

> *We have a small shareholder base so I think they are all fairly aware of what's going on. The larger shareholders talk to us directly anyway so it covers off governance [communications].*
>
> *The big boys get the information they need – they will just ring the CEO.*
>
> *Two or three contact me once a month for a chat. We have still got the six MBOs in the top 20 and five or six shareholders we talk to on a regular basis.*
>
> *In addition to those in the annual report we make it our business to talk one on one to major shareholders on a regular basis. It is discriminatory but every company is the same - we talk regularly with our top 6-8 shareholders or any interested shareholders - those considering buying.*

However, as Dallas and Scott observe, this does not mean there is no agency problem just that it is a different type of agency problem, namely “the extent to which the interests of controlling shareholders might differ from those of small shareholders” (2006, p118). This is borne out in our research, with several interviewees mentioning problems stemming from a controlling shareholder, for example:

> *It is hard to have a non-executive director as a shareholder. What's good for the company is not always good for a shareholder. It seems weird but it's true. For example, if we wanted to do a fund raising, we might want $6 million to create capital reserves and the shareholder might just see the dilution and want, say, $4 million.*

I think in this sector you often find you have one dominant founder with too much stock and a controlling interest which can be a problem.

We have five non-execs but one is not independent. He owns 55% of the issued capital so if he wants to be Chairman, he will! It's deemed one of the corporate governance nasties. He was MD at one stage too and that does cause problems occasionally.

This suggests that monitoring by substantial shareholders is not the answer. In fact, it demonstrates the importance of independent directors who will take into account the interests of all shareholders as a group. In contrast to some of our interviews with larger corporations, there appeared to be overwhelming support for independent directors from most SME participants. They were seen as vital if quality decisions were to be made:

Yes, we did go looking for independent directors. [One] left and all three remaining were non-independent. So there were not enough directors because there were a lot of issues where the two major shareholders were involved. There was a real need for more – we were getting desperate because we just couldn't take decisions. It was not just about compliance.

I'd prefer to see all independents other than the executives. I much prefer people without interests. You get better decisions out of the board.

As soon as you are not just looking after your own money you've got problems if there is no independence.

In micro-caps like us that are recently listed, you'll find we are entrepreneurial businesses that have been given life by one or two individuals. Not surprisingly those individuals are quite mercurial in foreseeing business opportunities but not that au fait with corporate law and governance etc. There can be interesting dynamics in governance, between personalities. Having independent directors that are experienced in public companies is very important.

To some extent, the debate on independent directors revolves around the role of the board in SMEs. Corporate governance requirements such as the ASX Principles are designed to facilitate the monitoring role of the board. The argument is that this monitoring role is not important where shareholders are few and in close contact with management. So, if the monitoring role of the board is less important in SMEs, what is the board's role?

This is an area where academic research is still in its infancy (van den Heuvel et al, 2006, p.468). In 2000 Morten Huse set out a review and research agenda for boards of directors in SMEs on the basis that prior research was fragmented, a view that probably still holds true. Nevertheless, there seems to be some consensus that, like most boards, there are two main roles for SME boards: control and service. Van den Heuvel et al explain that, "the control role is mainly based on agency theory, whereas the service role embraces several theoretical perspectives" (2006, p.481). Primarily, the service role emphasizes the board's function as a source of counsel and advice as well as a link to external resources through connections and networks. Pugliese raises a third strategic role which could perhaps be included within the service role (2006). It comprises the role of the board in setting the strategic context and direction of the business.

Our research supports these different roles. Participants spoke positively about the discipline that the board as a whole exerted over the key executives but were also very aware of the skill set of their board in terms of the services members could provide. Those boards that were looking for additional members were very clear about the skills, knowledge and/or connections that they hoped to gain from a new director:

Our only weakness is the non-executives. We do need another independent non-executive with device experience… Really we want someone US-based too because most of our trading is there.

I'd say we do need someone from Queensland Inc… it pays to be inside the loop.

None of the SMEs were concerned about their board members having too many other directorships. They were more likely to be concerned about directors not having enough. The experience and connections gained from those other directorships was seen as very valuable:

> *It would be a concern if, for example, our founding [director] was approached by a competitor but outside of that it is seen as valuable. It gives us an understanding of the workings of other boards and how they approach things, for example, a fund-raising. It gives us contacts if we need them.*

Interestingly, Van den Heuvel et al find that CEOs tend to view the service role of their board as more important than the control role (2006, p.479). Thus, we can see how some CEOs may resist the introduction of independent directors if it means they will lose a trusted, long-term board advisor. Participants commented:

> *If you go back to the role of a board at a high level and think where it should be spending its time - in my view it is there to help the CEO succeed and to represent the shareholders as they would expect, rather than as dictated by regulators… What we are seeing with boards currently is that they don't understand that that is their role. They too often revert to process.*
>
> *The board is used as a sounding board by the CEO and myself. Its role is to challenge what we are doing…*

What we really want to know is whether any aspect of the boards' role is of greater significance in SMEs than in large enterprises. If so, does corporate governance regulation support or impede directors in carrying out that role? Pugliese gets to the nub of the issue with the comment:

> *…it is becoming increasingly common to see reforms in the corporate governance domain calling for an increasing number of outsiders or independent directors on boards also in small firms; but it seems that the rule-makers do not take into account the different characteristics of these firms, by simply copying a reform-scheme which applies to listed companies without any changes despite their diversities.*

Pugliese's research finds that the most important features affecting the strategic role of the board in SMEs are the qualitative attributes of the board members such as industry knowledge, diversity of background and personal motivation (2006 p.51). He finds it paradoxical that these are the only attributes that are not ruled upon or defined by norms and codes (2006, p.51).

Lynall et all take a wider approach to the issue of board roles by looking at the way in which board composition can change over the company life-cycle (2003). They conclude that the composition of the board at formation will depend on the relative power of the CEO and financiers as well as the stage of the organizational life-cycle within which the company finds itself (2003, p.427). Some boards are formed when the company is still in the entrepreneurial stage, others are formed later when the company is becoming more complex and is starting to introduce a more formalised structure. Lynall et al argue that the role of the board will vary as the company moves through these stages and its composition will reflect that role. They would agree that agency theory and the monitoring role of the board is less important in the early stages of the company life-cycle.

Cost

The Australian Government's Regulatory Taskforce's January 2006 report *Rethinking Regulation* heard much evidence from small business that red tape is absorbing time and energy and becoming a drag on entrepreneurial drive (p5). In summary (pii):

> *"The costs of regulation to business involve not just extra time, paperwork and capital outlays, but also deflect management from the core activities of the business. Submissions indicated that compliance matters can consume up to 25% of the time of senior management and boards of large companies. The impact is even greater for small businesses, which generally do not have the in-house capacity to deal with and keep*

abreast of the regulatory morass. Regulation can thus stifle innovation and crowd out productive activity in the 'engine room' of Australia's economy."

Of course, this report was dealing with all regulation rather than just corporate governance requirements but the point made about the impact on small business may still be valid. Eric Mayne, a member of the ASX Corporate Governance Council, stated in a speech in November 2005 that the CGC was looking into whether corporate governance reporting could be made simpler for smaller listed companies. This was because:

"The costliness of compliance with the Corporate Governance Council principles and recommendations was another issue that emerged from our discussions with industry participants."

However, there have not been any concrete suggestions as to how costs could be reduced for SMEs. It was implied in the speech that perhaps SMEs did not fully understand the inherent flexibility of the Principles and needed to be educated on how they could make use of the 'why not' option. Following the IRG's second report, specific guidance on exception reporting was published in the form of examples. However, company representatives say that the pressure to comply does not come from the regulation, rather from the investors and rating agencies that fail to properly engage with exception reporting.

Importantly, our research to date does not provide strong support an argument that corporate governance regulation is unreasonably costly for SMEs. This may be a consequence of our methodology and/or the relatively small size of our SME sample. It could also be a result of the fact that putting a dollar cost on corporate governance is extremely difficult in any size of organization (Chittenden et al, 2002). As the quotes below demonstrate nearly all participants said that the greatest cost had been in terms of time. As most of our interviewees held the position of company secretary, this often equated to their own time.

The costs I couldn't identify but they are not high. More effort has been put into drafting the website disclosures but no wholesale training has been required. The cost has been in time more than anything else.

Time. We've not used any externals because we were tight on cash but it's taken up a lot of my time. I've got more people in my team now but I don't think that's because of governance – just because we've grown - although it does assist.

It's not been a great cost other than my time. I got some assistance from my mates in accounting firms – templates etc – which doesn't cost us anything.

Certainly there have been no major external costs. A little on the legal side - sub $10,000 which we could have put to better use

Thus the costs are internal and hard to quantify. Several company secretaries commented that the most significant cost to the company was their salary, some had been employed specifically for the job although most also had another role within the company, commonly CFO.

Next to costs, I wrote my name! They have had to employ me as a part-time company secretary… and it has taken up time for [the executive directors].

One participant noted that because of the increasing governance workload, it was becoming more common for SMEs to employ a governance specialist:

There seems to be a flip when a company gets to a certain market cap they employ a specialist company secretary. That line is moving down – CFOs just can't handle both.

This kind of employment cost should not be underestimated for a recently listed company. It can be costs such as these that restrain newly listed companies in appointing more than a minimum of board members. Also, the significance of any expenditure on employees and/or direct costs will depend on how well the company is doing financially:

> *There is a significant cost associated. The costs are principally, my salary. I don't do only corporate governance, I am involved in strategy too. They can't afford for me to do corporate governance alone. There is a direct cost for the functions I have to do: disclosure, holding AGMs, publishing the annual report. I don't know how many dollars but for a company that has not yet made any profit or paid a dividend it's a significant cost.*

However, the recently listed companies tended to include the cost of corporate governance in the overall cost of choosing to list. Several interviewees commented that listing was an extremely expensive way to raise money and only worth considering when all other options had been exhausted:

> *It is becoming increasingly difficult to say that there's value in being listed when you are a micro-cap. The liquidity of stock and access to capital is more illusory than real. There is a significant dollar cost and resource cost in that you loose the time of your senior people worrying about governance when they should be focused on the business.*

> *I've said to others, if you don't need to list then don't – it's not glamorous. You do it to raise money to continue operations or for some specific purpose or as an exit strategy. Otherwise it is a lot of cost for no value.*

Benefits

The greatest benefit for SMEs in implementing corporate governance procedures appeared to be the enforcement of discipline on directors who were very much used to doing things their own way. One participant described the change as a "cultural revolution" that had been quite awkward for some of the original founding directors. Most said it had led to a much higher level of professionalism and better decision-making processes:

> *It gives the shareholders comfort and it is useful for the board to have the guidelines, e.g. for trading shares. They have that framework to refer to. The directors can't say, I didn't know I couldn't do that.*

> *Certainly it has introduced discipline – a more disciplined approach to decision-making – which is a benefit to the company. We have had to drag [the founders] into it – there is a monthly battle over the board reports but we eventually get them. Where everyone is an employee you set the deadline and they meet it but here there is still an owner-mentality.*

> *Effectively there's an awareness that was always underlying but has now been made more visible. It's now something you can refer to – label things as governance whereas before they would be just an ethical issue. It has formalised what we would have done anyway – you are forced to think twice.*

> *Being listed is certainly a function of moving from a cosy environment of investors on the board doing as they please into a level of professionalism.*

Of course, corporate governance regulation has a dual purpose. As well as improving the running of companies it is designed to protect ASX investors. The maintenance of investor confidence is vital to the sustainability of the ASX as a market and thus will benefit the companies indirectly. It is perhaps because of this indirect nature of the benefits that several participants found it harder to identify the value of the procedures they had implemented:

> *There is not a lot [of benefit] for people who take their fiduciary duties seriously. Your gut tells you if you are on the right track or not – you don't need a 20 page document.*

> *There are not too many [benefits], I guess. I really do see it as a compliance exercise. There was never a real issue.*

UK Developments

Can we draw on developments overseas in assessing the appropriateness of the Australian regime? The UK is often the first port of call because it has a similar system based on 'comply or explain'

disclosures. A number of the provisions of the UK's Combined Code do not apply to 'smaller companies'. For the purposes of the Code a smaller company is one that was below the FTSE 350 throughout the year immediately prior to the reporting year. The exemptions are not extensive. In summary, the board of a smaller company need only have two independent directors rather than a majority. This means that the audit and remuneration committees need only be made up of two independent directors rather than three. However, the introduction to the Code expressly recognises that SMEs may find some provisions inappropriate:

> *Smaller listed companies, in particular those new to listing, may judge that some of the provisions are disproportionate or less relevant in their case. Some of the provisions do not apply to companies below the FTSE 350. Such companies may nonetheless consider that it would be appropriate to adopt the approach in the Code and they are encouraged to consider this. Investment companies typically have a different board structure, which may affect the relevance of particular provisions.*

In September and October 2006, the UK's Financial Reporting Council (FRC) conducted interviews with over 40 chairs of FTSE 250 and small-cap companies regarding the impact of the Combined Code. Not surprisingly, the issue of cost was raised:

> *It was widely felt that the costs of complying with the Code were proportionately higher for FTSE 250 and smaller companies than for the FTSE 100, and that this was exacerbated by the comparative difficulty in persuading investors to engage in dialogue which left these companies feeling under pressure to comply. (Financial Reporting Council, 2006)*

In the UK, much like in Australia, it has been observed that companies can feel pressured by investors to comply with the Code rather than explain their non-compliance. This is because they feel that investors are taking a tick-box approach to compliance and not taking the time to read, engage and understand their explanations. This leads to a perception at the FRC that the rules themselves are not flawed, instead market participants' response to them (particularly rating agencies and institutional investors) is the problem. If small companies felt free to explain their non-compliance, this would keep costs to a minimum.

This issue was also raised in a 2005 review of the UK Code. Although the review did not recommend any changes to the Code to relieve the burden on SMEs, the issue of compliance costs for smaller listed companies was to be kept under review. Thus, the issues of cost and the effectiveness of the comply and explain system were again put forward for consultation in the 2007 review:

> *The FRC recognizes that the potential compliance costs are proportionately higher for smaller companies, particularly bearing in mind the possible frustrations of "comply or explain" referred to above. If these are considered to outweigh the benefits associated with the Code, there may be an argument on regulatory impact grounds for some modification to what is required from smaller companies. On the whole, the 2006 consultations with the Chairs of smaller companies were not compelling on the point, but the sample was small and continuing open-mindedness on the FRC's part is appropriate. (Financial Reporting Council, 2007)*

Despite this, the 2007 review did not result in any SME-specific changes and the issue has been somewhat overshadowed in the 2009 review by the global financial crisis and its implications for corporate regulation as a whole.

US Developments

In the US the Sarbanes-Oxley Act of 2003 (SOX) was introduced in response to the collapse of huge firms such as Enron and Worldcom. Its most notorious provision was Section 404 requiring management assessment of internal controls. SOX is often described as a hasty over-reaction to the events of the early 2000s and because it is much less flexible than the reforms of Australia and the UK it is also seen as being much more expensive, especially for SMEs. Kamar et al explain:

> *"Small firms may incur relatively higher SOX-related compliance costs for a number of reasons. First, they may experience a disproportionately large increase in audit fees because some of the costs associated with establishing, maintaining, and evaluating internal controls over financial reporting are fixed and because small firms often lack the staff to perform in-house the additional accounting work" (2009:9).*

The lack of in-house staff also means that small firms struggle to respond to complex standards and tend to require more guidance than their larger counterparts. In the case of the SOX internal control provisions the SEC issued final rules in June 2003 but did not release interpretive guidelines until May 2007 (Kamar et al, 2007:9).

Although audit costs are the most prominent issue for SMEs, several other issues have been raised:

> *One concern is that some of the new rules make it difficult for firms to attract individuals to serve as directors because they increase liability exposure and tighten independence standards. This concern might be greater in the case of small businesses because serving on their boards is less prestigious. Consistently, Linck, Netter, and Yang (2007) find that, after the enactment of SOX, director fees as a percentage of net sales increased significantly more for small firms than for large ones. Another concern is that preoccupation with compliance discourages taking business risks. This can be especially problematic for small firms at the start of their growth." (Kamar et al, 2007:10)*

Empirical work on the issue is most readily available regarding the issue of audit costs"

> *"Several studies compare SOX costs of small and large firms. They report that Section 404 implementation costs comprise a larger percentage of revenues for small firms, and that this percentage declined between the first year and the second years after the enactment of SOX for both small and large firms." (Kamar et al, 2007:12)*

Interestingly, however, these studies also showed that even before the passage of SOX audit costs were disproportionately higher for SMEs. Nevertheless, this disparity did increase after SOX's enactment.

As in other countries the issue of regulatory costs for SMEs has been considered by the supervisory authorities. In April 2006 the SEC issued a report recommending scaling down the requirements under Section 404 for firms whose stock market capitalization is between $128 million and $787 million ("Smallcap firms"), and further scaling down these requirements for firms whose stock market capitalization is less than $128 million ("Microcap firms"). Like in Australia and the UK, carve-outs for SMEs were rejected in favour of better guidelines and a postponement of implementation.

Policy Conclusions

This survey of the regulation of corporate governance in SMEs highlights a number of policy conclusions:

- The need for corporate governance guidelines to include flexibility, particularly for companies early in their life-cycle.
- The need to reinforce the robustness of the "if not-why not" approach and educate the market that disclosure, not uniformity, is important.
- The fact that corporate governance demands upon companies develop as they increase in scale and complexity with more diffuse shareholders
- The existence of a critical period in corporate governance when private companies become listed entities with wider accountability and a corresponding need for a more independent board.
- The importance of legal and regulatory guidance and director education for companies preparing to list.
- The fact that companies may carry with them problems of inadequate corporate governance and dysfunctional boards if these are not resolved early in the company life-cycle.

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The Use of Internet Reporting for Small Business

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Abstract

Small business is receiving increasing attention from government because of its potential to drive innovation and economic growth in the wake of the global financial crisis. The lean governance structures in small business mean that decisions are quickly made and implemented. Multiple decisions can modify production processes, produce a new product, apply new marketing methods or tap new markets. These decisions are deeply connected with issues of technological capability and incentives to invest in new innovations. However, many small businesses are likely to have limited access to skills, and lack information about markets and technology. Knowledge about these issues in small businesses is often provided by their accountants. The purpose of this study was to determine how accountants could assist small businesses to make better use of emerging web based technologies to communicate with their accountants. The research was supported by a major grant from the National Institute of Accountants. This paper reports research in which twenty two accountants and their clients were interviewed to determine the potential adoption and use of web based information and communications technology to provide immediate on-going communication between small businesses and their accountants. It is the first article to investigate the support for and barriers to the use of interactive technology to promote small business via the web. The research questions addressed in this paper were: What uses do small businesses currently made of ICT? What are some of the new opportunities offered by ICT to accountants? What are the barriers to the use of new technology? What are the benefits to accountants and their small business clients?

Keywords

ICT adoption, accountants, small business, e-business

Introduction

The most significant driver of innovation at the present time is information and communications technology (ICT). In small business, the major uses made of ICT technology are in the management of a business and responding to compliance with government regulation. Small businesses may lack specialist knowledge. Therefore when there is a need to comply with regulation and/ or legislation, a key option available to small businesses is to use consultants. The most common consultant that small businesses engage is the accountant. In most cases an accountant can assist a business to comply with record keeping required by law and occasionally may be required to provide advice such as recommendations on computer systems (Burgess and Hill 2004). Accountants play a significant role in many small businesses, not only in compiling the end of year figures but also in day-to-day operations, risk management and monitoring cash flows and performance.

The purpose of this study was to determine how accountants could assist small businesses to make better use of emerging

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technologies based on the web to communicate with their accountants.

It is common to hear small business referred to as the “engine room” of the economy because, of its potential to drive innovation and economic growth[24]. There are approximately 1.93 million active small businesses in Australia. They represent ninety six percent of all businesses. Small businesses employ over 5 million people, accounting for around fifty one percent of private sector employment. Small businesses contribute over one third of Australia’s total GDP.

Not only is small business a source of economic activity but the sector is expanding rapidly. The past two decades saw a four-fold increase in the number of small and medium enterprises from 577,100 in the financial year of 1983-84 to more than two million in 2007 (see Figure 1). One can equally say that one person out of ten in Australia owns his/her own business[25]. SMEs accounts for about 99.71% of all private sector entities, while large firms never exceeded 1% of aggregate firm numbers during 1983-2007[26].

In general, corporate governance is concerned with the structures and processes for decision-making, accountability, control and behaviour at the top of organisations. Numerous guidelines and standards for good governance have been developed. For the most part they are directed at ‘big’ corporations. Decision making refers to all those matters which affect the vision, performance and long term sustainability of an organisation. IT is one of the most significant expenditure items and consideration of the IT strategy is a major issue for most boards. The E-environment offered by integrative technology offers SMEs a new way to manage their businesses and probably impacts on the sustainability of small businesses in general.

The lean governance structures in small business mean that decisions can be quickly made and implemented. At a time of recovery from the global financial crisis (GFC) small business activity offers a major safety net for employment. Research has found that small business make a disproportionate contribution to employment (Birch 1987; Gallagher and Miller 1991).

Because of its importance and potential for further growth, the Australian government is examining ways of supporting small business and reducing the burden of compliance with regulation. One way of doing this is to determine if there are other less intrusive and innovative ways of ensuring compliance. A significant driver of innovation at the present time is information and communications technology (ICT).

A variety of stakeholders can benefit from the use of internet reporting facilities. SME owners will have access to ongoing updated reports of business performance. They may also be more efficient if data entry can be made only once for the variety of regulatory bodies and their accountants. Regulatory bodies such as ASIC and the Taxation Department and a host of industry regulators could have information automatically collected and aggregated in regular standard reports. Accountants could have a continuous reporting regime from their clients in which figures are automatically updated and forwarded from their clients at regular intervals (instead of the one major ‘dump’ at the end of the financial year). Too often, a SME will only become aware of cash flow or other problems when their accountant finally gets to look at their accounts. Therefore The theoretical contributions of this project relate to the governance of SMEs (Francis and Armstrong 2006) and the development of new approaches to the adoption of integrative adaptive systems for businesses in an E-environment.

Although there is considerable research into the barriers to small business growth (Doern 2009) there is very little research on the use, and barriers to the use, of communications technology in this context. The purpose of this study was to fill this gap by determining how accountants could work with small businesses to make better use of emerging technologies based on the web. This article discusses the characteristics of small business, describes the methodology and the conceptual framework and the results of the study.

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24 Senator Hon Nick Sherry Assistant Treasurer 2009 The importance of small business to the Australian economy. Speech to the Small Business Forum. Hobart, Tasmania 21 November 2009

25 The last Census shows the Australia population is about 22 million.

26 Australia Bureau of Statistics (2007), Counts of Australia Businesses, including Entries and Exits. Cat. no. 8165.0. Canberra.

Characteristics of Small Business

There are various definitions of small business but the one adopted here is that of the corporations law (Australian Corporations and Securities Legislation 2009). A company is classified as a small business if it satisfies two of three following conditions:

- Consolidated revenue for the financial year is less than $25 million.
- The value of gross assets at the end of the financial year is less than $12.5 million.
- The company has less than 50 employees at the end of the financial year.

The Australian Bureau of Statistics also has a lesser category that it calls micro, which has less than 5 employees.

Two thirds of small businesses with less than 20 employees are home-based, and more than half of them do not have any staff at all; an estimated 10-30% of all business owners are in their second or third time to start a new business; and almost 10% of small business operators run two or more businesses concurrently.

The characteristics that are identified with small business are:

- They have a relatively small share of their marketplace;
- They are privately, often family owned;
- They are managed by owners, often owner/managers;
- They are independent, in the sense that they are not part of a larger enterprise;
- They may have resource constraints.

Family owned businesses are well represented in small businesses and the philosophy of the family or owner/manager will have a major effect on business generally and particularly in relation to the adoption and use of new technology (Breen, Sciulli et al. 2003).

Due to the particular characteristics of small businesses, the way they deal with corporate governance issues are different form larger firms. For example small businesses may be owner/manager operated, family businesses or even partnerships. Navarro and Anson (2009) provide empirical evidence of family corporate governance structures. Boards are smaller than non-family firms. They are biased towards insiders, and have fewer non-executive directors and board committees. Similar results were reported in relation to small corporations in an Australian study (Clarke and Kettner 2009 in press). Family companies have longer serving chairmen, often the owner. In Asia, more than two thirds are controlled by a single shareholder (Navarro and Anson 2009). This latter point means that the traditional explanation for the introduction of modern governance practices, agency theory, may have limited application for these kinds of organisations, as the interests of managers and owners are aligned.

Many small firms occupy niche markets and offer a specialized service or product. Storey (Fillis Ian and Wagner Beverly 2005) identifies three areas where small firms differ from large firms: (1) *uncertainty:* the small business has a limited customer base and products; (2) *Innovation*: refers to the niche role of some firms but also refers to the extremely fast rate at which some firms can grow. Small firms tend to be more likely to introduce essentially new innovations and less committed to existing practices and products; (3) *Evolution:* small firms are more likely to evolve and change.

Due to the above characteristics, small businesses face various barriers to IT implementation. Prior studies report that the barriers to implementation of IT management systems for small businesses are: cost, lack of time to devote to the implementation and maintenance of IT, lack of knowledge combined with difficulty in finding useful and impartial advice, lack of use of external consultants and vendors, lack of understanding of the benefits that IT can provide, how to measure those benefits and lack of formal planning, the cost of new infrastructure, the time to implement solutions, and uncertain returns on investment (Burgess 2002) and lack of time and effort put into planning where the business is heading (Burgess and Schauder 2003).

Financial management is also a significant issue for small business, due to the volatility associated with situations such as cash and profit position, reliance on short term debt and need for financial

information. Large number of small businesses fails in the first five year of business. The reasons for the failure are: no formal reporting requirements, no proper debt management, cash-flow problems, insufficient reliable information to measure their performance (Watson and Everett 1996), high rate of interest demanded by the banks. Eighty percent of all new businesses fails due to undercapitalization (Festervand and Forrest 1991). Hence, the financial services offered by accountants can make a significant contribution to the success of a small business.

The main issues emerging from consideration of small business characteristics is that their use and adoption of innovations, such as new ways of communicating with their accountants, may be influenced by lack of time, expertise, and financial resources, and access to IT resources (equipment, manpower, skills, time) (Burgess and Schauder 2003) and the values of the owner/manager. The most recent development in ITC is the use of the internet.

The driving factors behind owner/ managers adoption of IT appears to be the need to take control of the financial management coupled with improved accounting software and more powerful hardware systems. Small business financial management has improved since the widespread embracement of computerised accounting software (Breen, Sciulli et al. 2003).

Breen, Sciulli et al. (2003) state that the major benefits of implementing computerised accounting systems are to make execution of business processes more efficient and timely and it takes control of financial management. Burgess (1997) in his study reported the two top ranked benefits as increased efficiency and better access to information. Breen, Sciulli et al. (2003) argued that these benefits would represent time and cost savings for small business and therefore make the cost of accounting software affordable for small businesses.

E-Business

E-business is a term used to describe business activities and processes conducted on the internet. Zwass (1994) described it the sharing of business information, maintaining business relationships and conducting business transitions by means of internet-based technology. More recently electronic commerce has been identified with a whole business strategy (Lawson, Alcock et al. 2003) that offers a range of services and opportunities including data exchange, mobile telephone, internet, intranet, and email (Quayle 2002). In the context of this study it specifically refers to two way interactive access by accountants with their small business clients. This mode of communication would enable ongoing monitoring of the small businesses and their performance and the provision of management accounting services to the businesses.

Several researchers have identified the opportunities offered by e-commerce to small firms. They include the ability to reduce transaction costs, the development of a more level playing field with larger firms, improved communications, the ability to identify and extend marketing efforts, new markets, cost reduction and developing relations with suppliers (Evans and Wurster 1997). Among the issues that need to be considered include the opportunities and benefits which e-commerce offers, the resources needed, the barriers that must be overcome and the management of risk.

Other studies have shown that firm size, degree of exporting, awareness of benefits and customer type appear to dictate how ICT strategies develop in small firms (Lauder and Westall 1997) and yet others refer to factors which inhibit adoption such as the limited resources of personnel, finance and business knowledge of the small firm compared with its larger counterparts (Simmons, Armstrong et al. 2008). A relationship between size of the business and level of adoption of information technology has also been reported.

Not least is perception of its benefits. Often this means that the competency, knowledge and willingness of the owner/mangers are the deciding factor in the adoption of new technology (Ramsey, Ibbotson et al. 2003).

In addition to these internal factors which influence the adoption of new ITC, external mechanisms have also been found to have an influence. Among these are specific industry and sectoral factors, competitiveness, globalisation, and the growth of a firm in international markets.

The internet is considered an extremely efficient means of accessing, organising and communication of information, (Peterson, Balasubramanian et al. 1997). Internet reporting has the advantage of the distribution of financial information at a low cost; the ability to provide real-time financial reporting to support internal decision making; and companies that can track financial performance quickly are in a position to discuss any events in an intelligent frank and timely manner when bad news strikes suddenly (Berk 2001).

However, recent research shows that adoption rates of Internet Business Solutions (IBS) are significantly lower for SMEs than for other larger organisations in US and EU. This has led to concern among policy makers that SMEs lag behind the larger firms in adoption of wealth creating technologies and adversely affect their economic performance. The scope of this study is restricted to the investigation of communication via the web between accountants and small business using the internet. The research questions were:

- What use do small businesses currently make of ICT?
- What are some of the new opportunities offered by ICT to accountants and small businesses?
- What are the barriers to the use of new technology?
- What are the benefits to accountants and their small business clients?

Methodology

This was an exploratory research study that uses quantitative and qualitative methods, which are appropriate for an exploratory study. The study was conducted using in-depth interviews using a structured interview schedule. The qualitative method of content analysis of comments and other qualitative responses and quantitative analysis to obtain descriptive statistics enables the researcher to understand and explain in detail the responsibilities, personal experiences and focus on people's understanding and interpretation rather than seeking external causes or laws for behaviour. This also allows the researcher to report research issues from a participant's perspective.

The survey was conducted using questionnaires which included closed and open-ended questions which gave respondents opportunities to provide comments and raise issues that would be of benefit to the study.

The total sample was 31 respondents comprised of accountants and their small business clients. The sample of accountants was obtained through the National Institute of Accountants who sent an invitation to their Victorian members inviting volunteers to participate in the study. Twenty two accountants responded. The accountants were then asked to contact small business clients who were the owners/managers of small businesses and invite them to participate. Nine SMEs responded. Both accountants and small business owner/managers participated in a one hour interview using a semi-structured interview schedule which collected both quantitative and qualitative data. Data were analysed using SPSS for descriptive statistics of the quantitative measures and by content analysis of the qualitative data. The perceptions of the accountants are reported in the tables as frequencies and percentages

Results

The sample

Of the sample of accountants, 82% were male and 18% female. Over half 55% had postgraduate qualifications and three quarters (86%) had over 11 years experience. Two thirds (69%) were located within the Melbourne CBD or suburbs and one third (32%) in regional Victoria. All except one reported that over 20% of their clients were small businesses.

Seven of the small business respondents were male and two female. They operated in a range of industries: manufacturing (2) Building (2) bookkeeping (2), and financial services, IT and hospitality (1 in each). Two thirds (7) had less than 20 employees and two employed less than 50 employees.

What use is currently made of ICT?

The Study canvassed the perceptions of both accountants and small business use of the internet.

The Accountants

The most frequently used IT systems (Table 1) by accountancy firms were MYOB (by 100%) Excel ((79%), QuickBooks (/quicken) (50^), BankLink (21%).

The majority of Accountants in this sample (n=17; 77%) reported that their firm had a website. However, many spontaneously commented along the following lines:

- *These days, it is a market expectation that Accounting firms have a website and that having a website (somehow) demonstrates that the firm is properly established/ legitimate.*
- *While the firm's website had been established primarily for marketing/ advertising purposes (n=14), little, if any, business had been generated from the site.*
- *The website delivered little value to the Accounting firm other than acting as a source of contact information for (a small number of) clients.*
- *The exceptions were one accounting firm that provided a client portal service on its web site and another that provided educational tools on its site.*
- *"$10,000 spent and no response." (Accountant)*

Electronic lodgement of Government returns (Taxation, BAS, Payroll tax, ASIC returns, WorkCover, etc) was widespread. All but one of the 20 Accountants, who prepared taxation returns and other government returns for SME clients, reported lodging such returns online.

Only one SME respondent (an Accounting business) prepared their own tax return. In most cases (n=8) the return was prepared by an Accountant and lodged online (n=7).

Respondents were asked about servicing interstate and overseas clients. Seventeen (77%) of the Accountant respondents had IT systems (remote access to their office server and mobile email and Internet access). A few also had remote access to their clients' networks.

However, only one serviced overseas clients. In this case, it was a trust run out of London with much of the communication being via Skype. It was pointed out that most Australian accountants have no standing to provide accounting services overseas.

Table 1: Current IT Usage - Accountants

IT Usage	Number (n)	Percentage of responses (%)	Percentage of respondents (%)
Accounting software	14	26%	70%
Office software applications	9	17%	45%
Internet applications	7	13%	35%
Online access to Government (ATO, ASIC) and other agencies	7	13%	35%
Data transmission	4	8%	20%
Intranet applications	2	4%	10%
Remote access to client data	2	4%	10%
Remote access to office systems	2	4%	10%
Mobile communications (e.g. email, diary via i-Phone)	2	4%	10%
Management of client and supplier databases	1	2%	5%
Timing and costing of work units	1	2%	5%
e-Commerce	1	2%	5%
Continuing Professional Education	1	2%	5%

The main way in which accountants transferred data to their clients was via email (905) but paper was still important (75%). Disk, fax and memory sticks were also used. The results confirm previous findings in a study conducted by Poon and Swatman (1997) who also report email as a main form of communication with customers.

Small business

All the businesses used IT packages. As one said:

> *We use it for everything – client control, financial plans, receiving and transmitting information, liaising, making appointments, on-line training, etc." (SME)*

Eight of the nine SME respondents had a business web site which was used as follows:

- Marketing information for customers and potential employees (7 mentions);
- Provision of contact information (2);
- Educational tool (reference information for technicians who use the company's products, an electronic newsletter) (2);
- Facility for clients to lodge a request for a quote (2).

What are the barriers to the use of new technology?

Fourteen (64%) respondent Accountants and four SME nominated factors that could or would deter Accountants from using a continuous online monitoring and access system with their SME clients. However, the most frequently reported reasons (Tables 2 and 3), were cost and compatibility with other systems.

Three Accountants respondents rejected the possibility of adopting a new interactive system entirely; maintaining that they had no need for such a system and did not perceive any benefits from using it.

Table 2: Barriers to Adoption by Accountants

Barrier	Accountant Sample		
	Number (n)	Percentage of responses (%)	Percentage of respondents (%)
Cost	8	38%	57%
Concerns about security/privacy of data	3	14%	21%
Unauthorised access to the data	-	-	-
No need; no perceived benefits	3	14%	21%
Time required to set up and integrate with other systems	2	10%	14%
Implementation and maintenance issues	2	10%	14%
Poor Internet service in regional areas	1	5%	7%
Accountant's liability	1	5%	7%
Lack of expertise/need for training	1	5%	7%

> *Sixteen (73%) Accountants and seven SMEs nominated factors that could or would deter SMEs from using a continuous online monitoring and access system.*

A third of the Accountant respondents noted that at least some SMEs would not have the resources (time, computer equipment, IT knowledge and training) required to establish and maintain such a system.

Table 3: Barriers to Adoption by SMEs

Barrier	Accountant Sample		
	Number (n)	Percentage of responses (%)	Percentage of respondents (%)
Lack of expertise	8	27%	50%
Cost	7	23%	49%
Privacy concerns	5	17%	31%
Time required to set up and manage	3	10%	19%
Incompatibility with other systems	2	7%	13%
Poor Internet service in regional areas	2	7%	13%
No need (e.g. does not fit with SME monthly reporting cycle); no benefit	1	3%	6%
Access to information	1	3%	6%
Glitches with new software programs	1	3%	6%

Some opinions were:

> *"The client must accept that the accountant will make a valid contribution. Many are protective or defensive about advice in helping the business." (Accountant)*

> *"Hacking [would be a concern]. We would need to be confident about the data security… It might be incompatible with IT systems for example, if the client has old systems…. And, all new systems have glitches…. I already do a lot of the record keeping for them [small business clients] for example, minutes of meetings. Therefore the client may see the new system as 'more work for me'. They may prefer that the accountant still does this." (Accountant)*

Just under half of both the Accountant (n=10; 46%) and SME sample (n=4) had concerns about privacy, confidentiality and/or security. The suggestions of seventeen Accountant respondents (77%) and eight SMEs to address concerns about privacy, security and/or confidentiality, a back up/disaster recovery facility, codes of conduct, Secure IP address, and firewalls.

Table 4: Concerns re Privacy, Security& Confidentiality

Barrier	Number Accountants (n)		Number SMEs (n)
The risk of hacking	4		4
The privacy/security of confidential information (including third party information)	3		2
Confidentiality	2		-
Compliance with the Privacy Act	1		-
Restrictions regarding the disclosure of Tax File Numbers	1		-
Viruses	1		-
Liability for data integrity	1		-

(Sample bases: 10 Accountants and 4 SMEs who nominated concerns)

What are the benefits to accountants and their small business clients of web based ITC?

The following table 5 summarise the likely benefits of a continuous online monitoring and access system for Accountants, SME clients, and the Government, respectively.

Some benefits seen by accountants were that it could prove time saving, offer better service, and information. As they said:

> *"This could be good for some of the big clients; those with over $10M turnover … It would generate fees and cement the relationship." (Accountant)*

"The concept of having a 'window to the business' is good. Automated reporting could be an add-on option, but it would have to be sophisticated and tailored to the particular business." (Accountant)

"Like BankLink where you can get the clients' bank statements and can code it." (Accountant)

"Time saving ... real time information ... more accurate and up-to-date information and we don't have to rely on the client providing all the information needed (often it comes in drips and drabs)." (Accountant)

"It's management by exception, which I like. I like the monitoring system… The benefit over others [packages] is that the accountant has [continual] access to it [the client's data]…. MYOB has something similar but I've not had much luck with it. It must be easy to use and easy to export data." (Accountant)

"Improved service and less paper-based services." (Accountant)

"Increased income and profit… Enhanced advisory services." (Accountant)

Not all the views were positive:

"I don't see any benefit. I don't need on-going real time access to client information. I deal with clients, event by event." (Accountant)

"Most are very small and in control and know what funds they have… Most don't seek financial advice about the business performance and some are shy – their information is private." (Accountant)

Table 5: Benefits for Accountants

(Sample bases: 20 Accountants and 8 SMEs who perceived benefits for Accountants)

Benefit	Accountant Sample		
	Number (n)	Percentage of responses (%)	Percentage of respondents (%)
Enhanced client service	14	14%	70%
Fast client notification of problems	13	13%	65%
Direct communication with client	11	11%	55%
Ability to identify clients' impending financial problems	11	11%	55%
Reduced cost (to client)	10	10%	50%
The potential for proactive offers of new services	10	10%	50%
Efficiency and productivity gains	8	8%	40%
Improved client relationship	8	8%	40%
Save time	6	6%	30%
Easy access to client data; convenience	4	4%	20%
Facility to monitor client KPIs	1	1%	5%
Accountant access to more accurate, up-to-date, real-time data	1	1%	5%
Better understanding of the business' activity	-	-	-
Opportunity to generate more fees	-	-	-

The business respondents identified the practical advantages (Table 6) of having ease of transfer of information and increased efficiency:

"He could access our information whenever; he wouldn't need to visit and back up our MYOB files [which are too large to email and so have to be put on disk]… It's an accessibility benefit - they can access the data whenever they want - after hours, on the weekend, if I'm away…" (SME)

"[The benefits would be] streamlined operations, easy access, automated, remote access, efficiency." (SME)

Table 6: Benefits for SMEs

(Sample bases: 20 Accountants who perceived some benefits for SMEs; 6 SMEs who perceived some benefits for their respective business)

Benefit	Accountant Sample		
	Number (n)	Percentage of responses (%)	Percentage of respondents (%)
Fast notification of impending problems	11	15%	55%
Reduced service response time	11	15%	55%
The ability to respond quickly to orders, tenders, etc	10	14%	50%
Direct communication	9	13%	45%
Reduced cost	9	13%	45%
Quicker budget projections	6	8%	30%
Would help identify profit drivers of business	5	7%	25%
Better quality/more data/up to date data	4	6%	20%
Ready access to information (faster decision making)	4	6%	20%
Save time	2	3%	10%
Minimise amount of work required by client	1	1%	5%
Reduced administration	-	-	-
Facility to automate government returns	-	-	-

In regard to a continuous system that could be accessed by government, both Accountants and SME respondents raised concerns that the Government might have access to SME files in their system.

Some small businesses thought that there were advantages:

> *"The information would be more accurate and so there'd be fewer problems with people understating their income [to the ATO], etc." (Accountant)*
>
> *"This fits with automated BAS, tax and super returns, which is OK. But, many would not want to, say, flag to the regulator that their earnings had gone up in a quarter." (Accountant)*
>
> *"It could not be linked to government. Clients are very nervous about government/ATO getting their details – Big Brother." (Accountant)*
>
> *But there were reservations:*
>
> *"It's OK if it's between the accountant and us ... But we don't want ATO having access. For example, if we put something [an entry] in the wrong place, we need the opportunity to correct it." (SME)*

Table 7: Benefits for Government Regulators

Benefit	Accountant Sample			SME Sample
	Number (n)	Percentage of responses (%)	Percentage of respondents (%)	Number (n)
More accurate data	5	30%	39%	4
More businesses would meet government deadlines	4	24%	31%	2
Faster lodgement of returns	1	1	1	3
Increased compliance (e.g. re GST)	2	12%	15%	1
Less time required for SMEs to prepare returns	1	6%	8%	1
Fits with Government plan to drive eBusiness	1	6%	8%	1

(Sample bases: 9 Accountants and 6 SMEs who perceived benefits for government)

While the majority of Accountants in this study did not perceive any direct or flow-on benefits that a continuous online monitoring and access system would deliver to Government regulators, six of the nine SME respondents were able to nominate at least one benefit for government regulators.

What are some of the new opportunities offered by ICT to accountants?

The study explored the perceptions of the usefulness of a continuous online communication system between accountants and small business clients which, would include various reporting facilities and have a trouble-shooting facility whereby both parties would be alerted should any pre-programmed criteria be met (e.g. evidence of an impending cash flow problem).

The majority of Accountants in this study (80%) thought such a system would be useful or very useful for (at least some) SME clients and for Accountants who service SMEs (81%). As one said "An early problem detection system would be useful".

Some reservations expressed by small business were that it would be "*not useful… too much information; don't want to give the accountant access to all that…Over-engineering…No need" and "we would have to pay more for this…"* Others were more positive. SMEs appraised the system as having greater utility for Accountants than for SMEs: 67% of SMEs thought such a system would be useful or very useful for their business; 86% thought it would be useful or very useful for Accountants.

Conclusion

The purpose of this paper was to determine the potential for the adoption by small business and accountants of new technology such as interactive ICT. The investigation selected the interaction of small businesses with their accountants, the most used consultant by small business, to research the issue. The opinions of both groups were necessary as one could not act without the compliance of the other.

The review of the literature identified a number of factors which could inhibit the adoption of ICT by small business. In this study similar results were found. Cost, lack of time, skills and knowledge were uppermost. Small business may have the capacity to respond quickly to new innovations but both accountants and small business respondents expressed reservations about the adoption of interactive ICT. Among the barriers to adoption were cost, compatibility with existing systems and privacy issues.

The limitations of the study were the small sample size. Although the sample size was small, accountants were distributed across regional and metropolitan areas, and they included a range of gender, age and qualifications. Because it was a 'volunteer' group it may be biased towards those with higher levels of qualifications and interests in adopting newer information technology. The diversity of small business industries represented by their clients suggests that their views could be representative of the sector. However, their very diversity means that the internal firm mechanisms identified in the study as having an impact on perceptions of the innovation may differ if the types of business and their specific use of "ICT were taken into account. This could only be done by further research with a much larger sample.

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The Impact of Emerging Technologies on SMEs

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Abstract

This paper explores the potential of emerging technologies in transforming and automating the business processes of Small and Medium Enterprises (SMEs) and enable them to engage with trading partners and customers in global networks. The technologies are associated with Services Oriented Architecture (SOA) through Software as a Service (SaaS), cloud computing and innovative application environment developed through the Phoenix research program at Victoria University. A service framework based on the emerging technologies from the Phoenix program is presented and discussed in response to the SME barriers raised in accessing those technologies.

Keywords

SME, Supply Chain, Business Process, Applications Integration, Cloud Computing, SaaS.

Barriers of ICT Engagement for SMEs

Information and Communication Technologies (ICTs) are having an increasing impact on business activities and offer unprecedented opportunities for business success. However, companies with different sizes and structures are taking up the opportunities offered by ICT at different speeds.

Research from the European Union (EU) and US shows that Small and Medium Enterprises (SMEs) do not take advantage of ICT and e-Business solutions in the way that large companies do. This makes SMEs more vulnerable to changing economic conditions as they have a relatively lower level of competitiveness (Arendt, 2008).

The nature of SMEs (due to their size) is that they do not usually commit financial and human resources for ICT investment to gain competitiveness and productivity. Most of the SMEs consider ICT as a set of tools for solving short-term operating problems instead of long-term strategic goals. On the other hand, research indicates that even though in the UK the SMEs are swiftly switching to the Internet to explore potential business opportunities, they are still slow to accept e-business as the foundation for business communications and transactions. Furthermore, even though the 1.9 million small businesses in the UK are connected to the Internet, exceeding the government's original goal of 1.5 million, the UK's Federation of Small Businesses research shows that the usage of the Internet by SMEs is still relatively undeveloped. SMEs still likely to use the Internet only to send e-mails, transfer files or documents or gather information. There is no evidence that SMEs use and invest in ICT with an intention to improve services, processes and business automation.

The "Sectoral e-Business Watch" study of the 2007 European Commission report also confirms that e-Business activities of large companies are rapidly maturing. These companies hold very strong ICT systems, which enable them to conduct business processes efficiently and deliver business benefits. However, there are still many SMEs who are struggling to get digitally connected with their suppliers and customers, and running the risks of losing emerging business opportunities as well as competition advantages with larger firms.

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The benefits for SMEs of improving business process and productivity are potentially huge. Maguire et al. (2007) explored how SMEs may use ICT to secure a competitive advantage. The key outcomes of this research were the following:

- SMEs considered ICT as a key factor in cost reduction;
- ICT could enrich product development and service quality at a very high level in SMEs;
- SMEs viewed sales forecasting, customer analysis, and pricing as the most effective ways of utilising ICT for competitive advantage.

Australia's SME sector consists of over two million firms with less than 20 employees and an annual turnover of $A2-10 million (National Australia Bank SME survey, 2008). SMEs play vital roles in new job and venture creation, sustainable microeconomic growth, emerging export markets, innovation, and business resilience.

However, barriers exist for SMEs to adopt and take advantages of ICT systems as e-business solutions. In a recent study (Task Force, 2006), the barriers were classified into two broad categories: macroeconomic and microeconomic. This article focuses on the microeconomic aspects of the barriers.

The first microeconomic barrier was the lack of awareness, knowledge and skills within the SME environments. This makes it difficult for SMEs to select the right technologies as these are changing rapidly. Hence, they often use the services of external advisors. The second barrier is that existing ICT products are not well suited to meet SMEs' needs. This therefore increases pressures on SME owners and managers to invest in employee training for future e-business readiness. It was also demonstrated that the SMEs sector was experiencing greater problems in finding e-Business solutions than large enterprises. The reasons behind this were a lack of time and the lack of internal information and knowledge. Furthermore, SMEs choose to use the existing and familiar business models to avoid the risk of transferring to the new ones based on ICTs.

Supply Chain Management from SME Perspectives

In modern e-business environments, individual business, including SMEs, cannot survive on their own. It is highly desirable that SMEs can engage effectively with its business partners and customers. Some larger firms require specific way of e-business interactions with their suppliers, putting more burdens including costs on SMEs, but at the same time offering business opportunities. Therefore electronic supply chain management is also critical to the business success of SMEs. Supply Chain Management (SCM) represents a set of disciplined approaches to effectively integrate business partners e.g. suppliers, manufacturers, and customers for improved performance of the individual companies and the supply chain as a whole (Chopra and Meindl, 2004).

Increasingly, SMEs play key roles in supply chain management as they participate in value creating activities. They supply raw materials, produce products, and distribute finished goods to customers. Through their efforts, SMEs have significant impacts on supply chain processes (Huin et al., 2002). Many studies of supply chain management focus on the practices of large firms, while small firms are treated mostly from the viewpoint of larger firms (Chopra and Meindl, 2004; Kukalis, 1989; Lambert and Cooper, 2000).

Previous studies highlighted the growth patterns of SMEs in the context of information systems (Levy et al., 2001; Venkatraman, 1991), industrial marketing (Kalafatis et al., 2000), strategic planning (Berry, 1998; Cooper et al., 1986), and integration issues (Shiels et al., 2003). More research effort is needed to study the impacts of SMEs in the context of supply chain management. Since the long-term sustainability of SMEs depends on "where they compete" and "how they compete", decisions on their chain relationship position and operational focus should be strategic.

However, accessible and low-cost SCM remains a major barrier for SMEs to achieve the economies of scale and scope for global competitive advantage. Many SMEs recognize the potential value of supply chain integration to provide a holistic view of customers, suppliers and the business value chain. However, whilst some SMEs have benefited from the SCM functionality provided in early e-business platforms they have largely been unable to achieve the promised competitive benefits due to

technology-associated high learning curves, high transaction costs and complexities in managing business partners' relationships. The existing SCM solutions were conceived for trans-national corporations; for SMEs they have high up-front costs associated with hardware, software, training and integration. SMEs consequently face entry and infrastructure barriers. Lowering entrance and participation barriers will help SMEs gain access to technologies and to help them instantaneously participate in point-to-multi-point supply value nets (Bovet and Martha, 2000).

The Emerging Technologies

Cloud computing

Cloud computing can be thought of as computing resources sharing and services delivery for users conveniences. Cloud computing particularly offers the following features to support users' needs: 1) Services on Demand: services with various purposes can be acquired anytime, anywhere; 2) Database Sources on Demand: a gathering of relevant data sources (e.g. database) in relation to the application needs; 3) Applications on Demand: delivery applications according to specialized processes; and 4) Platform on Demand: provision of application environments for users. For SME users, ICT infrastructure, platform, equipments and the majority of the application data can all be taken care through cloud computing to support individual business needs.

From the Phoenix application environment at Victoria University (url: **Error! Hyperlink reference not valid.**), depending on users' requirements, appropriate levels of computing resources are organized which lead to a cloud. The outcome of processing users' requirements within the cloud reaches the concerned users through wired or wireless Internet as cloud-delivered services.

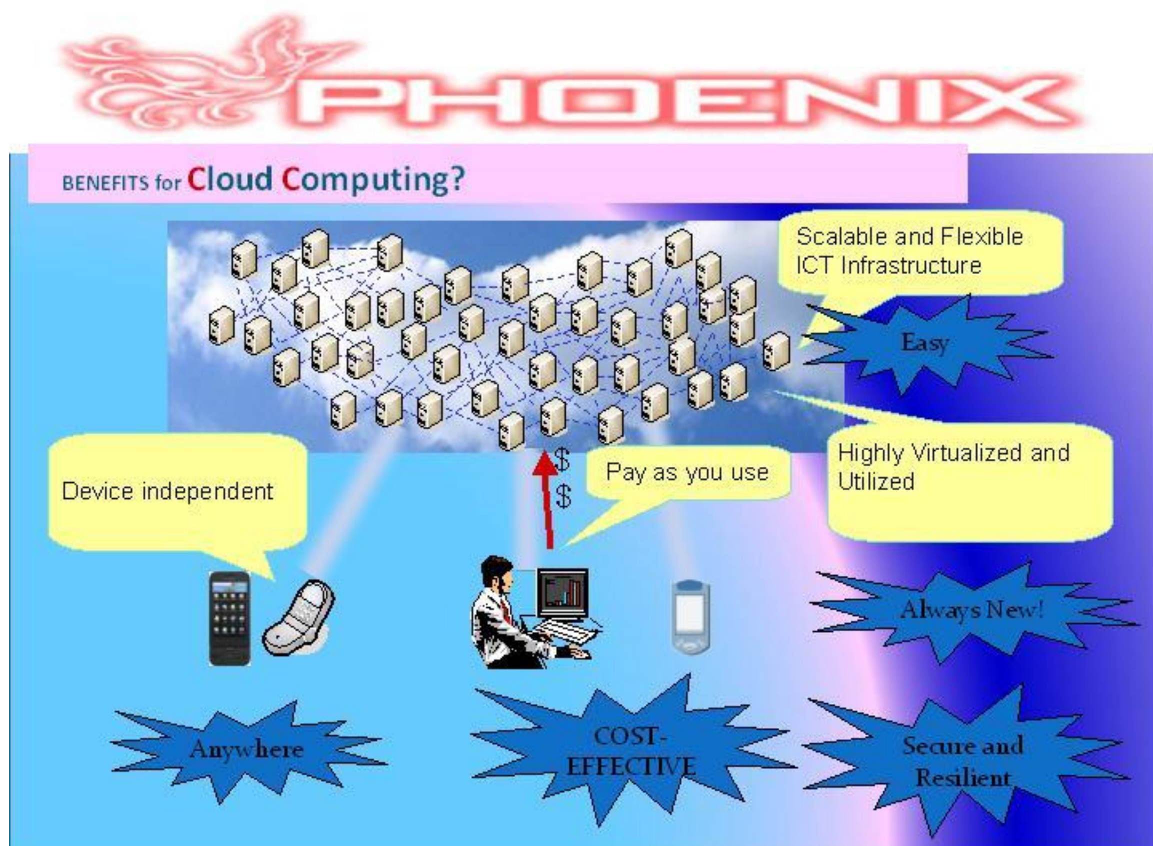

Fig. 1: Cloud Computing Benefits

One of the big advantages of cloud computing is that small businesses can access best of breed of software infrastructure and resources without making upfront investment. Particularly, (as illustrated in figure 1), SME staff can access the required software services and support using conventional devices and equipments such as a mobile phone or a PC regardless of time, place, communication

protocols or standards imposed, therefore allowing SME staff focusing on core business activities such as sales, ordering etc.

Software as a Service

To provide cost effective services to business, and especially SMEs who do not have resources for high-end computing facilities and a training budget, a Software as a Service (SaaS) model is studied and adopted for a proposed services framework that is positioned specially for the SME sector. Under SaaS, the service framework (mainly consisting system services) is no longer running on premise on a customer's IT infrastructure but is hosted in a SaaS provider's data centre and accessed over a network such as Internet. Customers can subscribe to or unsubscribe from the service framework as they desire. The main advantage for the customers is that they can use the service framework on demand (i.e. when they need it) without the need to provide the necessary computing infrastructure to run the software. Providers also profit from the SaaS model by offering applications as a utility to their customers. Similar to traditional utility providers such as water or power providers, SaaS providers can exploit economies of scale. They can offer the same physical application to different customers, thus, the provisioning of the necessary hardware and middleware is needed only once and can be used for different customers over and over again.

Software as a Service (SaaS) is the term used for delivering software applications across networks such as Internet. SaaS can help remove the need to purchase expensive server infrastructure. The SaaS model is being used to provide a whole host of software applications from email to enterprise mobility solutions (Liao & Tao, 2008).

The traditional model of packaged software application requires customers to pay upfront. As the software may include many features that customers will never use, in many situations, it may not represent a cost-effective investment particularly for SME users. By creating an environment where the IT spending is on based services that are actually needed, businesses such as SMEs can be better off in their cash-flow positions. This also gives rise to an immediate tax deductable expense instead of having to factor in depreciation on big upfront costs as well as removing complexity and cost involved in on-site systems maintenance (Godse and Mulik, 2009).

Innovative Solutions

This article investigates a new generation solution framework for SMEs through innovative use of the emerging technologies discussed above. The framework is based on the services orientation paradigm to provide integrated e-business integration that brings benefits to both individual SMEs and their partners. In order to better support business activities among business partners and their partners, Services Oriented Architecture (SOA) offers integration infrastructure and support among services on behalf of various business entities.

Under the SOA paradigm, a service is basically a well-encapsulated business function or process with a clear identity and programmatic accessible interfaces. These services are typically implemented using Web service technology, although services under other platforms such as OSGi (www.osgi.org) are also gathering momentum. SOA is a way to integrate business with a set of linked loosely coupled services. These services can work together in an on-demand mode, i.e. in response to arising business needs. Because SOA utilizes a service-orientation principle to create an enterprise IT architecture that addresses the business problems, the service identification, granularity, and construction need to match business process characteristics. Driven by business processes, the service patterns, service rules, and service defining methods that need to be subsequently established, constitutes a technology roadmap of SOA.

The Phoenix research program at Victoria University shares the vision of integrated e-business solutions with traditional Enterprise Resource Planning (ERP) systems (Figure 2).. The research framework presents itself as an integrated web based solution used to manage a company's resources. It aims to provide real-time service oriented applications to meet dynamic e-business requirements, and has the potential for offering integrated solutions to SMEs in a more flexible, dynamic and cost-effective way. If compares advantageously with existing ERP systems adopted by the larger firms.

Phoenix adopts cloud computing as its software packaging capability and SaaS as its services delivery model.

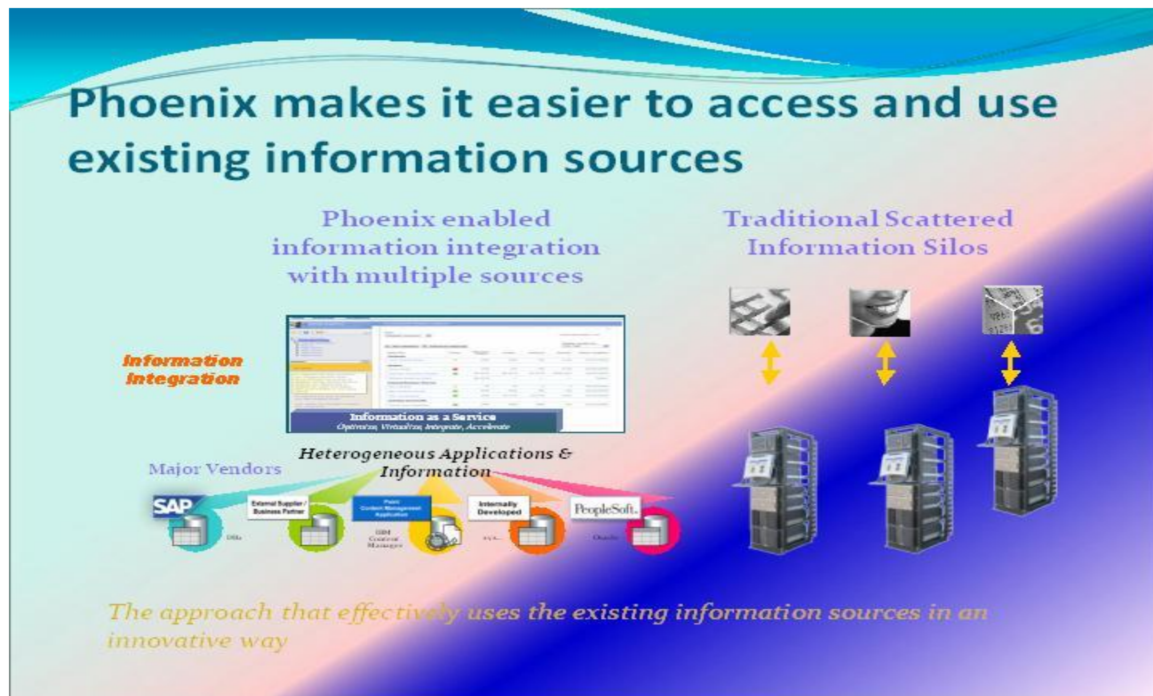

Fig. 2: Information Sources Integration

Services Management

The goal of serving business effectively is accomplished through services management that coordinates and applies the relevant services to meet users' requirements. The services fall into two broad categories: system services and business services.

System services

System services provide the fundamental functionality to ensure the smooth and effective operations on a Services Oriented Architecture (SOA), e.g. operations in relation to services management from services registry and repository, services coordination and execution. These typically contain no intrinsic business logic, but are used to provide service-based access to existing operational systems. Often referred to as *atomic services* (as they generally don't depend on any other services), they are usually provided directly by the underlying operational system—although it may be custom built using whatever interface mechanisms are available. The methods exposed are typically general purpose and fine-grained, as they are primarily designed to be reused by other services. Whilst this interface could be accessed by the ESB, best practice is to allow this to occur only if the service interface is sufficiently generic and does not introduce an element of tight coupling between consumer and provider. The framework provides such system services in form of knowledge management Information services, data management services, communication services and task management.

Business services

Business services are those directly associated with business functions and processes, e.g. issuing purchase order, credit checking etc. These services contain the business logic that will be used by the business processes, and are often referred to as *composite services*, as they may delegate processing to a number of other businesses or IT services. Unlike IT services, the methods exposed are generally coarse-grained and typically relate to a specific business activity.

The key in delivering the complete services to SMEs relies on integration of systems services with business services (Dai, 2009).

Engaging with SME Users via Services

From an architectural perspective, SOA is an architectural style that supports service orientation. From a technology perspective, SOA is supported with standards-based infrastructure, programming model, and technologies, such as Web services. From a business perspective, SOA consists composite applications and a set of agreements between service consumers and service providers who specify the various metrics concerning business and users including the description of quality of service. A composite application is a set of related and integrated services that support a business process built on an SOA. To scale it up, depending on the nature of the application tasks, Enterprise-SOA is proposed by major software vendors, which is a higher level of business application environment with the focus on business processes using standard interfaces (Datz, 2004).

To engage SME users with the modern services oriented framework, two styles of interactions i.e. demand driven and event driven as shown in Figure 3 are recommended and discussed below.

Fig. 3: Improved business agility through flexible services delivery.

Demand-Driven SOA

According to Malatras et al (2008), the main technical barriers to the wide-spread adoption of ICT systems by the business users were the tight coupling of services to implementation and inflexible infrastructure The services delivered are therefore too expensive and can only fulfil the partial needs for the business community. The inflexible infrastructure also led to a very limited usage of available resources. The framework aims to improve the SOA latency in response to arising demands from users.

Latency within SOA has a direct correlation to how well the infrastructure can respond to customer's demand. The latency and responsiveness of an SOA infrastructure are specifically related to business tasks that may come in many forms and are often unpredictable. The tasks are generated according to business situations and needs such as preparing budget report, generating purchase orders etc. Solutions delivered from the framework are specifically related to the tasks.

Event driven SOA

An Event-Driven Architecture (EDA) provides a means for systems to respond dynamically as events occur, e.g. low inventory of products, special advertised business offers etc. For systems to be most responsive, they must be able to quickly determine the necessary actions when events are triggered. To this end, events should be published and consumed across all boundaries within the SOA (Phippen et al, 2005). Essentially, events are signals that something has occurred or in some situations a representation that something has not happened when it should have (Granebring and Revay, 2007).

Events can be high-level and business-oriented, or low-level and technical in nature. As events are detected under the Phoenix event driven services delivery mode, SME users can be alerted in time to deal with arising situations that may have business impact.

The service framework will allow SMEs to continuously monitor changing circumstances in business environments in order to have early opportunities to respond to arising situations that may materially impact their operational effectiveness. Event driven applications are particularly effective with data that are high volume and frequently changing. The discovery of events will allow SMEs to know what has happened, where it is happened, and when.

The environment in which the business operates demands the capability to respond quickly to conditions that impact the business. When conditions change, the events that reflect that change must be analysed as soon as they happen. Otherwise, the opportunity to take action may be lost. An event-based system, powered by Phoenix, can monitor the events and respond to a triggering event (or pattern of numerous events) as soon as it happens. Furthermore, event driven service delivery can, through its available knowledge, respond to a new change of situation in customer environment and give recommendations to the customers.

Conclusion

This article attempts to link SMEs with ICT solutions. It analyses the barriers for SMEs to access to advanced and high-end computing capability. Considering the existing barriers and emerging technologies, a service framework that can be easily and cost-effectively adopted by SMEs has been presented. It aims to overcome the existing barriers and open up business opportunities and increase productivity for SMEs.

Acknowledgement

The author would like to thank Ms Neelu Sharma whose MBA minor research project has contributed towards the development of this article.

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Small Corporations: Better Controlling the Spigot of 'Red Tape'

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Abstract

Regulation in Australia appears to be increasing at an exponential rate. For small businesses that, are often resource poor and isolated, compliance is a burden. They face a paradigm conflict with regulators, who often are imbued with the objective of maintaining quality standards and perceptions of servicing an industry, while the regulated see regulation as an evil and a cost to doing business. Two case studies illustrate the political minefields in alternative approaches to regulation. Finally, the paper reviews changes in regulation internationally and in Australia and puts forward some innovative options for the future implementation of regulation of small businesses.

Keywords

Small business, regulation

Introduction

This paper examines the issue of the regulation of small corporations in Australia. Regulation has at its core a relationship to manage between the regulator on the one hand and the single firm, as a regulated entity, on the other. Whilst much of the analysis in this area focuses on the apparently relentless growth of regulation, the corollary is to seek a more simple set of regulatory rules, especially for small, resource constrained firms. Seeking to simplify rules, and to ensure they are tailored to commercial realities, remains an important aim for small firms; it is also useful to explore new ways of developing the working relationship between the regulator and the regulated market. This paper sketches some new possibilities for small firms to work more collaboratively with one another via the use of networks so as to reduce their individual regulatory burden. A possibility for promoting such regulatory networks may well lie with peak bodies, such as the Council of Small Business of Australia (COSBOA).

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Principles Underpinning Small Corporations

Small corporations in Australia, as essentially resource restrained entities[27], are guided by four key operating principles, what might be called the 'four Ps':

[27] Small corporations are defined by the Australian Bureau of Statistics as having less than 20 employees http://www.cosboa.org/Resources/Small-Business-in-Australia.aspx. Section 45A of the Corporations Act (Cth) 2001 provides that a small proprietary company is a small proprietary company for a financial year if it satisfies at least 2 of the following paragraphs: (a) the consolidated revenue for the financial year of the company and the entities it controls (if any) is less than $25 million, or any other amount prescribed by the regulations for the purposes of this paragraph; (b) the value of the consolidated gross assets at the end of the financial year of the company and the entities it controls (if any) is less than $12.5 million, or any other amount prescribed by the regulations for the purposes of this paragraph; (c) the company and the entities it controls (if any) have fewer than 50 employees, or any other number prescribed by the regulations for the purposes of this paragraph, at the end of the financial year.

People – their people and their skills, including the directors, the board, senior managers, and other employees.

Plan – the business plan and the business portfolio. What is the nature of the business? Is it single or multi focused ? What are the business silos and how do they interact? How is planning carried out and decision-making achieved?

Property – What are the key property rights (real, personal and intellectual) which need protecting or asserting? In turn, what are the main contractual obligations and what are the intellectual properties that require protection, e.g. business name protection.

Profit – small business will first focus on the costs, before they turn to profits. Cost control provide the safety barrier which businesses must have before the business is safe to proceed. Other related issues include who is in competition now, and who is likely to in the near future? What are the margins of safety of operation, of profit, and increasingly of risk? For small firms, the margins of safety are small and the margins for error large. Start-ups often fail and the spectre of a business going bad haunts most businesses in the first cycle of their development.

Whilst there can be some argument about whether the 'four Ps' carry the day, a fifth indicia is increasingly central to the set up, operation and survival of small corporations; that is, it carries weight as a factor across all elements of the firm's life cycle. The '5th P' is policing or what we now term under the ever expanding rubric, regulation.

Although governments and their regulators, legal and economic theorists and others like to portray regulation as benign and business-helpful, as the friend of the start-up and the guide and friend of the small corporation, regulation is viewed by the regulated as the necessary evil, as a cost of doing business.. For the time and resource constrained business operator, taking time to see to regulation is time spent away from core business. It is marginal business at best, and significantly costly given the opportunity cost is measured by time spent away from overseeing core business functionality.

The stance of the regulator and the regulator are paradigm opposites. For the regulator, it is perceived as core business. The regulator asks, how can we maintain standards and the public interest, and, ideally not diminish business value? The business asks, how can we grow the business, and how can we comply with our regulatory requirements in the least time possible, so as to keep down the opportunity costs to be able play/compete in the chosen game/business field? [28]

Regulation Case Studies

These two opposing views are evident in the following two cases. They address the questions: What are the contextual imperatives of regulation in Australia? How is regulation set up and what are the political attitudes towards it and theoretical options available?

Case study 1: Childcare regulation in Australia

The National Childcare Accreditation Council (NCAC) regulates childcare services and the flow of Child Care Benefit to Australia's 9000 plus services which are typically small organisations. The NCAC's role is primarily as an accrediting agency reporting directly to the Federal Government. The NCAC also seeks to see standards improved, and provides commentary and advice to centres on continual industry practice improvement. In addition to the essential regulatory core of its business function and despite the NCAC's claim to provide an the industry with a quality/ excellence maintenance service, the regulated industry essentially views the organization as a regulator and as the overseer and enforcer of standards.

The service providers are almost exclusively small businesses. Their issues of concern, in relation to the regulatory cycle are legion: too much paper work, too many complex policies, too much technical material, too much reading, too paper based, regulated too often, and too many key staff kept from core business by the process. In response, the NCAC has tentatively promoted the concept of a

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[28] This refers to game theory analysis, see for example, Cass Sunstein (ed), *Behavioural Law and Economics*, CUP, 2000.

responsive regulatory model, where its focus is less on more regulation, and more on problematic services.

In keeping with the theories of Ayres and Braithwaite[29] this approach has reflexively sensible appeal in a mass industry where 9000 services across Australia range in standard from gold class to some which might be called concerning outliers.

Nevertheless, policy options are limited. The reaction of the Ministers (of both major political parties at the Federal level) is not to be seen to dilute the standards required of all childcare centres, whether gold, bronze or other class. NCAC as a regulator, may want to be an educator and a flexible, responsive regulator, but the political frameworks are tight and costs, in terms of political risk, are very high.

Another tack is to simplify the regulatory mix between the Commonwealth's role as accreditor and standard setter and the States as signing off on licenses to operate and enforce OH&S issues. What has end up is an ever increasing arch of complex Federal compliance and a myriad of state and territory standards at the local level. As a final strategy to unlock the tangle, Council of Australian Government plans have been hatched so as to share, vest or transfer power, typically to the Commonwealth.

The relevance of this case study to small corporations is that they too share this basic model of good intentioned, simple regulatory frameworks and yet end up as another example of complex Federalism, and a myriad of political compromise. The *Re Wakim* litigation[30] is testament to the uncertainties of cross vesting of power, in that case, State to Commonwealth. That journey of power essentially being transferred to the Federal sphere has been a steady-state journey since 1901. If history is the guide, that is likely to continue for corporations regulation, including those applying to small corporations.

Case study 2: Accreditation of law schools

Australian law schools are not regulated except by their own organizations and, in terms of delivering the Priestley 11 units, that means each school has an irreducible core curriculum. However because of the perception of the increasing national and international focus of law, and legal education, it is seen as apt that the Council of Australian Law Deans (CALD) develop a set of national standards. The standards have been formulated, in the first instance, as a set of self accrediting benchmarks against which law schools can judge their own practices and delivery.. Whilst this low level, voluntary, self accrediting model is the starting iteration of the national scheme, how will the scheme evolve? Will it become compulsory? In differentiation to the regulation of childcare, the scheme has been set up not in a regulatory guise but as being a mechanism for improving standards. Whilst the first iteration is benign, what will the scheme entail as it evolves? What, for example, will be the sanctions for non participation in the scheme, or for failing on key benchmarks? Will de-accreditation become a necessary potential cost of involvement in the scheme?

These are all theoretical issues to be played out, and as yet remain unclear. But one can see that this is how regulation journeys and creeps into a central position. The arguments for standards being raised, transparency and consistency, give the regulatory model its first and powerful impetus; the second phase is the real world of resources needed to comply, and identifying the range of consequences for the regulated. As history illustrates, each market develops battle lines between the regulated and the regulator.

Regulatory Trends

A relevant question is: How does the regulatory environment in Australia compare with other countries?

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[29] I Ayres and J Braithwaite, *Responsive Regulation Transcending the Deregulation Debate*, OUP, 1992.

[30] R*e Wakim; Ex parte McNally/Re Wakim; Ex parte Darvall*
Re Brown; Ex parte Amann Spinks v Prentice High Court of Australia, 17 June 1999
(1999) 163 ALR 270

International trends

The global financial crisis (GFC) has seen the introduction of more 'lock-step' behaviour from national governments and from lawmakers. Whilst there are local exceptions and cultural imperatives, Governments and lawmakers are increasingly on safe ground when they discuss and act in the name of synchronized international action; this has been particularly prevalent in terms of financial regulation and re-regulation in Europe and the US. In terms of the area of corporate law regulation, an example of synchronization lies in the particular topic of directors' liability for corporate faults and defaults. Dr Helen Anderson has undertaken a wide-ranging international study, investigating various aspects of this topic.[31] These include capital raising, unremitted employee tax instalment laws, and environmental protection laws. These areas 'were selected because they represent a range of powerful stakeholder interests.'[32] Anderson found that in respect of these areas there was 'a considerable degree of similarity'[33] and that they showed 'marked similarities across the jurisdictions selected.'[34] The jurisdictions included Australia, Canada, New Zealand, China, South Africa, Hong Kong, the United States of America, Malaysia, South Korea, and France. By any reckoning, this is an extensive comparative survey with a selection of common law, civil law and 'emerging model' legal systems. Anderson concludes that:

> *'What is noteworthy from an examination of the legislation governing these areas across the jurisdictions surveyed is the stringency of the laws and the degrees to which they adopt a common form of words and structure.'*[35]

Anderson's study supports the thesis of increasing international synchronization in key aspects of corporate law regulation, to the point even of common words and structuring of the relevant legislation. She also finds some 'noticeable dissimilarities'[36] among the surveyed nations is certain areas, including insolvent trading law, recovery of employee entitlements and protection of tort creditors.[37] Therefore the thesis of convergence of laws in this area is not uniform. However, Anderson concludes that convergence is the broad trend. She notes:

> *'While there are many reasons for convergence and divergence of laws, based on political, economic, practical and evolutionary reasons, a pattern is suggested from the areas of law examined- that areas of stringent liability on directors broadly, but not precisely, correspond with widespread international adoption of similar laws, and conversely that more lenient laws are unlikely to be copied internationally.'*

That is, a trend internationally to tougher and more encompassing patterns of regulation is clearly in evidence in post GFC environment.

Australian regulatory trends

There are three discernible trends in Australian regulatory policy which are discussed below.

Regulators working together

In terms of the trends amongst regulators, it can be argued that regulators are sharing more information - and this trend is borne out by the case law and certainly the commentary on the relevant areas of legislation. For example, recently, under ASIC's use of transcripts, Section 22 of the *Australian Securities and Investment Commission Act 2001* (Cth) (the ASIC Act) ASIC can seek information on oath from people, and the examination is supposed to be, in fact, private, and ASIC has

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[31] Helen Anderson, 'Directors' liability for corporate faults and defaults- An International Comparison,' 18 Pac. Rim L.& Pol'y J., 2, 2009, 1-51.

[32] Above Anderson n 5, at 4.

[33] Above Anderson, n 5, at 2.

[34] Above Anderson, n 5, at 3.

[35] Above Anderson, n 5, at 4.

[36] Above Anderson, n 5, at 51.

[37] Above Anderson, n 5, at 51.

to treat it as confidential. But that is not an absolute confidentiality requirement, because 'ASIC is permitted to disclose the transcripts of examinations to other persons or agencies in certain circumstances.'[38] Section 25 of the ASIC Act provides that disclosure may be made for the purpose of litigation. Andrew Eastwood argues[39] that the scope of this disclosure has been interpreted broadly by the Federal Court.[40]

Section 127 (2A) of the ASIC Act provides that ASIC is authorized to disclose information to other Australian regulators. Section 127 (2B) of the ASIC Act provides that ASIC is authorized to disclose information to overseas governments and their regulators The implication of these far-reaching practices is that whilst ASIC may be eliciting transcript information and related sensitive data, it is actually able to be shared with other domestic regulators including Australian Prudential Regulatory Authority, and the Reserve Bank of Australia, and there are Memoranda of Understanding with international bodies as to such sharing. The ability to disclose and share information is broad and the discretion vested in ASIC is fettered simply by the obligation to 'observe the rules of natural justice.'[41]

Whilst the ASIC investigation of an individual is ostensibly private, the information can in fact be systematically shared. This is an example of a complex network of regulators working together. The ASIC case study provides the actuality of more, and more connected, regulation knowledge sharing amongst the regulators. Taking these practices as exemplars of what the regulators are doing, there may be some useful implications for the small business sector generally.

More regulation

Australia has a well documented regulatory paradox, where there is a lot of debate around the reduction of red tape reduction, and yet there is an oft heard complaint of over regulation. Evidence can be found in the public address by Gary Banks, Chairman of the Regulation Taskforce[42] and the work done by the Productivity Commission (also chaired by Gary Banks)[43], corporate regulation review, and so forth. The paradox's core is whether it is politically achievable to actually reduce the applicable red tape, even if business and other sectors wholeheartedly seek it reduction? This growth of regulation in Australian corporate and political life seems inevitable, and it holds sway despite the particular hue of the national Government at any given time. For example, even during the Howard era of so-called economic reform, the political rhetoric focused on regulation reduction, but the actual practice was that of an increase.

The perceived need to reduce red tape, supported by the rhetoric of the business lobby and those in the government dealing with business portfolios, has been met with the operating reality of a neo-conservative restraint where finance has been in short supply, risk has been the catch cry, and the established banks have reasserted a low risk lending dominance.

Even before the GFC and during the course of several simplifications acts, things on the ground seemed to have got more complex for corporations and the directors. As Stephen Bottomley has noted[44], it is a curious Australian law making instinct to legislate and to regulate so that there is a matrix of ever-growing complexity; indeed, the impulse to regulate seems to form part of the Australian national culture as expressed through the political process.

So whilst we search to reduce red tape the opposite happens: the paradox in action. We assume minimal regulation – an aspiration or regulation optimism. What if instead there is 'regulation realism' i.e. that in the real world the impulse is to provide further rules, more law, more regulation.

Assume for a moment that more regulation and more complex regulations are, in fact, an inevitable corollary of 21st century civic life. That the production of red tape is always, just about at least,

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38 Andrew Eastwood, 'Potential uses of transcripts of ASIC examinations,' (2009) 27 C&SLJ 555-560, 555.

39 Eastwood, above n 12, at 556.

40 *Gray v. Australian Securities and Investment Commission (2002) 122 FCR 12* as discussed by Eastwood above n 12.

41 Eastwood, above n 12, at 556.

42 Gary Banks, Reducing the regulatory burden: the way forward, Monash Centre for Regulatory Studies, 17 May 2006

43 Corporate and Financial Services Regulation Review, November 2006

44 Most recently in *The Constitutional Corporation Rethinking Corporate Governance,* Aldershot, England: Ashgate Publishing, 2007.

guaranteed to follow a growth trajectory? Recently the High Court of Australia sought to shift personal responsibility to the public and the individual drinker away from the small/large business owner serving alcohol.[45] The political reaction was immediate. The impulse was to announce a legislative solution, to install a set of solutions to apply a framework to alcohol providers. The High Court sought a *de minimis* solution; in response, the political will however was to revert to the application of a set of rules. This was a rule-based legislative reflex on alcohol servers in response to a common law ruling favouring the principle of personal responsibility for adult behaviour and decision making.

Based on both analysis and practice, can we assume that regulation will always grow more complex to reflect a quicker more connected, more integrated and more complex social environment? If this assumption holds true, how then can the situation be best navigated by the legion of small corporations?[46] Given the numbers, it's a big problem and hence there is a big possible pay-off or solution.

With more regulation and more isolated small firms operating in relation to more networked regulators, the power imbalance between the regulator and the regulated are growing ever wider. How can this imbalance be redressed?

The pitch of less regulation, however, is now politically a very hard item to sell to the broader political electorate in the wake of the global financial crisis.[1] In other words, the political risk of a light touch regulation can often be seen as too high, especially in what are seen as traditionally high risk areas. These include childcare, education and the corporate law area. The corporate law area is characterized as being in the high risk category because every 10 years or so, the Australian public witnesses the excess of the Australian boardroom- and the catastrophes and subsequent litigation in the wake of high profile corporate collapses. Whilst these outlier cases tend to be at the public end of the market, their consequences tend to affect the regulation of the entire corporate sector.

Whilst we may be in the age of corporate social responsibility, the corollary of heightened ethical awareness, if not behaviour at the board level, there is a distinct lack of appetite to reduce the rules of the game of corporate compliance at the macro political level.

The conclusion is that whilst the focus on actually reducing or excising the burden of regulation, might make many in Australian so-called 'regulation optimists', is the reality in fact such that regulation is here to stay, that it will keep growing necessarily, and so, in a post-GFC society, that is what we essentially are stuck with, a tap that cannot be turned off or is very difficult to turn off because that is the reflex.

Isolated, under resourced small corporations

Between 2003 and 2007, approximately 777,000 companies did not survive. So, whilst the small business sector is a huge industry by size, it's got a persistently high failure rate. What is the genesis of that failure rate? Is regulation a factor? How do they control the spigot of regulation, federal and state, such that it truly is benign and does not take up the time of the best and possibly only people they have?

The operating paradigm is single businesses dealing with a gateway of regulators- the regulators form a network or federation. Yet, attempts have been made to make regulations accessible to small business. An example is the small business guide in the Corporations law which provides text specific to small firms. Further guidance is provided in the replaceable rules which replicate, in part at least, the fundamentals of business as seen from a business perspective.

Yet, under resourced small corporation directors can miss basic stuff. A start-up with a good idea talking to a big firm requires a confidentiality agreement as a threshold piece of legal protection. If the

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[45] Judgment date: 10 November 2009, C.A.L. No 14 Pty Limited t/as Tandara Motor Inn & Anor v Motor Accidents Insurance Board; C.A.L. No 14 Pty Limited t/as Tandara Motor Inn & Anor v Scott [2009] HCA 47.

[46] According to the Council of Small Business of Australia (COSBOA) there were 1.93 million active small businesses in Australia at June 2007, http://www.cosboa.org/Resources/Small-Business-in-Australia.aspx.

business owner cannot readily afford $300-600 an hour for legal advice, and there is no obvious peak body, the business may waste six months of time and effort pursuing a fruitless deal which is lost all because a director was not aware of a basic tool protecting commercial-in-confidence negotiations. A confidentiality agreement is a business-first tool; it can stave off a whole lot of regulatory consequences – contract, Trade Practices Act, Intellectual Property, other legal disputes potentially involving expensive litigation, insolvency, directors' duties and so on.

Network Theory and its Implications for Small Corporations

One of the interesting ideas to be gleaned from regulatory practices is the notion of networks and informal networks. That is, if the regulators are using networks and swapping information and collectively gathering information and using it, this practice may be usefully applied to the regulated market. It is potentially the case that small businesses can start to adopt such practices as well.

Network theory arises out of the broader field of complexity theory. It has been applied in economic contexts and more recently has branched into legal contexts. For example, Andrea M. Matwyshyn uses[47] network theory, a branch of complexity theory, to examine questions of internet jurisdiction in the context of intentional torts and intellectual property harms – the types of internet harms traditional personal jurisdiction frameworks have difficulty addressing. It then proposes a trusted systems approach to these jurisdictional determinations.

Network theory 'concerns itself with the study of either symmetric relations or, more generally, of asymmetric relations between discrete objects.'[48] This definition with asymmetry at its core neatly replicates the traditional regulatory relationship between the well resourced and informed regulator, and the isolated small business. Complexity theory 'recognizes that complex behaviour emerges from a few simple rules, and that all complex systems are networks of many interdependent parts which interact according to those rules.'[49] Again, this describes the core of the regulation of the small corporation market, which has been added to by layers of ever more complex rules.

The notion is that if small businesses can be seen as networks, they can begin to operate more effectively and collectively. That is, to behave more like the regulators who have begun to develop, between themselves, fairly complex and apparently efficient informal networks. Regulators are certainly leading the field in terms of making up business networks and working cooperatively together, but it may well be that networks have other business applications, particularly for small corporations.

The key is not to reduce regulation, nor to continue to hope that Australia can devise simpler federal-state bargains across a myriad of good, services and business sectors. This is still a slow moving, top down, political solution to the nimble business problem. The challenge is to develop the possibilities of networked solutions for the regulated sector so as to reduce the information and power asymmetries between the powerful cohort of regulators and the mass of small corporations.

The main improvement would be for *better networks, synchronization and co-operation at the business level* between often micro, resource-tight corporations, so as to provide more parity, less duplication, more efficiency, and richer databases of information that can be put to use for reporting and regulatory purposes. A networked regulatory response by small corporations could begin as an informal practice, and potentially become more formal. For example, it could be an informal practice based on a legislative scheme as evidenced by the ASIC's example of information sharing with other regulators. The networking agents for small corporations could be chosen from several potential sources including:

- Peak bodies such as COSBOA, the Council of Small Businesses of Australia, and other industry bodies;

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[47] Andrea M. Matwyshyn, 'Of Nodes and Power Laws: A Network Theory Approach to Internet Jurisdiction Through Data Privacy,' The Wharton School, University of Pennsylvania, *Northwestern University Law Review, Vol. 98, 2004*

[48] http://en.wikipedia.org/wiki/Network_theory

[49] http://businessdictionary.com

- Professional advice providers, such as accountants working within peak body groups such as CPA Certified Practicing Accountants; or
- A combination of these two approaches.

COSBOA: a new role as a networked regulatory go-between?

As its website indicates,[50] COSBOA is primarily an educator of, and advocate for, the small business sector. It could also become a networked regulatory go-between acting in the space between the regulator and the regulated elements of the market. This potential third function could enhance the first two functions. COSBOA as a peak body enjoys a natural advantage. It is already working on the business commercial level of the market, rather than from on high as a regulator *per se*, and as such has insights into the common concerns facing small corporations.

This model of networked small firms with a common business platform providing data updates to their informal partner/educator i.e. the peak body, gives a single small company a direct interest in the wider business field; that is, it networks or links into multiple like businesses. The peak body becomes a hub for the hybrid reporting- regulatory-education-knowledge sharing aspects of small corporations. It is a social and commercial good to share information- good to talk- to help the sector collectively. Compliance and regulation is embedded in the business to peak body relationship, it is bottom up (and as such earthed and grounded in business reality) rather than the traditional top-down government/regulator to firm relationship (which is often seen as policing by the regulated market).

Does this idea of network nodes amongst the regulated market blur regulation and improvement models? Yes, but probably more productively than is currently the case where for example, ASIC is first and foremost a regulator, not an educator or disseminator of best practice. But more fundamentally, does it really matter at the practical business level?

The Federal Government could fund national peak bodies, in the first instance over say a phased five year period, to develop lean regulatory maps, diagnostics, compliance devices, which make sense to small corporations and different areas of activity because they are road tested, devised, authored, recalibrated at the industry level. We could stop thinking of geographic territories and the tyranny of jurisdiction, and think instead of the commonalities of say a food business in Melbourne and one in Marble bar, a wine distribution business in Weipa or Williamstown, or a chiropractor in Civic or Claremont. Those businesses and the way they are run will have a great deal in common, and their regulation should, as a secondary matter, reflect that underlying business realism.

Business specific regulation, via an agency network, makes a lot more sense to the business. It inverts the traditional model of regulation[51], but given the three realities of market- weak atomized small firms, networked regulators sharing information, and the steady increase in technical law and regulation requiring ever greater compliance costs, a radical revision of the present regulatory model is timely.

Conclusion

Just as the new tax system of 'exception reporting' by taxpayers is fast becoming the steady state, the fundamental notion of what is efficient regulation for business needs to be reconsidered. Moving the red tape reduction argument from the mode of the Government versus a single business, that is a 'David meets Goliath' narrative, to a more nuanced networked version, may be worth considering and is perhaps a point of confluence and further exploration for practical regulatory analysis and review, and for peak bodies to play a centrifugal part. In this way, just as the early 20th century was the period of collective strength for unions and employees, the urgency of making the relationship between the regulators and an individual small corporation, could herald the emergence of critically important peak bodies as networked 'go betweens.' The legion of small corporations situated at the interface of public power and private entrepreneurship in Australia could stand to gain exponentially from this re-figured regulatory landscape.

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[50] http://www.cosboa.org.au/default.aspx.

[51] See Appendix 1.

Appendix One (refer footnote 25)

A. The traditional 'vertical' top-down model of regulation

Top down model	The Regulatory relationship	Characteristics of the regulatory relationship
The regulator	The regulator oversee the regulated market via a budget, resources and expertise	Top down Often a complex and asymmetric system Most of the rules suit and apply to large firms *De facto* and by default- this system of regulation is applied to small corporations
The regulated	The small corporation acts in isolation; and seeks to comply with the regulatory burden. The demands of the business are constant and the first priority of the managers and shareholders. The regulatory burden is often a distraction from 'the business of the core business.' The business may not be able to properly resource its regulatory compliance effort (whether via in-house efforts or by resort to qualified third parties)	Act in isolation and often in ignorance whilst seeking to meet their compliance burden

B. Small corporations- using a 'networked' or bottom-up model of regulation

Bottom-up model	The regulatory relationship	Effect
The regulated	Advisors and relevant peak body- private entities, run by business experts; but with resources for excellent databases, material collection and dissemination- subject to privacy laws. Use of technology to drive the network Peak bodies are business enablers first and foremost; they educate, and seek to document best practice; they are reflective of improved standards; they operate with a 'business first, regulation secondary' mind set. (The tail does not wag the dog.)	Effect: the business works on its business primarily and complies with industry/sector relevant regulation in partnership/working collectively with its advisors/peak body. This model introduces the advisor/peak body as a networking hub
The regulator		The peak body provides a single, seamless industry relevant regulatory report to a single point of government e.g. ASIC for distribution to other regulators. This model reduces the asymmetries between the regulator and the regulated.