

Evidence On The Corporate Governance Of New Zealand Listed Companies

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Contents

- I. Introduction
- II. Corporate control
- III. Foreign control
 - A. Introduction
 - B. Foreign equity investment into New Zealand companies
 - C. Foreign control of New Zealand listed companies
 - D. Evidence from the New Zealand Stock Exchange Top 40 companies
 - E. Reasons for increased foreign investment in New Zealand
 - F. Advantages and disadvantages of foreign investment
 - G. Conclusions
- IV. Institutional investment
 - A. Introduction
 - B. Types of institutional investors and their shareholdings

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1. Insurance companies
2. Banks
3. Bank nominee companies
4. Superannuation, retirement fund and trustee company shareholders
- C. Implications for corporate governance
- D. Conclusions
- V. Board structure
 - A. Introduction
 - B. Changes in board structure in New Zealand
 1. Outside directors
 2. CEO duality and executive board chairs
 3. Board size
 - C. Conclusions
- VI. Interlocking directorships
 - A. Introduction
 - B. Distribution of multiple directorships
 - C. Distribution of company and director interlocks
 - D. Comparison with recent Australian findings
 - E. Conclusions
- VII. Conclusions

I. Introduction

This article considers and adds to research on corporate governance in New Zealand listed companies. We present quantitative evidence on corporate control, foreign control, institutional investment, board structure and interlocking directorships. The evidence has implications for a range of contemporary legal issues in New Zealand such as corporate governance, foreign investment, takeovers and securities regulation. In this regard, the article is intended to provide an intellectual foundation for subsequent analyses. It is not the primary purpose of this article to tease out implications although some observations are made.

Some of our findings are consistent with international experience, namely a rise in institutional investment and increasing institutional activism. Other findings appear specific to New Zealand. For example, we find an increase in the proportion of majority controlled companies¹ in New Zealand and a decrease in company and director interlocks.² The main reasons for these phenomena

¹ Majority controlled companies are those in which the major shareholder owns over 50 per cent of issued voting capital.

² Company interlocks are the number of companies with which a company has common directors. Director interlocks are, for any given company, the number of board positions its directors hold on other boards.

are likely to be associated with deregulation in New Zealand and the sharemarket "crash" of 1987. Observable increases in foreign equity investment and foreign control of New Zealand listed companies require more complex explanation. In brief, however, these phenomena can be regarded as a product of international processes such as deregulation of capital flows, increasing institutional investment and domestic economic reform.³

II. Corporate Control

It is often argued that, in the modern corporation, the ownership of shares is so widely spread that management can pursue their own interests unchecked by shareholders. Symptoms of management's alleged pursuit of self-interest are believed to include conglomerate building and excessive salaries and perks.⁴ An early expression of the notion that managers may not act in the best interests of shareholders was proposed by Adam Smith in the *Wealth of Nations*:

The directors of [joint stock] companies, however, being the managers of other people's money than their own, it cannot be expected, that they should watch over it with the same anxious vigilance with which the partners in a private copartnership frequently watch over their own. Like the stewards of a rich man, they are apt to consider attention to small matters as not for their master's honour, and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company.⁵

In contrast to this cynical view of managerial behaviour, a more charitable view of managerial behaviour is given by *stewardship theory*, which proposes that, "... the executive manager, far from being an opportunistic shirker, essentially wants to do a good job, to be a good steward of the corporate assets".⁶ This view has recently gained some empirical support in the New Zealand context.⁷

In this section we address the issue of management versus owner control of New Zealand listed companies. Specifically, we focus on the extent to which shareholders in New Zealand's listed companies are likely to have the ability to influence the actions of management.

³ On this point see the sources cited in G. Walker, "The Policy Basis of Securities Regulation in New Zealand" in G. Walker and B. Fisse, eds., *Securities Regulation in Australia and New Zealand* (1994), 171, 186, fn 8. A recent account is M. Clifford, "New Zealand's Racy Economy" *Far Eastern Economic Review*, July 13, 1995, 70.

⁴ B. Dumaine, "A Knockout Year for CEO Pay" (1994) 130(2) *Fortune* 136; Y. Amihud and B. Lev, "Risk Reduction as a Managerial Motive for Conglomerate Mergers" (1981) 12(2) *Bell Journal of Economics* 605.

⁵ A. Smith, *The Wealth of Nations* (1776), cited in H. Hunt, "The Separation of Ownership and Control: Theory, Evidence and Implications" (1986) 5 *Journal of Accounting Literature* 85.

⁶ L. Donaldson and J. Davis, "Stewardship Theory or Agency Theory: CEO Governance and Shareholder Returns" (1991) 16(1) *Australian Journal of Management* 49.

⁷ M. Fox and R. Hamilton, "Ownership and Diversification: Agency Theory or Stewardship Theory" (1994) 31(1) *Journal of Management Studies* 69.

Previous studies of corporate control in New Zealand have, with the exception of Firth,⁸ used the classification scheme devised by Fogelberg.⁹ That scheme classifies companies listed on the New Zealand Stock Exchange (NZSE) according to the degree of control of those owning voting shares. Under the scheme, companies are given one of four control classifications: *majority*, *minority*, *joint*, or *management*. Each of these four types of control is seen to represent different stages in the detachment of ownership from management control (refer to Table 1). At one extreme, *majority control* represents a situation where there is a major shareholder (or group of shareholders) that holds an unassailable position in terms of control of a company. At the other extreme, *management control* represents a situation where shareholdings in a company are so widely dispersed as to ensure that no individual shareholder can exercise control in the direction of the company. The most recent study is by Fox and Roy and looks at corporate control in 1985, 1990 and 1993.¹⁰ Table 2 summarises the results of this and previous studies.

TABLE 1
Classification of control types¹¹

<i>Classification</i>	<i>Deemed to exist when:</i>
Majority	Majority of capital (over 50%) held by one holder or a tightly-knit group.
Minority	An individual or small cohesive group of shareholders hold sufficient votes to be able to dominate the company through their interest. Exists where there is an important minority interest or family group accounting for between 15 to 50% of the votes, where this minority interest is represented on the board.
Joint	Minority interest strengthened by a close association with management, or management control enhanced by a sizeable minority interest. One of two situations may apply. Either: <ul style="list-style-type: none"> • owning a minority interest of 10-15% coupled with board representation, or • owning or controlling a minority interest of more than 5% with board representation and active management involvement.
Management	Ownership is so widely distributed that no one individual or group has a minority interest which is large enough to allow them to exert dominance over the company's affairs.

TABLE 2
Control types of New Zealand listed companies, 1962 to 1993¹²

Control classification	1962 ¹³		1974 ¹⁴		1981 ¹⁵		1985		1990		1993	
	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%
Majority	7	16.3	3	7.0	45	22.1	54	37.8	73	54.5	58	50.0
Minority	14	32.6	13	30.2	78	38.2	69	48.3	52	38.8	48	41.4
Joint	5	11.6	6	14.0	19	9.3	10	7.0	4	3.0	7	6.0
Management	17	39.5	21	48.8	62	30.4	10	7.0	5	3.7	3	2.6
No. of companies	43		43		204		143		134		116	

Two previous studies have interpreted changes in ownership leading up to 1985.¹⁶ The first, conducted by Fogelberg, examined the 43 largest surviving NZSE companies listed between 1962 and 1974. Of these companies, Fogelberg commented, "... by the early 1960s there had been a substantial movement towards management control. During the next 12 years this movement continued, 13 firms moved either directly or more closely towards management control."¹⁷

If we conduct a chi-square test on all the available data (as given in Table 2) we do find some significant differences in control classifications by year (refer Table 3). Interestingly - and in contrast to our expectations from Fogelberg's comments - no statistically significant change in the proportion of companies having various control classifications took place between 1962 and 1974.

⁸ M. Firth, "Control-Type and the Financial Structure and Performance of New Zealand Firms" (1992) 26(2) New Zealand Economic Papers 1.

⁹ G. Fogelberg, "Ownership and Control in 43 of New Zealand's Largest Companies" (1980) 2 New Zealand Journal of Business 54.

¹⁰ M. Fox and M. Roy, "Corporate Control and Foreign Ownership of New Zealand Listed Equities" (1994) 1(2) New Zealand Strategic Management 24.

¹¹ Derived from Fogelberg, op cit, at 61-64.

¹² Our 1985, 1990 and 1993 samples comprise 66, 94 and 89 per cent respectively of all listed companies in each of these years.

¹³ Fogelberg, op. cit.

¹⁴ Ibid.

¹⁵ R. Chandler and B. Henshall, "Corporate Directorship Practices in New Zealand Public Listed Companies" *Research Paper No. 1* (Department of Business Administration, Victoria University of Wellington, 1974).

¹⁶ Fogelberg, op. cit.; Fox and Hamilton, op. cit.

¹⁷ Fogelberg, op. cit., 55.

TABLE 3
Chi-square statistics for differences in distribution of control categories between adjacent years

	1962-74	1974-81	1981-85	1985-90	1990-93
Majority	2.29	66.51	15.99	9.92	0.43
Minority	0.07	4.32	3.75	2.48	0.20
Joint	0.20	3.15	0.83	3.08	3.61
Management	0.94	14.21	25.76	2.04	0.41
<i>Chi-square statistic (3 dof)</i>	3.50	88.19*	46.33*	17.51*	4.65

*significant at .001 level

We find that the first major changes in corporate control occurred between 1974 and 1981. Between these two years we observe a significant difference in the proportion of majority and management controlled companies. We also find a higher proportion of majority controlled companies in 1981 and a lower proportion of management controlled companies in the same year.

The 1981-85 period saw further significant changes in the distribution of companies among different control categories. Compared to 1981, in 1985 there was a greater proportion of listed companies in the majority and minority categories. Furthermore there were significantly fewer companies in the management controlled category in 1985 as compared to 1981.

The changes highlighted above are consistent with Fox and Hamilton's comment that, "... by 1981 there had been a big rise in the proportion of majority controlled companies and a roughly equivalent fall in the proportion of management controlled companies (as well as consistent if less marked shifts in the minority and joint categories). These changes continued on through to 1985."¹⁸

The 1985-90 period also saw a difference in the proportion of companies having majority control, with a greater proportion observable for 1990. There was no significant change in the distribution of firms by control classifications between 1990 and 1993.

In summary, we conclude that, over the period from 1962 to 1993, there has been a significant shift to majority control among New Zealand listed companies. By 1993, 50 per cent of our listed companies were majority controlled. This increase in majority controlled companies has taken place along with a decline in the proportion of our companies that are management controlled. Fogelberg's 1980 study found that 39.5 per cent of the 43 largest companies in the year 1962 were management controlled. In contrast, by 1993 only 2.6 per cent of all listed

¹⁸ Fox and Hamilton, *op. cit.*, 74.

companies were management controlled. A significant increase in the proportion of minority controlled companies is also evident over the 1962 to 1993 period, as is a significant decrease in the proportion of listed companies having joint control.

From the preceding analysis, we conclude that there is little evidence of a "managerial revolution" in terms of the control of New Zealand listed companies. In fact, the reverse is the case, with companies coming increasingly under the control of major shareholders. Hence, it is unlikely that there will be scope for managers to pursue actions which are not in the best interests of shareholders. In the event that managers do pursue actions which are not in the interests of major shareholders then, given the high degree of control exhibited by these shareholders, it is likely that moves will be taken to align management's actions with those desired by shareholders.

III. Foreign Control

A. Introduction

This section investigates the extent of foreign control of New Zealand listed companies. The evidence has relevance for an assessment of the benefits and potential negative consequences that foreign control can have for investors on the New Zealand sharemarket and for corporate governance. The structure of this section is as follows: first, foreign equity investment into New Zealand between 1989 and 1994 is examined; second, foreign control of New Zealand listed companies is analysed. Evidence that foreign control has increased is supported by a study of the NZSE Top 40 companies. The final part of this section considers why this increase has occurred and the consequences of foreign investment in New Zealand listed companies.

B. Foreign Equity Investment into New Zealand Companies

There has been a significant increase in foreign equity investment in New Zealand in recent years. Statistics New Zealand reports that foreign equity investment was \$9.8 billion in the year to March 1989 but increased to \$28.0 billion for the year to March 1994. This is an increase of some 186 per cent (refer Table 4).

The data for foreign direct investment (FDI) in New Zealand companies is particularly interesting.¹⁹ FDI increased from \$8.4 billion in 1989 to \$26.5 billion in 1994, an increase of some 215 per cent (refer Table 4). In contrast, portfolio investment - which is non-direct investment in, for example, stocks and bonds - declined from \$1.4 billion in 1989 to \$0.9 billion in 1992; a decline of some 38 per cent. However, portfolio investment has significantly increased between 1992

¹⁹ Direct investment is any investment made to acquire 25 per cent or more of the voting shares in a company, the purpose of the investment being to gain a voice in the management of the company. Also see, K. McConnell and G. Walker, "Foreign Direct Investment in New Zealand" in G. Walker and B. Fisse, eds., *Securities Regulation in Australia and New Zealand* (1994), 191.

and 1993, but dropped again for the year ending March 1994. From this analysis it is apparent that changes in equity investment have increasingly resulted in foreign investors gaining some form of control of New Zealand companies.

TABLE 4
Foreign equity investment in New Zealand companies (\$NZ millions)

	1989	1990	1991	1992	1993	1994
Direct Investment	8 412	12 293	13 294	17 750	21 035	26 494
Portfolio Investment	1 378	1 561	1 766	850	2 483	1 532
Total	9 790	13 854	15 060	18 600	23 518	28 026

Source: Statistics New Zealand, *Hot off the Press* (1995).

C. Foreign Control of New Zealand Listed Companies

Having noted - in section II of this article - an increase in ownership concentration among listed companies and, above, a general increase in foreign equity investment in recent times, we decided to investigate the extent to which increase in ownership concentration is a result of increasing foreign investment. With this in mind data were collected on foreign ownership for those companies that were in our original control classification samples for the years 1985, 1990 and 1993. This simply involved identifying whether or not the controlling shareholder(s) in terms of Fogelberg's classification scheme (as given in Table 1) were of local or foreign origin. Information on the country of origin for controlling shareholders was obtained from annual reports and the relevant editions of the *Directory of Shareholders New Zealand Public Listed Companies*.

Table 5 shows data collected on foreign control of New Zealand listed companies for the years 1985, 1990 and 1993. From this table, we observe that there has been a significant increase in foreign control of New Zealand listed companies between 1985 (when 16.8 per cent of all listed companies were foreign-controlled) and 1993 (when 39.7 per cent of listed companies were foreign-controlled).

Two chi-square tests confirm that major changes in foreign versus domestic control of listed companies occurred within our control categories. For the first chi-square test, we find that there is a significant difference in the distribution of companies among control categories for 1990, compared to what we expect from the 1985 data.²⁰ We also find a comparable change for companies listed in 1993, compared to what we expect from the 1990 data.²¹

²⁰ Chi-square statistic=52.65; 5 degrees of freedom; significant at alpha=0.005.

²¹ Chi-square statistic=30.28; 5 degrees of freedom; significant at alpha=0.005.

TABLE 5
Foreign control and ownership types of New Zealand
listed companies: 1985, 1990 and 1993

	Foreign controlled	1985		1990		1993		Foreign controlled / total (%)
		Total	Foreign controlled / total (%)	Total	Foreign controlled / total (%)	Total	Foreign controlled / total (%)	
Majority	18	54	33.3	21	73	28.8	31	53.4
Minority	6	69	8.7	12	52	23.1	14	48
Joint	0	10	0	0	4	0	1	7
Management	0	10	0	0	5	0	0	3
<i>Totals</i>	24	143	16.8	33	134	24.6	46	116

From Table 5 we observe several major changes in foreign control. First, between 1985 and 1990 foreign controlled companies having the minority control classification rose from 8.7 per cent to 23.1 per cent of all companies examined. Also, between 1990 and 1993 the percentage of all companies having the majority control classification rose from 28.8 per cent to 53.4 per cent. During this later period foreign minority controlled companies increased from 23.1 to 29.2 per cent and foreign joint controlled companies increased from zero to 14.3 per cent.

D. Evidence from the New Zealand Stock Exchange Top 40 Companies

The evidence presented above is supported by an examination of foreign ownership of equity in NZSE Top 40 companies. The sample comprises the largest 40 companies on the NZSE, in terms of market capitalisation at seven points in time, starting in December 1989 and ending in September 1993. Shareholder data for the top 40 shareholders of each Top 40 company was examined to classify investors as either local institutions, overseas institutions, local companies, overseas companies, or Employee Share Ownership Plans (ESOPs). A further classification of *other* was given to private investors who were in the Top 40 list of shareholders and all investors that did not make the Top 40 list of shareholders. When interpreting the data this means that the *other* category is likely to be overestimated and all other categories underestimated.

TABLE 6
Ownership structure of the New Zealand sharemarket, 1989 to 1993²²

Type of Investor	Dec	March	Aug	March	Dec	March	Sept
Local institutions	16	14	12	12	14	15	17
Overseas institutions	10	17	22	23	24	25	27
Local Corporates	21	15	11	11	10	9	7
ESOPs	4	8	4	4	4	4	3
Overseas Corporates	9	6	20	20	20	19	16
Other	40	40	31	30	28	28	30
Totals							
Institutions	26	31	34	35	38	40	44
Corporates	30	21	31	31	40	28	23
Overseas	19	23	42	43	44	44	43

The Top 40 list of shareholders was provided by Datex Services Ltd and was drawn directly from information held by the share registrars of each company. Table 6 shows the ownership structure of the sample between December 1989 and September 1993. With regards to foreign ownership, note that between December 1989 and September 1993 there was an increase in average overseas investment from 19 per cent per company to 43 per cent. Furthermore:

- total institutional investment rose significantly over the period, from 26 to 44 per cent
- between December 1989 and March 1992, local institutions reduced their holdings from 16 to 12 per cent, but this group increased their holdings after March 1992 (to 17 per cent in September 1993)
- overseas institutions significantly increased their holdings (from 10 to 27 per cent)
- total corporate investment declined significantly between December 1989 (30 per cent) and March 1991 (21 per cent), increased significantly to December 1992 (40 per cent) and has since dropped (to 23 per cent in September 1993)
- local corporates significantly reduced their holdings, from 21 to 7 per cent

We observe from the above that, while overseas investment in Top 40 companies rose significantly over the period of interest, much of this change is attributable to institutional as opposed to corporate investors.

²² Taken from *Ownership Structure of the New Zealand Stockmarket* (March 1991; September 1993), Doyle Paterson Brown Ltd. Note that the *Totals* categories overlap and therefore do not add to 100%.

A further study by Gaynor in 1993 confirms the observed trend towards increased foreign control of New Zealand listed companies.²³ Gaynor found that overseas investors owned 4.2 per cent of the New Zealand stock market (in terms of market capitalisation) in December 1986, compared to 30 per cent in December 1992.²⁴

E. Reasons for Increased Foreign Investment in New Zealand

It is instructive to ask why the observed increase in foreign investment in New Zealand listed companies has taken place. The main reason relates to the process of economic deregulation which has taken place in New Zealand, a process which started in 1984, under Sir Roger Douglas, the then Minister of Finance. Economic deregulation has resulted in New Zealand moving from one of the, "... most regulated societies in the free world, to the world's freest market economy".²⁵ Deregulation, and in particular the Employment Contracts Act 1991, has made New Zealand companies more competitive and has drawn the attention of foreign investors.²⁶ New Zealand's manufacturing sector is now seen to be "... on average, 15 per cent more competitive than those of its major trading partners and 30 per cent more cost advantageous over its leading trade partner, Australia".²⁷

New Zealand's current Foreign Direct Investment (FDI) regime has been described as, "... very liberal [with there being a] lack of restrictions on capital inflows".²⁸ From a policy viewpoint, high levels of overseas debt have led various governments to encourage FDI. As Colgate and Featherstone write:

... the combination of low economic growth and relatively small domestic capital markets makes FDI an attractive option to help fund investment growth. Second, FDI provides an alternative to the use of debt to finance New Zealand's persistent current account deficits, and could therefore be seen as part of a strategy to reduce overseas debt ratios to more acceptable levels.²⁹

Another major factor that has led to increased foreign investment in New Zealand is the increasingly global nature of investment by funds managers, especially, by fund managers in the U.S. This diversification of global investment

²³ B. Gaynor, "How to Ensure Better Protection for Shareholders" (1993) Proceedings: New Zealand Law Conference 49.

²⁴ *Id.*, 50.

²⁵ S. Passow, "New Zealand: An Economic Turnaround Lays the Foundation for Investment" (1992) 26(8) *Institutional Investor* 5. See also *Far Eastern Economic Review, Asia 1995 Yearbook* (1995), 180.

²⁶ Anon, "Southward, look, the p/e ratios are low" *The Economist*, September 18, 1993, 76.

²⁷ Passow, *op. cit.*, 5.

²⁸ P. Colgate and K. Featherstone, *Changing Patterns of Foreign Direct Investment in the Pacific Region: New Zealand Country Paper* (NZIER, 1992), 2. The Overseas Investment Amendment Act, 1995 extends this trend.

²⁹ *Ibid.*

has occurred for several reasons, namely: the increasing attractiveness of countries in Asia for investment; the increasing size of pension funds in the United States³⁰ and a stagnant North American economy.

The increasing international exposure of some large New Zealand companies has led to an improved international awareness of New Zealand as an investment destination. Some of New Zealand's largest companies are listed on overseas exchanges. For example, the shares of Brierley Investments Limited are also traded on the Australian and London stock exchanges and Fletcher Challenge Ordinary Division shares are traded on the Australian, London, Toronto, Montreal, Vancouver and Frankfurt stock exchanges. In particular the listing of Telecom Corporation of New Zealand locally and internationally (Telecom is also listed on the Australian and New York stock exchanges), and the high profile acquisition of a major stake in this company by two large U.S. telecommunications companies - Ameritech and Bell Atlantic - increased awareness among international investors of New Zealand as an investment destination.

New Zealand has also become increasingly appealing to foreign investors because of our General Agreement on Tariffs and Trade (GATT) exposure. Our agricultural industry is seen to be the most competitive in the world and therefore New Zealand is seen to be in a position to benefit greatly from increased international trade liberalisation under GATT.

Finally, the increase in the number and size of unit trusts internationally has led to more funds being invested globally.

F. Advantages and Disadvantages of Foreign Investment³¹

The major benefit of increased foreign investment relates to the ease with which New Zealand listed companies can raise equity. Raising initial finance is seen to be particularly difficult in New Zealand, because the country suffers from endogenous capital constraints.³² Take, for example, the following observations:

New Zealand lacks much of the financial expertise and advanced specialised capital markets that have helped industry in other nations.³³

and

³⁰ It is estimated that funds invested in pension funds today equal funds invested in savings, whereas ten years ago savings were approximately 10 times higher than pension fund investments.

³¹ There is a general review of the advantages and disadvantages of foreign investment in K. McConnell and G. Walker, *op. cit.*, 194-197.

³² See, generally, G. Walker, 1994, *op. cit.*; M. Fox and G. Walker, "Sources of Funding for Small and Medium Sized Companies in New Zealand" [1994] *New Zealand Law Journal* 421.

³³ G. Crocombe, M. Enright and M. Porter, *Upgrading New Zealand's Competitive Advantage* (1992), 111.

Large and sophisticated capital markets by definition offer a broad range of sources of debt and equity funding. The New Zealand market, however, is limited in size. Consequently, a small company seeking capital can soon eliminate possible sources which a large market might be willing, due to competitive pressures, to accept [at] higher levels of risk.³⁴

The problem of raising initial finance is particularly noticeable for large raisings. This problem was mentioned by Crocombe, Enright and Porter who commented, "... limited capital availability in New Zealand constrains business development and economic growth. Lenders and investors have limited amounts of capital to invest".³⁵ It is beneficial for New Zealand listed companies, and in particular large listed companies, to be able to raise equity through share placements to foreign investors.

A further benefit of foreign ownership relates to the liquidity of shares - the ease with which shares can be purchased and sold. Liquidity obviously increases as more investors are involved in trading on the New Zealand Stock Exchange.

Foreign investors may bring management expertise to bear on the New Zealand companies in which they invest, leading to improved performance. Carter Holt Harvey Limited is an example where the management expertise of a new foreign shareholder (the North American company, International Paper), was instrumental in restructuring and improving corporate performance. International Paper appointed one of their senior executives, David Oskin, as Carter Holt's new Chief Executive Officer. In addition to Mr. Oskin, two International Paper directors were appointed to Carter Holt's board of directors. Access to technology is another area where New Zealand companies can benefit from foreign ownership. For example, Milburn New Zealand is changing from coal to waste oil fuelled furnaces. This change was brought about through an association with Milburn's major shareholder, a Swiss company. This move is expected to improve Milburn's profitability.

The most disconcerting aspect of increased foreign investment is the possibility that capital flight may occur. Foreign investors may liquidate their holdings in New Zealand companies because of local events, such as perceived political uncertainty under an Mixed Member Proportional Representation (MMP) electoral system.³⁶ The first MMP election will be held in or before November 1996. In discussing MMP, ANZ McCaughan, Stockbrokers, note that "[t]he general consensus is that New Zealand's country risk premium has risen as a consequence of electoral uncertainty".³⁷

³⁴ Coopers & Lybrand, *Factors Affecting the Supply of Capital for Small Company Growth* (1993), 38.

³⁵ G. Crocombe, M. Enright and M. Porter, op. cit., 114.

³⁶ The system is described in A. McRobie, "The Electoral System" in P. Joseph, ed., *Essays on the Constitution* (1995), 312. See also M. Chen, "The Introduction of Mixed Member Proportional Representation in New Zealand - Implications for Lawyers" (1994) 4 *Public Law Review* 104.

³⁷ ANZ McCaughan, *MMP: The Changing Face of New Zealand Politics* (Research Department, ANZ McCaughan Securities Limited, November 1994), 2. See also, G. Walker, "Capital Shortage - Implications for New Zealand" (1995) 13 *Company and Securities Law Journal* 342.

There is some evidence that foreign investors will react differently to political instability depending on the industry or industries in which they invest.³⁸ Hence, the extent to which perceived political instability has negative consequences for New Zealand companies is likely to reflect the perceived impact on the industries in which these companies operate.

International events may also prompt capital flight. For example, relative returns in other investment destinations may become more appealing than returns available in New Zealand. Capital flight would have a major detrimental effect on New Zealand companies and New Zealand investors. It is estimated that approximately half the equity in New Zealand listed companies is foreign owned. If a significant proportion of this were liquidated, share prices could drop until local investors entered the market. These concerns are highlighted by Brian Gaynor's comment: "If the trend towards increasing overseas investment continues ... the New Zealand sharemarket will then become increasingly vulnerable to any changes in perception of New Zealand by overseas investors."³⁹

By far the most controversial aspect of foreign investment is the possible effects on the sovereignty of New Zealand as a nation caused by overseas investors.⁴⁰ Concerns over sovereignty invariably relate to listed companies in which New Zealanders, through an ownership stake held by the government, have an interest. In recent times, two such companies were the Bank of New Zealand, which was taken over by National Australia Bank, and Telecom, in which two American companies acquired a substantial interest. Objections to foreign ownership in such cases can be made on grounds that foreign ownership leaves the government "with less options in dealing with the control of the economy",⁴¹ that it leaves New Zealand open to exploitation by foreign companies or countries, and that it may result in the loss of employment for New Zealanders.

The prospect of the abuse of New Zealand's resources is another possible negative consequence of foreign ownership. For example, if an international company with a controlling interest in a New Zealand forest were pushed for cash then it might cut down forests before optimal logging time and sell logs rather than process the logs further in New Zealand.

Finally, foreign investors may use their ownership in New Zealand companies to provide them with leverage to exploit New Zealand as a market, leading to increased imports and a decline in the trade balance. A concomitant potential harm of foreign ownership involves research and development. Foreign investors may not do their research and development in New Zealand.

³⁸ K. Fatehi and M. Safizadeh, "The Effect of Sociopolitical Instability on the Flow of Different Types of Foreign Direct Investment" (1994) 3(1) *Journal of Business Research* 65.

³⁹ B. Gaynor, *op. cit.*, 50.

⁴⁰ This is a matter of increasing political concern in New Zealand. See, for example, B. Ansley, "Rolling out the Red Carpet" *New Zealand Listener*, May 13, 1995, 18.

G. Conclusions

The evidence presented demonstrates a significant increase in foreign control of New Zealand listed companies over recent years. In particular, the ownership of equity in listed companies by overseas institutions has increased markedly. These changes in the ownership of New Zealand listed companies have occurred primarily as a by-product of economic deregulation and have resulted in several obvious benefits to New Zealand investors and companies alike.

The benefits of foreign investment to New Zealand listed companies appear substantial. There are, however, several potential negative consequences, foremost among which is capital flight. This should not be a concern as long as New Zealand companies continue to perform well in comparison with investment targets in other countries.

IV. Institutional Investment

A. Introduction

In the previous section we discovered that institutional investors have increased their influence in New Zealand listed companies over recent years. However, institutional investors are not an homogenous group. In fact, there are different types of institutional investors. In this section we explore the influence of these different types of institutional investors in New Zealand listed companies. In so doing, we provide a New Zealand comparison with Ramsay and Blair's 1993 study of institutional investment and ownership concentration in a random sample of 100 Australian companies listed on the All Ordinaries Index.⁴² The New Zealand data was assembled by Fox and Walker in 1994.⁴³ As regards methodology, we followed the same procedure as Ramsay and Blair.⁴⁴ Data was obtained from the *Directory of Shareholders New Zealand Public Listed Companies 1994*. This publication lists the major shareholders of New Zealand listed companies as of January 1994. The sample comprised a total of 127 companies who had ordinary shares listed on the New Zealand Stock Exchange. For each company we recorded the percentage of ordinary shares held by each of the top 20 shareholders.

Following identification of the top 20 shareholders, we noted which of these shareholders could be classed as institutions. Institutional investors were classed

⁴¹ G. Kelly, *New Zealand Parliamentary Debates* (1992), 527, 10165.

⁴² I. Ramsay and M. Blair, "Ownership Concentration, Institutional Investment and Corporate Governance: An Empirical Investigation of 100 Australian Companies" (1993) 19 *Melbourne University Law Review* 153. For some implications of these findings, see, J. Hill and I. Ramsay, "Institutional Investment in Australia: Theory and Evidence" in G. Walker and B. Fisse, eds., *Securities Regulation in Australia and New Zealand* (1994), 289.

⁴³ M. Fox and G. Walker, "Institutional Investment in New Zealand Publicly Listed Companies" (1994) 12 *Company and Securities Law Journal* 470.

⁴⁴ Ramsay and Blair, *op. cit.*

as either: banks, bank nominee shareholders,⁴⁵ insurance companies, or superannuation, retirement fund and trustee company shareholders. As with Ramsay and Blair, we also noted occurrences of institutions holding between 5 and 10 per cent of shares, or holding more than 10 per cent of shares.⁴⁶ In the following section we discuss our findings with regards each type of institutional investor.

B. Types of Institutional Investors and their Shareholdings

1. Insurance Companies

Table 7 shows our results for insurance company shareholders. This type of institutional investor was observed to be listed a total of 52 times amongst the five major shareholders of all 127 companies (i.e., among 635 shareholding positions). This equates to 8.2 per cent of the observed shareholding positions. This contrasts with Ramsay and Blair, who found that insurance companies were listed 74 times amongst the largest 5 shareholders in their Australian sample i.e., 14.8 per cent of the observed shareholding positions. It appears that insurance companies are more prevalent among the largest shareholders of Australian as compared to New Zealand positions. Furthermore, the ownership stakes of insurance companies in Australian listed companies are larger than those of New Zealand listed companies. In our sample of 127 companies, we only found 7 occurrences where insurance companies held between 5 and 10 per cent of shares. In contrast, Ramsay and Blair found 38 such occurrences in their sample of 100 companies. In looking at insurance companies with over 10 per cent of shares we only found two such cases, whereas Ramsay and Blair found 12 in their sample.

From Table 7, we note that four insurance companies, namely Colonial Mutual, National Mutual, Norwich Union and NZI Corporation, hold noticeably more dominant positions in listed companies than do any other insurance companies.

⁴⁵ Bank nominee companies hold shares on behalf of clients in the same manner as do, for example, nominee companies of stockbroking firms.

⁴⁶ As an aside, we also noted the ownership concentration for the top 5, top 10 and top 20 shareholders. We found that the largest 5 shareholders held on average 61 per cent of issued shares. The 10 largest shareholders held 68 per cent and the 20 largest shareholders held 73 per cent. These figures for the largest 5 and largest 10 shareholders are higher than those found in Ramsay and Blair's sample of 100 Australian companies. They found that the 5 largest shareholders held 54 per cent; the 10 largest held 64 per cent and the 20 largest held 72 per cent.

TABLE 7
Insurance company shareholders

	<i>Number of times company is listed in the five largest shareholders</i>	<i>Number of times company holds between 5 and 10% of shares</i>	<i>Number of times company holds more than 10% of shares</i>
Colonial Mutual Life Assn	9	2	0
National Mutual Life Assn	10	1	0
Norwich Union Life Inc	10	1	0
Tower	5	1	0
AMP Society	4	2	0
NZI Corp	7	0	2
Sun Alliance Life	4	0	0
Guardian Royal Exchange Assn	0	0	0
Oceanic Life Ltd	1	0	0
Prudential Assn	1	0	0
All others (8 companies)	1	0	0
<i>Total</i>	52	7	2

2. Banks

Ownership of equity in New Zealand listed companies by banks is limited (refer Table 8). This is primarily because the Reserve Bank Act 1989 discourages banks from having substantial shareholdings (under the Act equities owned by New Zealand registered banks are deducted from the bank's equity in determining the bank's capital ratio).

TABLE 8
Banks as shareholders

	<i>Number of times company is listed in the five largest shareholders</i>	<i>Number of times company holds between 5 and 10% of shares</i>	<i>Number of times company holds more than 10% of shares</i>
Bank of New Zealand	1	0	1
National Bank of NZ	4	2	1
National Bank of Aust	1	0	0
Westpac Banking Corp	1	0	1
<i>Total</i>	7	2	3

3. Bank Nominee Companies

Table 9 shows our New Zealand results for bank nominee companies. An important point with regard to the interpretation of data such as that presented in Table 9 is made by Ramsay and Blair who caution that, "... there is an issue as to whether bank nominee companies can be classified as institutional investors. This is because bank nominee companies are an aggregation of a diverse range of individual and institutional investors."⁴⁷

For our sample of 127 New Zealand companies we found bank nominee shareholders were represented a total of 175 times among the largest 5 shareholders i.e., they represented 27.6 per cent of the top 5 shareholder positions examined. In contrast, Ramsay and Blair found 169 occurrences of bank nominee shareholders among 500 shareholding positions, or 33.8 per cent of positions examined.

Bank nominee companies were also seen to be more likely to have shareholdings of between 5 and 10 per cent (57 occurrences for New Zealand sample vs. 70 occurrences for Australian sample). However, New Zealand bank nominee companies were more likely to hold over 10 per cent of shares (42 occurrences) compared to Australian bank nominee companies (29 occurrences).

TABLE 9
Bank nominee shareholders

	<i>Number of times company is listed in the five largest shareholders</i>	<i>Number of times company holds between 5 and 10% of shares</i>	<i>Number of times company holds more than 10% of shares</i>
ANZ Bank Ltd Nominees	63	26	8
Austraclear	56	18	16
Bank of NZ Nominees	7	2	0
CBA Nominees	0	0	0
Chase Manhattan Nominees	1	0	0
Citibank NZ Nominees	2	0	0
Hong Kong and Shanghai Bank Nominees	4	2	1
National Aust Bank Nominees	35	9	16
Westpac Bank Nominees	7	0	1
<i>Total</i>	175	57	42

⁴⁷ Ramsay and Blair, *op. cit.*, 185. On this point see also G. Stapledon, "The Structure of Share Ownership and Control: The Potential for Institutional Investor Activism" (1995) 18 *University of NSW Law Journal* 250 at fns. 31-37.

4. Superannuation, Retirement Fund and Trustee Company Shareholders

Table 10 shows the New Zealand results for superannuation, retirement fund and trustee company shareholders. Such institutional shareholders were represented a total of 11 times among the 5 largest shareholders of all 127 companies, i.e., they comprised only 1.7 per cent of the positions analysed. This contrasts notably with Ramsay and Blair's study where such companies were listed a total of 20 times, i.e., represented 4 per cent of positions analysed. For our New Zealand sample, no institutional investor of this category held 5 per cent or more of shares. By contrast, Ramsay and Blair found 6 cases in Australian companies where institutional investors held between 5 and 10 per cent of shares.

TABLE 10
Superannuation, retirement fund and trustee company shareholders

	<i>Number of times company is listed in the five largest shareholders</i>	<i>Number of times company holds between 5 and 10% of shares</i>	<i>Number of times company holds more than 10% of shares</i>
Westpac Superannuation Nominees	8	0	2
Superannuation Investments Ltd	1	0	0
Colonial Mutual Superannuation	2	0	0
<i>Total</i>	11	0	2

C. Implications for Corporate Governance

Bank nominee companies appear to be the largest institutional shareholders in New Zealand listed companies. Because bank nominee companies may hold shares on behalf of individuals or non-institutional companies, the influence of this group is indeterminable. However, we can confidently say that insurance companies are among the most influential major shareholders in New Zealand listed companies. The potential influence of banks, superannuation funds, retirement fund and trustee company shareholders appears minimal.

The rise of institutional investors, as identified in the section III(D) and outlined in more detail above, has important implications for corporate governance. Benefits may be apparent for both capital markets and the monitoring of listed companies. Hill and Ramsay in a 1994 review of the research on institutional investment, capital markets efficiency and liquidity, noted that companies with higher levels of institutional ownership more frequently released information, had less variability in their share returns and that, "... shares traded heavily by institutions experience rising turnover, declining volatility, and narrowing bid-

ask spreads".⁴⁸ The obvious concern one should have with the studies reviewed by Ramsay and Blair⁴⁹ relates to causality. Institutional investors may not be the cause of the positive outcomes just mentioned, rather institutional investors may simply be more likely to invest in companies with these characteristics. Given this possibility, we should treat the findings mentioned with caution.

In addition to possible capital market efficiencies institutional investors may, by monitoring the companies they invest in, effect significant changes in corporate governance and strategy that will benefit all shareholders. Black mentions several areas where monitoring by institutional investors may add significant value.⁵⁰ The first involves the appointment of independent directors. Such directors are seen to benefit corporate performance for several reasons, one of which relates to their independence from management which, in theory, allows them to appraise the performance of management more effectively.⁵¹ Monitoring managerial performance is a governance function which is compromised when executive directors dominate a board of directors. Awareness of the desire of investors for independent representation on boards is a factor which has led some New Zealand boards to increase independent director representation. For example, Brierley Investments Limited stated in its 1992 Chairman's Report:

This board is aware of the investment community's view that boards should comprise significant numbers of non-executives. Accordingly as we review our own situation it is appropriate to have the means of accommodating any future additions.⁵²

A second area where institutions can positively influence corporate performance is by discouraging excessive diversification. This can add value to investment targets as some forms of diversification (e.g., those into related areas), are more beneficial to performance than are others (e.g., diversification into unrelated product areas).⁵³ Executive compensation is also an area where institutions can play a role in increasing firm value. Concern over what may be seen as excessive executive compensation has been expressed in the popular business press.⁵⁴ A recent New Zealand example of institutional intervention in this area relates to the executive share option scheme which Brierley's attempted

⁴⁸ Hill and Ramsay, *op. cit.*, 298.

⁴⁹ Ramsay and Blair, *op. cit.*, 153.

⁵⁰ B. Black, "The Value of Institutional Investor Monitoring: The Empirical Evidence" (1992) 39 UCLA Law Review 895. See also G. Stapledon, *Institutional Shareholders and Corporate Governance* (forthcoming).

⁵¹ On the gap between theory and practice, see, B. Gaynor, "How shareholders lost out in Noel Leeming takeover bid" *The National Business Review*, March 3 1995, 53.

⁵² Brierley Investments Limited, *Annual Report 1992*, 7.

⁵³ R. Hamilton and G. Shergill, "Extent of Diversification and Company Performance: The New Zealand Evidence" (1993) 14(1) *Managerial and Decision Economics* 47.

⁵⁴ Anon, "The Flap Over Executive Pay" *Business Week*, May 6, 90; Anon, "Recession Puts a Harsh Spotlight on Hefty Pay of Top Executives" *New York Times*, Jan 20, 1992, A1, Column 4.

to introduce in late 1993.⁵⁵ The scheme was abandoned following concern expressed by institutional investors.

Another area where institutional shareholders can wield influence is voting rights.⁵⁶ For example, in Australia, Rupert Murdoch informed shareholders in News Corporation that he wanted to change the voting rights in the company's shares, a change which would have seen the Murdoch family have greater voting rights attached to their shares, compared to those of other shareholders. The Australian Investment Managers Group (AIMG) subsequently defeated Murdoch's proposal. More recently, Australian institutions, reputedly led by AMP, lobbied for the removal of Goldman Fielder chief executive Michael Nugent. One press report stated: "Mr Nugent leaves in November. The putsch is, perhaps, the most blatant example of institutional heavying."⁵⁷

D. Conclusions

Institutional investors, and in particular insurance companies, are among the most influential groups of investors in New Zealand listed companies. On a global basis institutional investors are playing a more active role in the direction and monitoring of the companies in which they invest.⁵⁸ There is also some evidence that in New Zealand institutional investors are becoming more active.

V. Board structure

A. Introduction

Remarkably little is known about the boards of directors of New Zealand companies. The most recent research in this area was conducted by Turner who examined Chief Executive Officer (CEO) duality among listed companies for 1984,⁵⁹ Chandler and Henshall who examined board size, incidence of executive board chairs and the proportion of outsiders (non-executives) on the boards of listed companies,⁶⁰ and Firth who examined board size and interlocks of New

⁵⁵ M. Fox and G. Walker, "Institutional Investors and the Brierley Investments Limited Executive Share Options Scheme" (1995) 13 *Company and Securities Law Journal* 344.

⁵⁶ See S. Fridman, "Super-Voting shares: What's All the Fuss About?" (1995) 13 *Company and Securities Law Journal* 31; A. Mandelbaum, "Departure from the One-Share One-Vote Rule: An Overview and Some Lessons for New Zealand" (1995) 10(2) *Journal of International Banking Law* 56.

⁵⁷ D. McEwen, "Managers or Meddlers: The Changing Face of Kiwi Institutional Investment" *The National Business Review*, March 4 1994, 64.

⁵⁸ B. Black and J. Coffee, "Hail Britannia?: Institutional Investor Behaviour under Limited Regulation" (1994) 92 *Michigan Law Review* 1997.

⁵⁹ R. Turner, "Board of Directors Leadership" (1985) 7 *New Zealand Journal of Business* 59.

⁶⁰ Chandler and Henshall, *op. cit.*

Zealand Stock Exchange companies for the years 1972 and 1984.⁶¹ We seek to expand on these earlier studies and, in particular, identify what changes in board structure have since occurred. This analysis should give us a sense of the responsiveness of New Zealand companies to pressures for corporate governance reform,⁶² and the current state of corporate governance with respect to board structure variables. In particular, the research gives us a *prima facie* sense for the extent to which New Zealand boards engage in desirable governance practices, something which is of increasing concern to directors as a consequence of the Companies Act 1993.⁶³

B. Changes in board structure in New Zealand

We add to the data on board structure in New Zealand in several ways. First, we look at more board structure variables than do previous local studies (refer to Table 11 for a summary of the board structure variables of interest). Second, we update our knowledge of board structure variables, and changes in board structure, by including data for all listed companies in the year 1993.

TABLE 11
Board structure variables

<i>Variable</i>	<i>Definition</i>
CEO duality	Occurs when an individual is both chief executive officer and board chair
Executive board chair	Occurs if the board chair is also chief executive officer or another executive; "0" otherwise
Board size	Total number of directors (excluding alternative or deputy directors)
Number of Outsiders	The number of directors who are current executives of the company
Proportion of Outsiders	Number of outsiders divided by board size
Majority of Outsiders	Binary variable. Coded as "1" if greater than 50 per cent of directors are outsiders; "0" otherwise

⁶¹ M. Firth, "Multiple Directorships and Corporate Interlocks in New Zealand" (1987) 23(2) *Australian and New Zealand Journal of Sociology* 274.

⁶² See generally, L. Sealy, "Corporate Governance and Directors' Duties" (1995) 1(2) *New Zealand Business Law Quarterly* 92.

⁶³ See generally, A. Borrowdale, *Duties and Responsibilities of Directors and Company Secretaries in New Zealand* (1995).

Table 12 summarises the findings of past studies in New Zealand along with those findings for 1993. We now proceed to identify and examine changes which have occurred in the board structure of New Zealand listed companies since 1962.

Table 12
Summary of New Zealand board structure studies

Year	1962 ⁶⁴	1970 ⁶⁵	1972 ⁶⁶	1981 ⁶⁷	1984 ⁶⁸	1984 ⁶⁹	1987	1990	1993
Board size	7.21	6.96	6.66	6.95		7.12	6.14	5.70	6.07
CEO duality (%)					11.14				14.29
Exec. chairpersons (%)				20.30					16.54
Number of outsiders on board									4.57
Proportion of outsiders on board				71.50					74.18
Percentage of companies with a majority of outsiders									82.71
No. of companies	58	160	247	208	184	221	292	143	133

1. Outside directors

The major argument proposed in favour of representation by outside directors on boards relates to their perceived impartiality. One of the governance roles of a board is to monitor the performance of management. Executive or insider directors are viewed as being incapable of impartiality in this regard, whereas outside directors who are not involved in the management of the companies on whose boards they sit are more able to impartially appraise the performance of management.

⁶⁴ C. Laurent, *Interlocking Directorates in New Zealand* (Unpublished MCA Thesis, Department of Accountancy, Victoria University of Wellington, 1971).
G. Fogelberg and C. Laurent, *Boards of Directors in New Zealand Companies* (Research Paper No. 1, Department of Business Administration, Victoria University of Wellington, 1974).

⁶⁵ Ibid.

⁶⁶ Firth, 1987, op. cit.

⁶⁷ Chandler and Henshall, op. cit.

⁶⁸ Turner, op. cit.

⁶⁹ Firth, 1987, op. cit.

The mean number of outside, or non-executive, directors in 1993 was 4.57. The number of outside directors was greater than the number of insider directors on 82.7 per cent of boards in 1993. There has been a slight increase in the proportion of outsiders represented on the boards of listed companies since the work of Chandler and Henshall in 1982, the only other previous study to examine this variable for New Zealand. Those authors found that the mean proportion of outsiders was 71.5 per cent during 1981;⁷⁰ for 1993 we find this statistic to be 74.1 per cent.

From the above we can infer that New Zealand boards are, *prima facie*, likely to be able to impartially appraise the performance of the management of the companies on whose boards they sit.

2. CEO Duality and Executive board chairs

Those who argue that it is inappropriate for the CEO, or any other executive, to also be board chair typically propose that if one person holds both roles then the monitoring role of the board is inevitably compromised. Where CEO duality occurs, the question arises as to who monitors the performance of the CEO. After all, if the CEO is also board chair then he or she is likely to be in a position to dominate board meetings and filter information to the board as a whole. As Mallette and Fowler comment:

When a single individual serves as both a firm's CEO and the chairperson of its board, managerial dominance is greatly enhanced because that individual is more aligned with management than with shareholders and is likely to act to protect his or her job and enhance personal well-being.⁷¹

Furthermore, where CEO duality occurs the dual CEO may surround himself or herself with cronies who are typically other executives. These individuals are not in a position to perform effectively their role as directors as they lack independence, being responsible to the CEO on a daily basis and beholden to the CEO for their job and board position.

The incidence of CEO duality has increased between 1984 (when 11.1 per cent of listed companies had CEOs who were also chairpersons), and 1993 (at which point 14.3 per cent of listed companies had CEO duality). In contrast to the increased incidence of CEO duality there has been a decline in the incidence of executive chairpersons (from 20.3 per cent of listed companies in 1981 to 16.5 per cent in 1993).

The incidence of both CEO duality and executive chairpersons is quite low by international standards. For example, the incidence of CEO duality in American companies has been estimated as being as high as 76 per cent.⁷²

⁷⁰ Chandler and Henshall, *op. cit.*

⁷¹ P. Mallette and K. Fowler, "Effects of Board Composition and Stock Ownership on the Adoption of 'Poison Pills'" (1992) 35(5) *Academy of Management Journal* 1010.

⁷² Donaldson and Davis, *op. cit.*, 49.

3. Board size

There has been a significant change in board size between 1962 and 1993. Full information was available for board data for all years except 1962 and 1981 (in these years only the mean board size was available). Conducting an analysis of variance on the available data we found an F ratio of 14.62 ($p < 0.01$). An examination of the mean and standard deviations of the data for the years analysed indicates that board size is, generally speaking, higher in the earlier years and lower in more recent years (refer Table 13). A Scheffe test reveals significant differences between several years of data. To confirm the direction and level of significance of these differences, t-tests were then conducted for the pairs of years identified as having significant differences by the Scheffe test (refer Table 14). As expected these t-tests indicate that, compared to earlier years, board size is smaller in more recent years.

On the whole our analysis points to a reduction in the board size of New Zealand listed companies. In 1970 the mean board size was around 7 members, whereas in 1993 the mean board size was around 6 members. Board size was significantly smaller in each of the years 1987 and 1990 compared to 1970. The same was true in 1990 compared to 1972. Board size was also significantly smaller in each of the years 1987, 1990 and 1993 compared to each of 1980, 1984 and 1985. One possible explanation for this change is that lower board sizes in more recent years reflect "... the levels of insolvency, bankruptcy and resignations and the loss of legitimacy of some directors as a consequence of the 1987 stock market 'crash'".⁷³

Table 13
Sample characteristics for board size

<i>Year</i>	<i>No. of companies</i>	<i>Mean</i>	<i>Standard Deviation</i>
1970	160	6.96	1.99
1972	247	6.66	1.98
1980	129	7.24	1.91
1984	221	7.12	2.21
1985	148	7.45	2.11
1987	292	6.14	2.17
1990	143	5.69	2.27
1993	133	6.07	2.20

⁷³ M. Roy, M. Fox and R. Hamilton, "Size and Potential Corporate and Director Interlocks in Australasia 1984-1993" (1994) 19(2) Australian Journal of Management 201.

TABLE 14
t-tests for board size*

Year	1987	1990	1993
1970	4.063	5.153	
1972		4.268	
1980	5.222	6.109	4.670
1984	5.023	5.935	4.422
1985	6.070	6.821	5.409

* All significant at 1% level; blank cells denote no significant difference between years

C. Conclusions

As mentioned, lower board sizes may reflect the aftermath of the 1987 stockmarket crash. Hamilton and Shergill have noted that the number of companies terminated post-crash in New Zealand leapt dramatically from an average of around 1020 companies per year in the period 1980-88 to 4449 in 1990.⁷⁴ But there were other reasons compelling New Zealand businesses to "give primary emphasis to their own survival".⁷⁵ Foremost among these was the rapid deregulation of the economy. Companies in survival mode do not have the luxury of excess and unproductive board members. They are also more likely to be more responsive to external pressures (such as pressures from institutional investors). This may provide the most plausible explanation for lower board sizes.

VI. Interlocking Directorships

A. Introduction

The purpose of this section is to update New Zealand data on multiple directorships and draw some conclusions from that data.⁷⁶ Data for the year 1993 is compared with that obtained by Firth for the year 1984.⁷⁷ By way of introduction, we consider definitional matters and the mode of data collection.

⁷⁴ R. Hamilton and G. Shergill, *The Logic of New Zealand Business* (1993), 104.

⁷⁵ *Id.*, 107.

⁷⁶ This section draws on M. Fox, M. Roy and G. Walker, "Interlocking Directorships in New Zealand Publicly Listed Companies" (1994) 12 *Company and Securities Law Journal* 331.

⁷⁷ Firth, 1987, *op. cit.*

As to definitions: *company interlocks* refers to the number of other listed companies with which any given listed company has directors in common. *Director interlocks*, for any given company, refers to the total number of board positions held on other boards by its own directors. Finally, *multiple directorships*, for any given director, refers to his or her total number of directorships less one.

Our data was collected for each of the 133 companies listed on the New Zealand Stock Exchange in 1993. Information about listed companies was readily available from Annual Reports, *The New Zealand Company Register* and *The New Zealand Business Who's Who*. From these sources, a list of directors was compiled for each company.

As is common in studies of this type, potential (as opposed to actual) interlocks were calculated. This is because of the inherent difficulty in establishing whether or not interlocks are used for a particular purpose. Of course, the existence and proliferation of interlocks is not necessarily a cause for concern. The mere existence of interlocks does not provide evidence of a power relationship.⁷⁸ One cannot assume that directors use networks of board memberships for any particular purpose (e.g., insider trading), merely because the potential for such abuse exists. Interlocks are rather indicators of potential power relationships between corporations and directors. An actual interlocking directorate can only be said to occur where the link is of actual benefit to the firms involved.⁷⁹ Therefore, potential and actual interlocks must be distinguished.

Based on our data set, *direct* potential interlocks per company (company interlocks), and the potential interlocks for all directors of each company (director interlocks), were calculated. In addition, the number of board memberships (directorships), were calculated for each director.

This data is important because it may suggest legal and legislative implications in areas such as competition law,⁸⁰ the common law fiduciary principle that directors must avoid conflict of duties,⁸¹ and the codification of those duties pursuant to the Companies Act 1993. Ultimately, there is also a political context which may have legislative repercussions. In New Zealand, for example, concern has been expressed in the popular press regarding the power of the Business Roundtable and directors of listed companies.⁸² Also, in the United States, similar concerns prompted the Securities and Exchange Commission, in 1992, to require disclosure of interlocks where matters of executive compensation are concerned.⁸³

⁷⁸ A. Pettigrew, "On Studying Managerial Elites" (1992) 13 Strategic Management Journal 163.

⁷⁹ Fogelberg and Laurent, *op. cit.*

⁸⁰ See R. Carroll, "Trade Practices Implications of Director Interlocks" (1990) 18 Australian Business Law Review 395; R. Carroll, B. Stening and K. Stening, "Interlocking directorships and the Law in Australia" (1990) 8 Company and Securities Law Journal 290.

⁸¹ R. Christie, "The Directors Fiduciary Duty not to Compete" (1992) 55 Modern Law Review 506.

⁸² D. McLoughlin, "Nights of the Roundtable: The Gang of 45" North and South, September 1992, 66.

⁸³ M. Schwartz, "Executive compensation: A Brief on the SEC's New Rules" (1993) 17 Directors and Boards 59.

The Australian literature contains several studies of multiple directorships. Rolfe examined potential interlocks between the top 50 Australian corporations for 1963.⁸⁴ Hall scrutinised the existence of potential interlocks between firms listed on the Australian Stock Exchange during the period 1971-74.⁸⁵ Stening and Wan studied potential directorship interlocks among the top 250 Australian firms from 1959 to 1979 and reported a trend of increasing board memberships and potential interlocks.⁸⁶ A subsequent study compared this data to potential interlocks in the top 250 Australian companies in 1986 and concluded that potential interlocks were increasing significantly.⁸⁷ These findings were later disproved by Alexander and Murray who also revealed an error in the tallying of data in the Stening and Wan paper.⁸⁸ The Alexander and Murray study showed no significant change in company interlocks from 1959 to 1986 and a fall in interlocks to 1991.

Research on boards of directors and interlocking directorates in New Zealand commenced with the work of Laurent in 1971.⁸⁹ There has been subsequent significant research.⁹⁰ Firth's data ended in 1984. Since that time there have been significant changes in New Zealand's regulatory climate⁹¹ and - as we saw in earlier sections of this article - in corporate control.

B. Distribution of Multiple Directorships

Table 15 shows the distribution of directorships held for 1984 and 1993. There has been a significant fall in the number of directorships held per director (from a mean of 1.38 in 1984 to 1.22 in 1993) and the number of multiple directorships held (falling from a mean of 3.00 in 1984 to 2.51 in 1993). These findings are probably due to the falling number of listed companies over this period.

C. Distribution of Company and Director Interlocks

Tables 16 and 17 below present the distribution of potential company and director interlocks respectively over the period 1984 to 1993. The results are significant. From the 1984 data, potential company interlocks have fallen from a mean level of 7.00 interlocks per company to 2.60 in 1993. In 1984, only 10.86 per cent of firms had no interlocks with other companies. This figure rose to 30.08 per cent in 1993. The greatest number of potential company interlocks for a firm was 26 in 1984 and 12 in 1993.

⁸⁴ H. Rolfe, *The Controllers: Interlocking Directorates in Large Australian Companies* (1967).

⁸⁵ C. Hall, "Interlocking Directorships in Australia: The Significance for Competition Policy" (1983) 55 *Australian Quarterly* 42.

⁸⁶ B. Stening and W. Wan, "Interlocking Directorates among Australia's largest 250 Corporations 1959-1979" (1984) 20 *Australian and New Zealand Journal of Sociology* 47.

⁸⁷ Carroll, Stening and Stening, *op. cit.*

⁸⁸ M. Alexander and G. Murray, "Interlocking Directorships in the Top 250 Australian Companies: Comment on Carroll, Stening and Stening" (1992) 10 *Company and Securities Law Journal* 385.

The fall in potential company interlocks is mirrored by a reduction in potential director interlocks - see Table 17. Potential director interlocks measure the potential ties a company has through the number of directorships the directors on its board hold on other boards. Thus, potential director interlocks give an indication of the potential intensity of the company interlocks of any given company. These interlocks fell from a mean of 7.97 directorships per company in 1984 to 3.32 in 1993. In 1984 the largest number of potential director interlocks for any one company was 34. By 1993 the largest number of director interlocks was only fourteen.

The decline in the number of corporate and director interlocks between 1984 and 1993 is primarily due to takeovers, mergers and bankruptcies between those years (only 133 companies were listed on the New Zealand Stock Exchange in 1993 compared to 221 in 1984). The move toward minority and majority control of listed companies, which we documented in section II, is likely to provide part of the explanation for the observed decline in company and director interlocks. As Roy, Fox and Hamilton recently noted:

We contend that the observed decline in networks in New Zealand is a direct result of the rapid agglomeration of corporate assets in New Zealand since 1984... Networks of interlocks, the precursors to this process of agglomeration, have been usurped by it and hence are in decline. Corporate power in New Zealand is now much more narrowly concentrated.⁹²

D. Comparison with Recent Australian Findings

The most recent Australian findings are contained in the literature discussed above. These studies are not comparable with our recent New Zealand data because of their bias towards larger companies and the lag in years. Alexander and Murray observed that company interlocks declined between 1986 and 1991 (with mean interlocks of 6.58 and 4.52 respectively). A substantial decline in company interlocks was also evident in the New Zealand data from 1984 (mean company interlocks of 7.00) to 1993 (mean of 2.60). Accordingly, the comments of Alexander and Murray to the effect that potential interlocks for Australia, New Zealand and North America are higher than those of Great Britain but lower than the rest of Europe may still hold true. Hence, any grave concerns over potential interlocks in New Zealand compared to other countries would appear to be unfounded.

⁸⁹ Laurent, *op. cit.*

⁹⁰ G. Fogelberg and C. Laurent, "Interlocking Directorates: A Study of Large Companies in New Zealand" (1973) 3 *Journal of Business Policy* 16; Fogelberg and Laurent, 1974, *op. cit.*; Chandler and Henshall, *op. cit.*; Firth, 1987, *op. cit.*

⁹¹ C. Campbell-Hunt, D. Harper and R. Hamilton, *Islands of Excellence? A Study of Management in New Zealand* (1993).

⁹² Roy, Fox and Hamilton, *op. cit.*, 210.

TABLE 15
Distribution of directorships per director

		1984			1993	
<i>No of board memberships</i>	<i>No. of directors</i>	<i>% of directors</i>	<i>Cumul. %</i>	<i>No. of directors</i>	<i>% of directors</i>	<i>Cumul. %</i>
1	927	81.1	81.1	567	85.1	85.1
2	122	10.7	91.8	65	9.8	94.9
3	34	3.0	94.8	23	3.5	98.4
4	30	2.6	97.4	7	1.1	99.4
5	14	1.2	98.6	3	0.5	99.9
6	9	0.8	99.4	1	0.2	100.0
7	1	0.2	99.5			
8	4	0.4	99.8			
9	2	0.2	100.0			
<i>Total</i>	1143	100.0		666	100.0	
<i>Mean directorships held</i>		1.38			1.22	
<i>Mean directorships held</i>		3.00			2.51	

TABLE 16
Distribution of potential company interlocks

		1984			1993	
<i>Potential company interlocks</i>	<i>No. of firms</i>	<i>% of firms</i>	<i>Cumul. %</i>	<i>No. of firms</i>	<i>% of firms</i>	<i>Cumul. %</i>
0	24	10.9	10.9	40	30.1	30.1
1	10	4.5	15.4	17	12.8	42.9
2	15	6.8	22.2	22	16.5	59.4
3	25	11.3	33.5	17	12.8	72.2
4	17	7.7	41.2	9	6.8	79.0
5	15	6.8	48.0	7	5.3	84.2
6	13	5.9	53.9	6	4.5	88.7
7	14	6.3	60.2	4	3.0	91.7
8	10	4.5	64.7	6	4.5	96.2
9	12	5.4	70.1	2	1.5	97.7
10	10	4.5	74.7	1	0.8	98.5
11	9	4.1	78.7	1	0.8	99.3
12	11	5.0	83.7	1	0.8	100.0
13	8	3.6	87.3			
14	7	3.2	90.5			
15	2	0.9	91.4			
16	4	1.8	93.2			
17	2	0.9	94.1			
18	5	2.3	96.4			
19	3	1.4	97.7			
20						
21	1	0.5	98.2			
22	1	0.5	98.6			
23	1	0.5	99.1			
24	1	0.5	99.6			
25						
26	1	0.5	100.0			
<i>Total</i>	221	100.0		133	100.0	
<i>Mean potential company interlocks</i>		7.00			2.60	

TABLE 17
Distribution of potential director interlocks

	1984			1993		
<i>Potential director interlocks</i>	<i>No. of firms</i>	<i>% of firms</i>	<i>Cumul. %</i>	<i>No. of firms</i>	<i>% of firms</i>	<i>Cumul. %</i>
0	24	10.9	10.9	40	30.1	30.1
1	10	4.5	15.4	12	9.0	39.1
2	11	5.0	20.4	15	11.3	50.4
3	19	8.6	29.0	16	12.0	62.4
4	17	7.7	36.7	8	6.0	68.4
5	15	6.8	43.4	9	6.8	75.2
6	14	6.3	49.8	7	5.3	80.5
7	15	6.8	56.6	11	8.3	88.7
8	10	4.5	61.1	2	1.5	90.2
9	11	5.0	66.1	4	3.0	93.2
10	7	3.2	69.2	3	2.3	95.5
11	10	4.5	73.8	1	0.8	96.2
12	9	4.1	77.8	3	2.3	98.5
13	8	3.6	81.5	1	0.8	99.3
14	6	2.7	84.2	1	0.8	100.0
15	7	3.2	87.3			
16	2	0.9	88.2			
17	6	2.7	91.0			
18	4	1.8	92.8			
19	5	2.3	95.0			
20	1	0.5	95.5			
21	2	0.9	96.4			
22						
23						
24	2	0.9	97.3			
25	1	0.5	97.7			
26						
27	1	0.5	98.2			
28	3	1.4	99.6			
29						
30						
31						
32						
33						
34	1	0.5	100.0			
<i>Total</i>	221	100.0		133	100.0	
<i>Mean potential company interlocks</i>		7.97			3.32	

E. Conclusions

There has been a significant decline in company and director interlocks in New Zealand in recent years. The most likely explanations for this decline are the sharemarket crash of 1987 which greatly reduced the number of listed companies in New Zealand and the on-going process of economic reform.

VII. Conclusions

This article presents evidence on ownership and control of the New Zealand sharemarket. This is important for several reasons. First, any analysis of corporate governance, takeovers, foreign investment, securities regulation and associated issues in New Zealand needs to proceed from an understanding of the evidence. For example, one can analyse the implications for securities regulation in New Zealand flowing from increased institutional ownership of the market.⁹³ In the absence of the requisite evidence, analysis occurs in a vacuum. Second, the evidence presented here increases our understanding of the New Zealand sharemarket which has a present market capitalisation of approximately \$43 billion. The sharemarket is a prime mechanism for the formation and subsequent raising of capital for New Zealand businesses. New Zealand's national economic goals such as those articulated in the New Zealand Trade Development Board's "stretch scenario"⁹⁴ and the *Budget Policy Statement 1995*⁹⁵ are closely tied with the operation of the sharemarket. Indeed, the relationship is fundamental. In the U.S. context, Jane D'Arista has commented: "Economic growth is crucial to our nation's future. And our financial markets must be able to raise the necessary capital to fuel this economic growth".⁹⁶ New Zealand is a capital importing nation which needs domestic and foreign capital for growth and the sharemarket is a key mechanism for the attraction of that foreign capital.⁹⁷ Hence, our findings are also relevant to an assessment of New Zealand's economic goals.

⁹³ G. Walker and M. Fox, "Securities Regulation and New Zealand Sharemarket Patterns, 1989-1993" (1994) 5 *Journal of Banking Finance Law and Practice* 244.

⁹⁴ TRADENZ, *Stretching for Growth: Building an Export Strategy for New Zealand* (1993).

⁹⁵ The New Zealand government *Budget Policy Statement 1995* and the companion document, *Investing in Our Future: Toward 2010* both list enhancing and maintaining New Zealand's economic growth as key objectives. For a review of the 1995 budget, see *The National Business Review*, June 2, 1995. There is a good review of New Zealand's economic goals in *Far Eastern Economic Review, Asia 1995 Yearbook* (1995) 180, 183.

⁹⁶ J. D'Arista, *The Evolution of U.S. Finance, Volume II: Restructuring Institutions and Markets* (1994), xvii.

⁹⁷ G. Walker, *supra*, n.3.