

Impact of corporate governance compliance on mining IPOs

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Definition



Corporate governance is about the ways suppliers of capital assure themselves of getting a return on their capital.



Does CG matter?



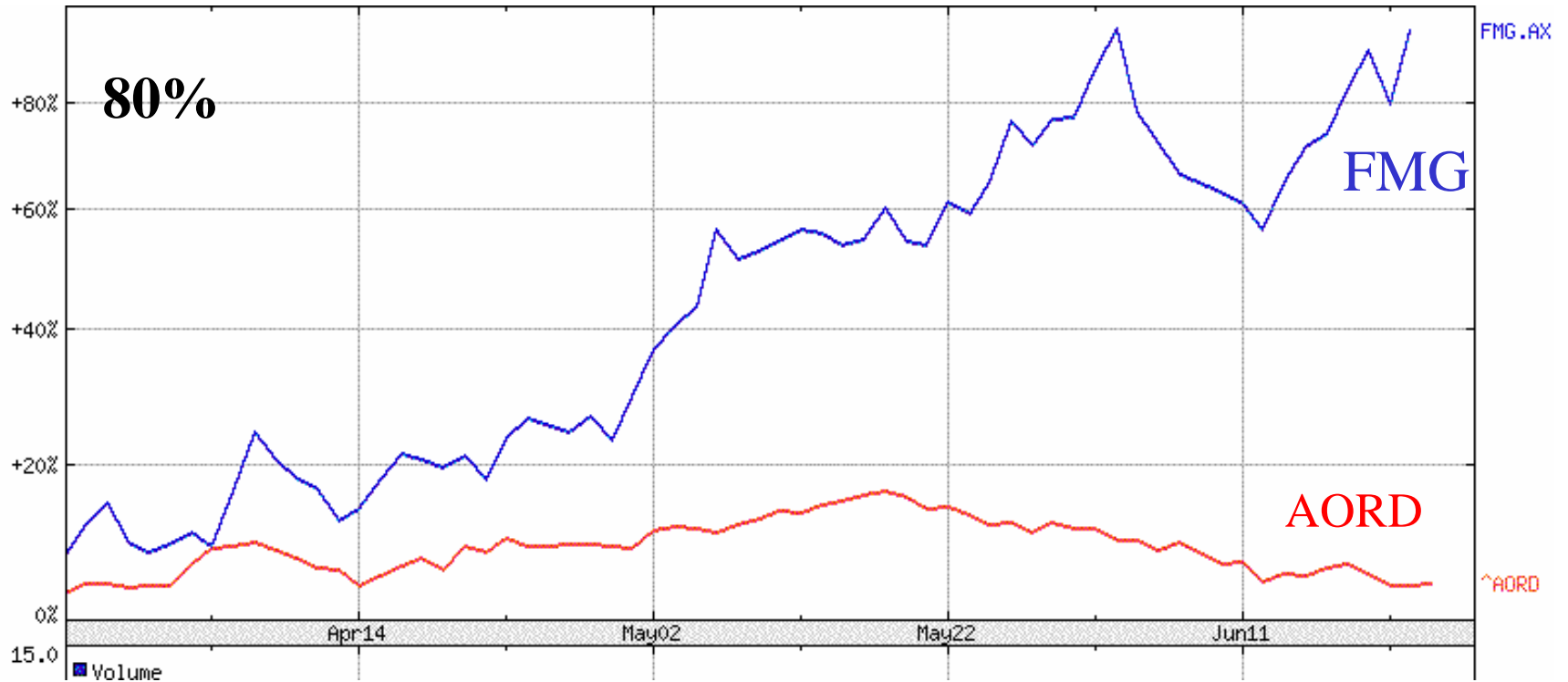
“Your columnist's hunch is that high standards are an integral part of a well-performing stock, but the “goodness” factor can't be easily separated from all the other drivers of a share price.”

Goodness its own reward at top end

Tim Boreham (18 June 2008 [The Australian](#))



Fortescue Metals price, last 3 months



Allan & Alan



Allan Moss

CEO 15 yrs

Macquarie Bank

→ #185 on BRW rich list



Alan Bond

Convicted for fraud, then
promoter of Madagascar Oil,
Lesotho Diamond Corp

→ #157 on BRW rich list

Market sentiment



- Survey evidence:
 - **67%** “amount by which our stock is undervalued or overvalued by the market” is an important factor in issuing stock
- Impact of company name changes
 - Increase in price of up to 74%



What can we conclude so far?



- Good projects matter
- Investor sentiment is a significant influence
- **Unknown:** Incremental value of good governance



Complications



- Corp Gov comprises tangible & intangible measures
- Tangible:
 - Number independent directors
 - Audit committees
- Intangible
 - Relationships
 - Reputation



Complications



- Can “tangible” measures alone ensure CG quality?
- ASX & TSE followed Sarbanes-Oxley Act (2002) in identifying tangibles as “best practice”
 - Unlike US, “comply or explain” approach adopted
- Is compliance a “box ticking” exercise?



Complications



- “Best practice” CG measures may improve investor confidence but costs might outweigh benefits
- Median IPO issue (2001-2007): \$4,400,000
 - Cost of six independent directors: \$300,000
 - Unlikely that “one size CG fits all”



Our questions



- Did promotion of “best practise” CG measures change companies’ level of compliance?
- Does closer compliance generate higher returns?

Our approach



We focus on IPO market on ASX & TSE

- IPO promoters maximise return by adopting optimal CG structure
- Use underpricing as measure of CG quality

IPO sale \$ per share	Price at end of first day's trading	Underpricing %
Co X \$1	\$1.5	50%
Co Y \$1	\$1.25	25%

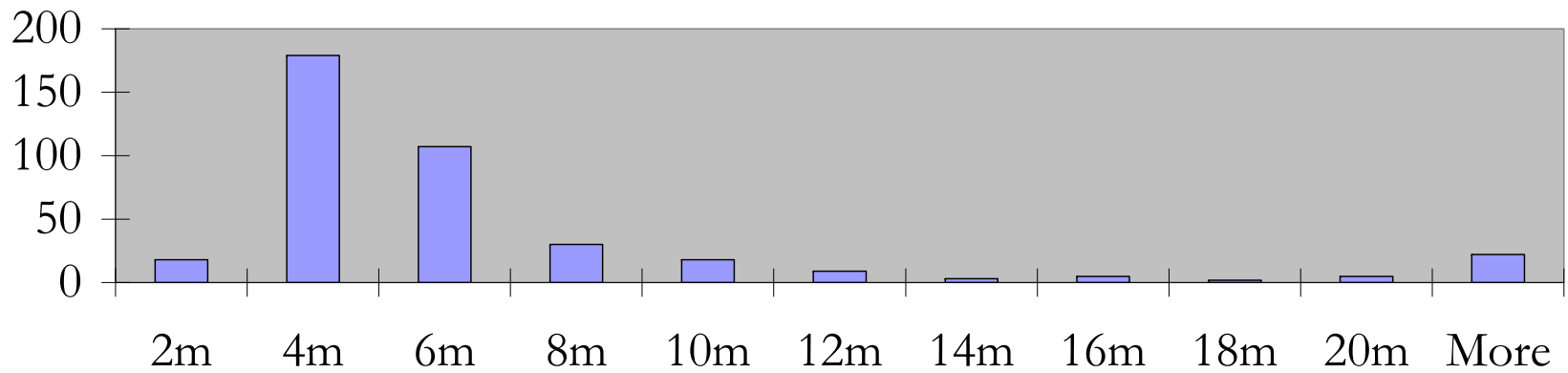
Sample

	ASX			TSE		
	<u>All</u>	<u>Resource</u>	<u>%</u>	<u>All</u>	<u>Resource</u>	<u>%</u>
1997	36	14	39%	15	3	20%
1998	28	8	29%	12	2	17%
1999	75	7	9%	10	1	10%
2000	118	22	19%	13	3	23%
2001	53	19	36%	14	3	21%
2002	51	31	61%	9	3	33%
2003	70	37	53%	4	2	50%
2004	133	59	44%	37	13	35%
2005	137	68	50%	37	18	49%
2006	161	109	68%	34	18	53%
Total	862	374	43%	185	66	36%

Notice impact of “best practice” CG post-2002?
(Perth home to more ASX cos, ≈762, than Sydney)

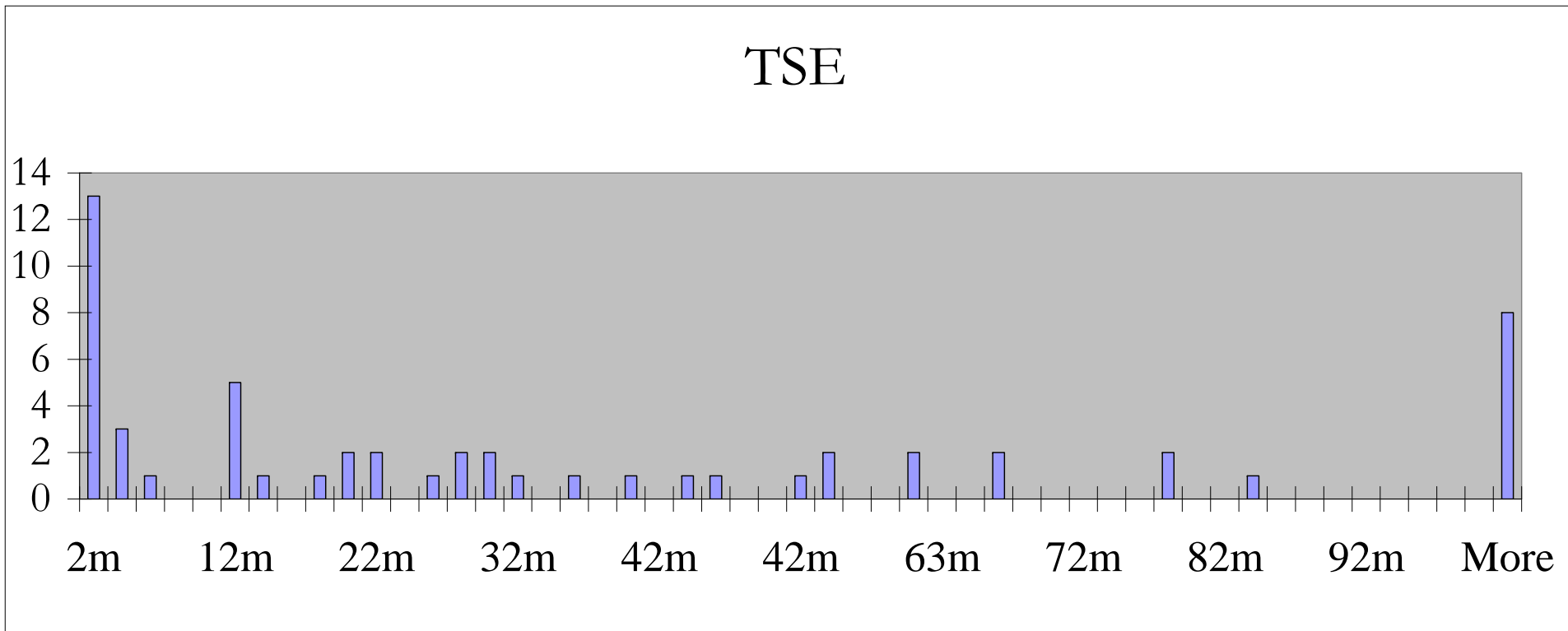
IPO size distribution

ASX



IPOs on ASX raise relatively small amounts of capital
Median amount raised: \$4.4m

IPO size distribution



Fewer IPOs on TSE but they raise more capital per firm
Median amount raised: \$28.8m

ASX & TSE “best practices”

- ASX more prescriptive in definitions
 - 28 measurable CGs from ASX
 - 15 from TSE
- TSE more reliant on principle than prescription
 - TSE: “unrelated director” is independent of management and of any relationship interfering with duty to act in best interest
 - ASX: “independent director” is not an exec director, is not a substantial shareholder, has not supplied material service or product in last three years, etc

Did CG practices change post-2004?

- TSE: Of 15 recommendations, just 3 adopted by a majority of post-2004 IPO firms
 - Board should comprise all independent directors (20 out of 23)
 - Chair should be independent (13 out of 23)
 - Entirely independent compensation committee (14 out of 23)
 - None wrote description of board duties and just 7 acknowledged board stewardship of issuer.

Did CG practices change post-2002?

- ASX: 12 out of 28 recommendations had majority compliance post-2004
 - Caveat: compliance greater for *pro forma* items, e.g., disclose functions reserved to the board
 - Canadians arguably better on substantive items, e.g.,
 - 20 (51%) of 39 ASX IPOs had majority independent directors
 - 20 (87%) out of 23 TSE IPOs had an *all-independent* board
 - Differences may be a function of IPO firm size

Is closer compliance associated with performance?



- No!
 - We do not find an association between compliance with best practice recommendations and either IPO underpricing or subsequent share market performance
 - This may simply reflect the importance of the intangible aspects of CG that we were unable to take into account
 - There is an association between firm size and closer compliance with “best practice” CG.

Conclusions



- Sarbanes-Oxley triggered debate & regulatory reform across the world
- Our results indicate the reforms have had little substantive impact on CG practices
- We find intriguing differences in interpretation of CG practices
 - ASX may wish to reconsider whether its prescriptive approach provides more benefits than the principles-based approach adopted by the Canadians



Future research directions



- It is unlikely that CG is unimportant
 - More work needed to identify the “intangible” (or least easily measurable) CG practices that investors rely upon
 - When do companies find it optimal to take on the more tangible CG measures identified as “best practice”? What are the trade-offs?
 - Perth provides a fertile environment to investigate these issues



Famous last words?



No end to resources boom

“Australia's resources boom is set to last for some time ... Reserve Bank report.”

Sydney Morning Herald (June 19, 2008)



Dear sir,

PROPOSAL FOR AN INVESTMENT PLAN

Miss Jan Taylor is my name, one of the daughters of the former Liberia President Charles Taylor, who is now facing charges for war crime charges.

The family wants to invest his wealth ...

Does CG matter?



What is the incremental value of good governance?



Does CG matter?



“If a company is perceived to be lacking in boardroom decorum, other merits won't be enough to install the stock on the list of investor pets that include the likes of BHP Billiton”

Goodness its own reward at top end

Tim Boreham (18 June 2008 [The Australian](#))



“ASIC asleep on the job ...”

Bryan Firth *The Australian* 10 April 2008



“Investors’ confidence has been undermined and the Australian securities market will have suffered reputation damage”



Fragility of trust



“It takes years to build trust ...
... and just a few seconds to lose it”

Sam DiPiazza
PricewaterhouseCoopers' global CEO