Written by Andrew Linden, Sessional Lecturer, PhD (Management) Candidate, School of Management, RMIT University

With the Banking Royal Commission’s interim report looming, public jockeying to influence what Commissioner Kenneth Hayne might recommend is intensifying.

In response to damming evidence at the commission, the Australian Institute of Company Directors (AICD) has doubled down to maintain the policy status quo (which helpfully protects its professional director members).

Read more: ***Solving deep problems with corporate governance requires more than rearranging deck chairs***

The AICD is involved in a quick redraft of the ASX corporate governance code . It is advocating voluntary increases in board gender diversity and continues to claim that so-called independent non-executive directors should dominate boards .

Controversially, new AMP chair David Murray has repeatedly attacked the AICD’s policy position . He declared that “the board’s got to conduct itself in a way that it looks to the CEO for everything”.

Now in a submission just published on the royal commission website, Treasury, Australia’s paramount source of economic policy advice, has weighed in to make some startling public concessions about the state of corporate governance in Australia.

Treasury concedes that, based on evidence to the commission, shareholders have no interest in protecting customers, the wider community or the public interest. It notes:

… shareholders' interests do not necessarily coincide with customers' interests, particularly in the short-term; indeed much of the misconduct has generated significant returns to the firms that have flowed through to healthy dividends. Of course, when misconduct affecting consumers threatens profitability and reputation, the response of shareholders can be quick and strong.

The idea of shareholder primacy and maximisation of shareholder value has shaped public discourse, dominated political debate and determined what constitutes "good" corporate governance in Australia for the last three decades.

To rephrase Charlie Wilson's observation about General Motors , it has been thought that what is good for shareholders is good for everyone.

Shareholder primacy has supported a political disposition favouring industry self-regulation and wars on red tape, as well as regulator cutbacks and passivity.

Treasury now says this received orthodoxy is dangerous.

Red flag calls for bolder reforms

This red flag on the dangers of shareholder primacy comes in the wake of a recent guidance note from the Australian Prudential Regulation Authority. APRA reminded directors they have core legislated duties that should not be equated with meeting shareholders' demands and that boards are not the playthings of shareholders.

However, Treasury then baulks at even broaching reforms that evidence from other jurisdictions (see here and here) suggests will increase board accountability and lower systemic risk.

Read more: ***The way banks are organised makes it hard to hold directors and executives criminally responsible***

Treasury devotes most of its paper to discussing important changes in prudential oversight and standards. It fails to mention these options for systemic corporate governance reform that could apply to all companies (not just banks).

For example, the British government is considering reforms such as employee directors. Even the UK equivalent of the AICD mentions this as a reform option.

Bizarrely, Treasury, perhaps anticipating the views of the government, then says a regulatory non-market-based response is its *least preferred option* for preventing systemic misconduct.

The Treasury's confused response is underscored by the Australian Securities and Investments Commission's recent approval of the revised banking code of conduct. The code is not mandatory and still relies on the banks to police themselves.

To be clear, relying on market-based responses, self-regulation and shareholder primacy will only result in more of the same.

For example, prominent corporate governance scholars claim that corporations ought to be regarded as republics and states-within-states . It's easy to see how managers and directors can justify ignoring the law using that logic.

And the royal commission has heard damning evidence that banks chose to ignore the law to maximise profits.

Fix the structure of boards

Instead of looking to quick conventional fixes (as Treasury does), such as re-emphasising directors' duties and increasing diversity through soft targets, we argue that the unitary board structure itself is an underlying factor in systemic misconduct.

Executive and non-executive directors sit on the same unitary board. This allows power to be concentrated in the hands of dominant (usually) executive directors. It's exactly what the APRA report on the governance at CBA describes.

The unitary company board structure urgently needs reform.

It has long been recognised that unitary boards are self-perpetuating oligarchies. Imperial CEOs or chairs who are themselves dominant or controlling shareholders (or owe allegiance to one) preside over these boards.

The board structure in Australia is a relic of early Victorian-era company legislation. Like parliaments of this era, unitary board systems like Australia's still use a property franchise to restrict voting eligibility and deny representation to other actors.

It's hardly surprising then that corporations presided over by unitary boards are regularly described as dictatorships and have poor external accountability.

Agency theorists valorise hyper self-interest and corporate dictatorships. They ignore that corporations rely on legislated rules to exist and directors have public interest obligations (for example, to follow the law).

In this context the agency theory-inspired idea that shareholder interests can be equated with customer interests or the public interest now looks ludicrously naïve.

Read more: ***Why shareholder value drives income inequality***

So, if shareholders can't (and won't) protect customers and the wider public interest, who can?

As we have argued recently , to lessen the chance of systemic misconduct, board representation should be broadened and board functions should be split across two boards.

That Treasury fails even to broach this option after acknowledging the system is broken, and instead opts for piecemeal solutions, is a recipe for future disaster.

Andrew received funding from RMITs EU Centre http://www.rmit.edu.au/about/our-education/global-outlook/european-union-eu-centre to conduct his doctoral research. The Centre is partly funded by the European Union

Warren Staples has received funding from Australia China Council, Department of Foreign Affairs and Trade (DFAT), and the Victorian Managed Insurance Authority (VMIA). Warren is currently a member of the Institute of Public Administration Australia (IPAA) Victoria's Sustainability Community of Practice (CoP) Advisory Committee.

Authors: Andrew Linden, Sessional Lecturer, PhD (Management) Candidate, School of Management, RMIT University

Read more http://theconversation.com/treasury-admits-corporate-governance-is-broken-but-baulks-at-systemic-fixes-100882