

BINDURA UNIVERSITY OF SCIENCE EDUCATION

FACULTY OF COMMERCE

GRADUATE SCHOOL OF BUSINESS

MASTER OF BUSINESS LEADERSHIP

EXECUTIVE MASTER OF BUSINESS LEADERSHIP


MASTER OF LEADERSHIP AND CORPORATE GOVERNANCE

MASTER OF SCIENCE IN ENTREPRENEURSHIP AND INNOVATION

CORPORATE GOVERNANCE AND BUSINESS ETHICS (MBL 508)

EXAMINATION PAPER

DURATION: 3HOURS 30MINUTES

 OCT 2023

Instructions and Information to Candidates

1. Section A is compulsory and carries 40 marks.
 2. Answer Question One from Section A and any three (3) questions from Section B.
 3. The paper carries six questions.
 4. All questions in Section B carry equal marks of 20 each.
 5. The use of cell phones is not allowed in the examination.
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SECTION A: [COMPULSORY]

QUESTION 1

CASE STUDY: LEIGHTON HOLDINGS: BUILDING BRIBERY

Case overview

Allegations relating to a culture of corruption, bribery and cover-ups involving the world's 12th largest contractor by revenue, Leighton Holdings (Leighton), shook the Australian corporate landscape in October 2013. It was reported that company executives of the Australian construction empire had known of various kickbacks paid to secure projects, and that payoffs made to Leighton employees had happened as early as 2009. Early warning signs that executives may be involved in rampant corruption and mismanagement had been observed. Other internal company documents also revealed a corporate culture that accepted and rewarded corruption, leading to a scrutiny of excessive remuneration packages paid out to former senior executives. The Leighton saga placed regulatory bodies in the spotlight, as the media and politicians heavily criticised regulators' lack of prompt and thorough investigations, which allowed the incident to manifest. The objective of this case is to allow a discussion of issues such as corruption and bribery; the response of the board, management and regulators to bribery allegations; the role of tone at the top; remuneration and other corporate governance practices in reducing bribery and corruption risks; and corporate governance in company groups.

Leighton on the rooftops

Leighton is a project development and contracting group headquartered in St. Leonards, Australia. Leighton's principal subsidiaries comprise of Leighton Contractors Pty Ltd, Thiess Pty Ltd, Leighton Asia Limited, John Holland Pty Limited and Leighton International Limited (Leighton International) and operates in Australia, Asia, the Gulf region and Africa. Leighton provides engineering, building construction, facilities management and contract mining services.

The bricks of bribery laid

"I asked did Wal K approve this? And he said 'yes'." - Memo by David Stewart, then acting Chief Executive A series of articles by Fairfax Media in Australia that began on 3 October 2013 revealed the existence of a handwritten memo by the acting Chief Executive of Leighton, David Stewart, on 23 November 2010⁴. According to the memo, David Savage, former Managing Director of Leighton International, and Wal King, who was the Leighton CEO for 23 years, were aware of and approved an A\$42 million kickback paid to a Monaco-based company, Uncoil, which was "nominated by Iraqi officials who selected Leighton for a A\$750 million oil pipeline contract". The payments were called "project support" fees in the contract. The fees were to be reviewed by the Board of Leighton International, including King, who was also part of the Board. However, these fees had "mysteriously disappeared... when they were revised by top Leighton's staff one month later". "He [Savage] said less than 50% of the payment." - David Stewart's memo on questioning the proposed payment and the real value of

the work to extend the Iraqi contract. Court documents between Unaoil and Leighton also revealed the existence of Memorandum of Agreements in early 2011 between the two firms to guarantee a minimum payment of US\$55 million for "construction and marketing fees in the event that the Iraqi government awarded Leighton with a second pipeline contract" that was worth US\$500 million. Of this US\$55 million, marketingspecific fees were specified to be "no less than US\$25 million", even though no actual marketing services were required.

Stealing steel

A specific incident involving Gavin Hodge, senior project manager for the building of an Indonesian barge, revealed senior executives' mismanagement of the impropriety, which may have enabled the culture of corruption and cover-ups to take root all across Leighton. In early 2009, a whistle-blower informed the top executives that Hodge had allegedly diverted A\$500,000 of steel from Leighton to build a barge for an Indian company, Adani, in a black-market project. A company legal report indicated that Russell Waugh, a Leighton executive who was also Savage's right-hand man, had approved of this transaction. Waugh later ordered internal investigations, which concluded that Hodge's actions "had no material benefit to Leighton" and put the company "in a position of potential compromise of integrity". Despite these findings, Waugh merely gave Hodge a stern warning. A second inquiry by the company's accountants then failed to find further evidence of these illicit payments and the matter was put to rest. Despite this, Waugh rewarded Hodge in appreciation of his "efforts over the last year", giving him an A\$40,000 bonus and salary increments upon closure of the incident. "If you go quietly, you'll be back in three months." - Phone conversation between Waugh and the whistle-blower who shed light on the Hodge incident The persistence of the whistle-blower eventually led to a launch of a third inquiry, this time independent of Waugh and carried out by a newly appointed Leighton executive. It was revealed that the investigations carried out previously were sorely inadequate. Reference was made to Waugh paying out a bonus to Hodge and also directing the investigations when he himself was in a potential conflict of interest, since Waugh himself signed off and approved the steel transaction. In response to criticisms, Leighton eventually dismissed Hodge and initiated legal proceedings against him to recover the money he allegedly stole. In Leighton's media release to shareholders in response to the allegations by Fairfax Media, it was mentioned that this incident also led Leighton to "strengthen and improve its corporate governance and risk management processes", such as the revision of its comprehensive Code of Business Conduct as well as a "5 gate tender review and approval process"

Building a Stonehouse

"Savage and Leighton International had extraordinary autonomy compared to the rest of the operating companies ... One of our major concerns here was that there was very little corporate governance within Leighton International." – Leighton witness to the Australian Federal Police (AFP) A lack of corporate governance and excessive autonomy within Leighton International also created the opportunity for Savage and fellow executives to use confidential information to establish a private business venture. All these were carried out via the company's internal email system, at a time when Leighton International was facing probes on corrupt practices. A review of Savage's confidential emails revealed that he had covertly launched "Project T",

which sought to lure Leighton senior officers to a private firm in order to compete directly against Leighton so as to win projects. This was evident as Savage's new venture "emphasised resource projects and offshore shallow-water projects", which was very much similar to work he had been helping to win for Leighton.

Towering remuneration packages

Amidst the corruption scandals and a time of heightened media attention, the excessive compensation packages of executives that came to light enraged the public further. During King's tenure, he was criticised for receiving excessive executive pay, collecting at least A\$100 million in remuneration since 2004, including a A\$14.7 million compensation package in 2010, which was the year of his departure. Moreover, King's remuneration package was not strongly linked to shareholder returns and mainly in the form of cash rather than equity. His short-term incentive was also substantially above his counterparts at similar-sized companies – in a year that Leighton suffered a fall in profits.

A closer scrutiny of Leighton's remuneration structure revealed its heavy emphasis on financial measures in its Key Performance Indicators (KPIs). More specifically, the company's profitability played a crucial role in determining the amount of remuneration. Executives' short-term incentives, such as cash bonuses, were directly linked to achievement and outperformance of profit targets, while medium-term deferred incentives hinged on profitability over a three-year period. Likewise, 50% of the long-term incentives were only achievable with substantial growth in earnings per share, which in turn depended on earnings and profitability. In 2009, King's and Savage's short-term variable bonuses constituted 65.6% and 62.9% of their respective total remuneration²³. This was noticeably higher than all other executives. Moreover, in 2009, performance against financial KPIs was also significantly weaker compared to previous years. On average, key executives only obtained 58% of the maximum remuneration payable to all eligible employees. The Board's grounds of defence Throughout Fairfax Media's numerous allegations, the Board had maintained the directors had "at all times executed their duties with the appropriate care and diligence, and in the best interest of each company [within Leighton]". Yet, the signature of former Leighton senior executive David Savage appeared on a preliminary tender document that includes an alleged A\$42 million kickback to win a lucrative project in Iraq. In defence of the Board's approval of the Iraq Project in October 2010 despite the alleged A\$42 million bribe, a former director claimed that the bribe was deliberately disguised by Leighton's management as an "onshore and security payment" to avoid raising the suspicions of the Board. He also added that there were no discussions of potential "agency" payments of bribes. Instead, the A\$42 million payment was portrayed as necessary by the management due to security concerns in Iraq. The evidence suggests that the Board approved the project without further inquiry despite knowing that the deal was carried out in a corruption-prone country. It was also revealed that a six-month audit in early 2011 had prompted Board members to "examine bribery-prone practices with necessary details", but this appeared to have been responded to with inaction.

In a leaked Australian Federal Police (AFP) interview transcript, a former top executive said that he “never got the sense that the Board was excited by this stuff [due diligence, upholding corporate governance standards etc.]. The way Leighton International had been managed was an absolute disaster from a commercial perspective” Fire alarms kept silent from authorities and shareholders Despite uncovering appalling evidence of serious misconduct and corruption, the media reported that Leighton had withheld the memos and files detailing corruption and failed to notify authorities. The company had waited a year before it called the Federal Police in 2011. It also took a further three months of delay till February 2012 to notify shareholders that an investigation was underway about the work in Iraq, and that the company had voluntarily notified the AFP of the alleged breach of its Code of Ethics³¹. In response to these accusations, the Board has maintained that upon their knowledge of the matter, they had immediately reported it to the AFP. The reason that the market and shareholders were only notified in February 2012 was due to the confidential nature of the investigation. A Board facing constant shake-ups in the midst of the alleged corrupt deals in 2010, Leighton’s controlling shareholder, the Hochtief Group, faced a takeover bid by Spanish Group ACS, and the hostile takeover was eventually successful³⁴. The stage was set for a new wave of power struggles within Leighton, with Hochtief engaged in a takeover bid to increase its stake in Leighton from 58.8% to 74%³⁵. With five out of 10 seats on Leighton’s Board already controlled by either Hochtief or ACS, the threat of a potential overhaul arising from the takeover was very real. According to former Chief Financial Officer Scott Charlton, the Board’s preoccupation with its internal struggles could have hurt governance and placed issues of potential corruption low on the agenda

In addition, the Board had been facing a flurry of changes to its pool of directors. An examination of the composition of the Board indicates that the Chairman of the Audit Committee changed every year between 2009 and 2011. Further, in Financial Year 2011, David Stewart held the post of CEO for a mere nine months, and then left along with six other directors. Clearly, the Board had pressing changes to deal with. In 2014, Hochtief ousted CEO Hamish Tyrwhitt and CFO Peter Gregg and replaced them with M Fernandez Verdes, CEO of Hochtief and former ACS executive, further cementing ACS’ control over Leighton and its Board.

Regulatory bodies with weak foundations

“I would be surprised if the federal police or ASIC have the expertise or technical knowledge to undertake investigations of this nature.” - Former top executive Stephen Sasse, in an interview with Fairfax Media⁴¹ the AFP and the Australian corporate watchdog, the Australian Securities and Investments Commission (ASIC) were also in the spotlight, with numerous reports published by Fairfax Media alluding that the AFP and ASIC had been slow to conduct thorough investigations. It was highlighted that “almost two years have passed since the AFP agents were first called in and they have still not spoken to key witnesses and suspects”. Similarly, ASIC had also been reported to not have had reached out “to even a single witness”. The AFP was overwhelmed by the case, due to reasons such as a lack of experience, technical knowledge, funding and manpower, and their “lack of urgency” was said to “stem from resourcing issues”, as revealed by former Leighton officials during interactions with the federal

police. ASIC was also under fire for not proactively fulfilling its duties as the corporate watchdog. In a bid to defend themselves, Greg Medcraft, Chairman of ASIC, told Federal Parliament's economics legislation committee that the agency was working to improve the handling of foreign bribery cases. They also asserted that ASIC's enforcement record had always been "solid". However, media reports referred to past instances of ASIC's tardiness in handling whistle-blower information, including a poor handling of serious misconduct within Commonwealth Bank's financial planning division'

ASIC also defended that they had to wait until the Police referred the case to them, and that the Police faced constraints as well, since there were laws in place to prevent the Police from sharing information with ASIC. It was only until 2 April 2014 that ASIC confirmed its launch of a formal investigation allowing them to exercise the powers of the Star Chamber to question the witnesses and also demand for documents. Upon hearing this, the Australian Senate criticised ASIC for their delayed efforts of investigation, claiming that formal investigation came two years late from the time ASIC had first known about the allegations in November 2011. Consequently, questions have been raised if Leighton corruption could have been mitigated if ASIC had stepped up on its investigations earlier. Upon pressure by the media and politicians, ASIC and AFP have since begun to find better ways of working together, starting with the signing of a memorandum of understanding, between both parties in October 2013. Furthermore, a proposal to the Senate has also been drafted to allow parallel inquiries to be conducted and there has also been a call for legislative reform to allow the AFP to share information with ASIC for such offences.

Investors scramble for the emergency exit

Leighton's share price dipped when shareholders caught wind of its work in Iraq; this was the first piece of public information received by investor community regarding the possibility of a breach of ethics and law. The share price fell a further 10.4% in a day when the reports were published by Fairfax Media, wiping A\$688 million from its market capitalisation. Hochtief Group's share price fell 7.9%, its largest single-day share price loss in more than two years. The following day, Leighton's share price fell another 4.6%, resulting in a cumulative total loss in market capitalisation of almost A\$1 billion. Further, it was estimated that the legal and reputational damage resulting from this scandal could amount to as much as A\$562 million, as Leighton faces possible fines under the Commonwealth Criminal Code and losses of future contracts or cancellations of existing ones.

In an unusual turn of events, on 20 February 2014, Leighton declared profits for the year 2013, up 13% from the previous year. Investors reacted positively to this earnings announcement, with the share price going up by 6.5% – or by A\$1.0755 – as Leighton was profitable even against the gloomy backdrop of a mining sector downturn. However, the share price of A\$17.48 was still slightly shy of the almost A\$20 pre-scandal share price. Leighton's former CEO Hamish Tyrwhitt remarked that "to get investor confidence back Leighton really needs to resolve those [corruption] issues".

Required:

- a) Using Leighton scandals, and the importance of tone at the top and remuneration policy in contributing to, or preventing corruption. Discuss. (8 marks)
- b) Explain to what extent the Board's internal struggles contribute to its failure to detect that a bribe had been concealed in the proposal they approved. (8 marks)
- c) The constitute 'of appropriate care and diligence' for directors in preventing bribery and corruption. Describe with evidence from the case study? (8 marks)
- d) It was said that 'Leighton International had extraordinary autonomy compared to other operating companies' in the Leighton Holdings group.
Discuss the key issues involved in the governance of subsidiaries within a company group. (8 marks)
- e) The media and politicians have heavily criticised ASIC's lack of speed and action in the handling of Leighton's case. Is the enforceability of corporate governance limited by the regulatory environment? Explain. (8 marks)

[Total: 40 marks]

SECTION B: *Answer any three (3) questions from this section.*

QUESTION 2

- a) Should Zimbabwean companies have board committees? (10 marks)
 - b) Evaluate the duties of any two board committees in a company. (10 marks)
- [Total: 20 marks]**

QUESTION 3

Discuss any current **six** responsibilities of the board of directors using practical examples.

[20 marks]

QUESTION 4

Using an organization of your own choice, explain the best theory for corporate governance Stewardship theory. **[20 marks]**

QUESTION 5

Explain any four 4 ethical theories giving practical examples. **[20 marks]**

QUESTION 6

Discuss with relevant workplace examples the current major ethical theories is deontology. **[20 marks]**

END OF EXAMINATION PAPER