
**THE DIRECTORS DILEMMA – HOW DO I SAY
NO TO A MATE?**

GRAHAM JONES

THE VENTURE GROUP LTD

*Navigating & working to create **positive** outcomes*

That endearing Australian cultural icon called 'mateship' pervades most of our lives.

From the earliest days of Australia's existence through to the current day, Australians have banded together, with arms entwined, to either fight off the enemy or to present the strongest possible front.

From wars through sporting triumphs to business, this small, remote country has punched 'above its weight'. 'Mateship' has been an important ingredient in all our successes.

And failures.

Indeed, our greatest failure (Gallipoli), has spawned our most enduring icon of mateship -(the Anzac Spirit).

In the Corporate scene there is no departure from the rules of mateship. Long term relationships are nurtured from school, business school, clubs (business and sporting), political affiliations, cities of residence, industry bodies and many other sources. Tribalism is rampant in the corridors of power. Just look around you. It is there every minute of the day.

For the most part, this mateship thing brings positive results, but when things go bad – the very foundations of mateship are tested to the limit. Who is to blame? How strong is the bond? What are the consequences of ratting on, or, worse still, dobbing in, a 'mate'?

This personal dilemma is nowhere more evident than in the Boardrooms of our nation.

Tribalism in Australia's Boardrooms is alive and well and (some would say) impregnable.

Over the past few decades, the consequences of *bad* tribalism are well documented, and the response of the authorities to the excesses of such practices as insider trading, predatory pricing, market manipulation (all of which grew from *bad* tribalism), have been both slow, and largely ineffective.

The consequences of *good* tribalism are not so well documented due largely to two things. The media focus on bad things as something worthwhile to cover, coupled with the overwhelming number of bad things in excess of good things which have happened.

The most recent initiative which has emerged to try and control *bad* tribalism is called "Corporate Governance". Jim Wolfensohn – our famous ex-pat President of the World bank, defines this as 'Corporate governance is about promoting corporate fairness, transparency and accountability' *Financial Times*, June 21, 1999.

All Australian companies are required to make formal statements in their annual reports about this new initiative to stop *bad* things happening.

The people who are charged with the onerous task of creating and managing the system of Corporate governance are the Board of Directors.

Boards of Directors are a very interesting group of people (or tribe). They are generally made up of a number of people from outside the business (non executives) and a couple of people from inside the business (executives). The people from outside the business are selected on a variety of bases for their position. Sometimes they are selected for their specific knowledge of that business, sometimes for having been an executive in the company for a number of years before retirement, sometimes because they provide paid consulting advice to the business and are therefore experts and sometimes because they are mates with the existing Chairman or other board members.

The incidence of the latter category is, unfortunately, very high. Recent surveys in the UK show that more than a third of all NED's (non executive directors) are in this category. Now, while we don't know the equivalent number in Australia, based on the International Mates Index (IMI), where Australia scores 60% higher than UK, we can assume that more than half of NED's in Australia are there because they are a mate of someone. This, then, meets one of Jim's criteria – transparency. For mates are mates and everybody knows it!

The same UK survey shows that one in six directors are drawn from professional and financial advisers to the company. There is evidence here that many NED's are in similar positions (and some of them manage to also fall into the 'mates' category. A good lesson here. If you can make it into two categories, you are absolutely impregnable. That there is a clear conflict of interest in serving as a so-called independent director while collecting (often substantial) fees for so called professional advice has by passed many.

Jim's second point of accountability is extremely interesting. In order to see what local large businesses are doing about accountability Venture Group has researched ten of Australia's top businesses. They are AGL, ASX, AMP, Brambles, Coles Myer, Lend Lease, NAB, Perpetual, Qantas and Woolworths.

We looked for the processes they all followed to ensure 'Proper Rules of Corporate governance were in place.'

The first thing they all did was to establish a number of Board committees to oversee the system of corporate governance. All have Audit or Audit and Risk committees. Only one specifically stated it has a Corporate Governance Committee (the whole Board). All have Remuneration, or Compensation, or similar committees. In addition some had other ad hoc committees.

In all, amongst the ten companies there were over 40 committees on which served over 150 directors. Now, this is in addition to the main board of directors. It represents a lot of governance (and, a cynic would say, a lot of additional directors fees.) A review of Annual reports for all the companies shows that their reports on corporate governance ranged from one to twelve pages. There is no evidence to suggest that the number of words written correlates in any way to the effectiveness of the system.

These committees are charged with ensuring adherence to a variety of operating disciplines, including ensuring the board itself is behaving. The point we would like to make is that in NO case was it evident that there was anyone, other than *existing* Board members, appointed to these committees on a permanent basis. Accordingly, when a 'mate' is doubtful about some aspect of the business, it is very difficult for him/her to stand up to the Chairman/Board if they don't want to rock the boat or do anything which may give the market some bad vibes. Undoubtedly, if true independence (and accountability) were in place, these decisions would be easier to take and have a significantly more telling effect.

Accountability? Rather mates looking after mates.

In order to assess results from these systems of governance we have looked at the stock market performance of this group.

To cut a long story short we have concluded there is no evidence whatsoever of a correlation between stock market performance and number of directors, number of committees or number of words written about corporate governance.

Nevertheless, the market is interested in good governance and undoubtedly factors that into its view of the business. Our guess (without further research) is that those businesses with fewer 'mates' on the board do much better and are better regarded.

Now to Jim's third point of 'Fairness'. The question is 'what is fair?'

Auditors are (or were) supposed to attest that the financial reports gave a 'true and fair view' of the state of the business.

As Alan Kohler observed recently in the *AFR*. 'The accounting profession is in a shambles'. The more the shambles of Enron in the US and HIH/FAI here (and there were plenty of 'mates' involved in both cases) evolves, the more likelihood there is of even more imposed regulation. This will not solve the problem. Only self regulation will improve things.

Thus we cannot rely on the auditors for fairness. Nor can we rely on the regulator – too little too late.

The answer is simple.

Do it yourself. 1`

The market will mark you up if it sees very good governance.

Very good governance will not happen if you have a high 'Mates Index'.

Get rid of your 'mates' and the highly paid professional advisers on the Board.

Make your committees more relevant by having a true expert outsider as the Chairman.

Reap the rewards.

Graham Jones
