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The Challenges of Attaining Growth:

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"Superhuman effort isn't worth a damn unless it achieves results"

Sir Ernest Shackleton

Chapter 4

Over-scrutiny of Boards Results in Risk Aversion

"...it's gossip, it's almost like scandalous stories."

In the view of many, Australian Boards are subject to levels of scrutiny unprecedented in other parts of the world. Gun-shy Directors avoid the spotlight, regulators, media, investor markets, and special interest groups, often missing growth opportunities for Australian businesses.

Chapter 4: Over-scrutiny of Boards Results in Risk Aversion



“When written in Chinese, the word ‘crisis’ is composed of two characters. One represents danger and the other represents opportunity”

John F. Kennedy

Participants suggested Australian Boards are subject to levels of scrutiny, from multiple directions, **“that are unprecedented in other parts of the world”**, based on their experience. This results in ‘gun shy’ Directors who refuse to do anything controversial for fear of stirring the interest of regulators, the media, investors, and special interest groups. This desire to avoid the spotlight results in ultra-conservatism in Board decisions, and missed opportunities for Australian businesses and potential frustration for CEOs.

Media

The Australian media was identified as fermenting the fear of failure among Boards, sometimes being compared to other countries where media are more focused on other topics besides business performance. One participant even described it as a tabloid

approach to business reporting, while others agreed the scrutiny was way out of proportion to the size of the market.

“I travel a lot in the States, a little bit in Europe, I read the papers there, but here in Australia, it’s almost like it’s gossip, it’s almost like scandalous stories or more, than over there. You never read that sort of stuff over there.”

“The business media in this country personalises news far more than probably other countries.”

“The size of media for this economy is “crazy” – and the focus is on bad news.”

“Small market – large media exposure”

“Small market with greater media and publicity than the US.”

“The actual level of in-depth business analysis is lighter in detail than in the US and the UK, but the focus on the personalities in Australia is far more obtrusive and potentially damaging. It is regularly misleading.”

This concept of a small market was probably more related to the relativities of the size of the Australian market to the scrutiny because in other contexts other participants were quite forthright in saying that using the excuse of Australia being a small market for lack of growth was not correct. These participants argued that Australia was not a small market in their view – ***“there are many opportunities if you look for them.”***

Another suggested that media scrutiny could cause a company to prematurely abandon what would otherwise be a viable long-term strategy.

“We tried 10 strategic initiatives in 7 years and every one of them failed. ... And I think the last one was not having the courage to hold the course. ... the media were all over us.”

Perhaps the most amazing assertion was that dissenting Board members would give ‘live feeds’ of Board decisions to selected journalists.

“They would have a Board meeting and half way through the Board meeting somebody would go to the toilet and then send a message to a journalist about what’s just happened in the Board meeting. You didn’t need ... the minutes (of the meeting) you just bought the Daily Telegraph.”

One Director even suggested that the media scrutiny is a remnant of the tall poppy syndrome.

“It’s a small market and the tall poppy syndrome is alive and well!”

“Somebody has got to put these high-flying Board Directors in their place and there seems to be no shortage of journalists willing to do just that”.

The state of the concern this is creating for some Directors and the impact it is having on their thought processes regarding innovation and risk is evident in the following statement:

“Why would I risk my reputation and put my house on the line, for 90 or 150 grand a year the kind of mudslinging that goes on in the media ... everybody wants to have a shot at a particular Chief Executive or Chair or Board member.”

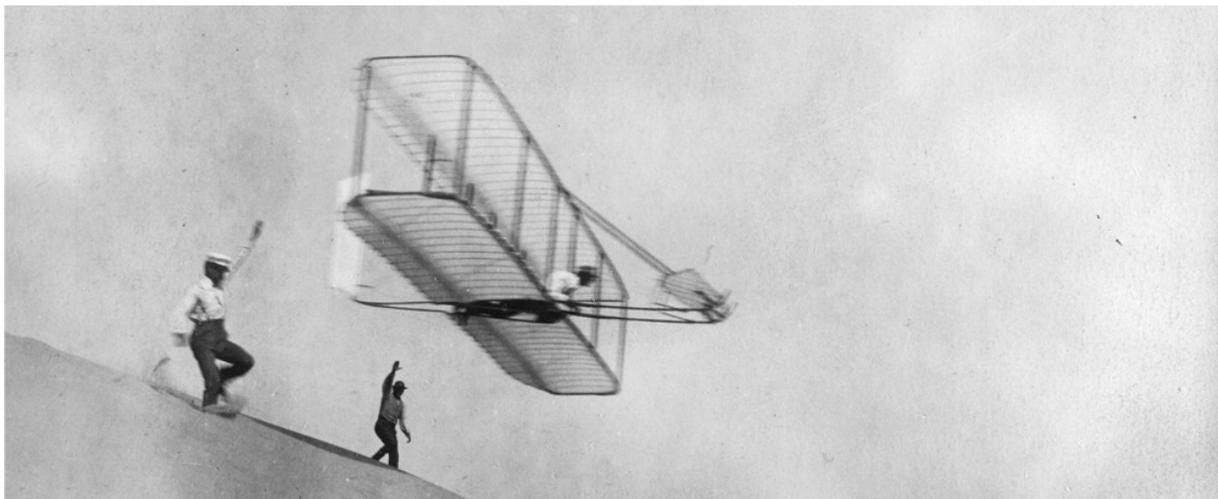
“Reputational risk is a major concern and as such we are holding the line as opposed to moving forward. If you think about Kerry Packer’s statement regarding decision making and strategy he said ‘if you get six out of ten right, you will be fine’. We have lost sight of the fact that leaders make mistakes.”

“In Australia one mistake and the heavens descend upon you” in many cases because the press is so ‘oppressive’ to business – ‘intrusive.’”

Director Fees

This aversion to being in the spotlight for any reason even extends to Director Fee pools where the pool quantum must be put to shareholders for approval.

“The press would have me for breakfast now ... we’ve only gone to the shareholders once for a fee increase. ... we don’t want all the flack so we’ll all work for nothing.”



*“If birds can glide for long periods of time,
then ... why can’t I?”*

Orville Wright

Shareholder Voice

One of the spill-over effects of the negative based scrutiny and propensity to scapegoat is that this has contributed to a shift in shareholder mentality regarding acceptance of risk in some Director's minds. This in turn has a knock on effect resulting in Directors, as the shareholder representatives, becoming more risk averse.

"Well, I think that my sense is that over time we've become a lot more risk averse, and so we protect the downside more than we look to the upside. ... I think first of all the shareholders seem to becoming more risk averse. So if you venture and fail, shareholders tend to be relatively unforgiving, so that in itself is a bit of a brake on becoming too radical in your growth."

The reality is that shareholders do *"have a 'large voice' in a public company"*, and because shareholders have such a voice in influencing Board decisions, part of a Director's role is to help the company articulate its business strategy and approach to risk management to proxy advisers and investors (i.e., informing markets). Not that this is new but some would say it is now essential, with the time commitment and importance increasing exponentially. There is a need to tell a good story to investors and other external constituencies, however the flipside is that it can take time away from other vital Board functions for Directors, and time away from the CEO in managing the business. Some participants argued strongly that the nature of the market being so small and the corresponding level of scrutiny by the various constituencies made this now a fact of life and as one put it, *"to ignore it is at your peril"*. The following quote by one Director provides an interesting take on the consequences of such a *"large voice"* of these external constituencies, even to the point of determining whose strategy to follow.

"Shareholders have a really loud voice and they have a lot of power.proxy advisors have an incredible amount of power so managing that stakeholder relationship, making sure you're really clear on what they want and either being prepared to take them along your journey, or be prepared to accept that their journey is the one that you're going to need to be on, is vital."

What does this really mean in practice? Director and CEO participants talked at numerous times of the potential lack of congruence of Company (under Director and CEO stewardship) and shareholder objectives. For example *"what do you do when you have shareholder groups with different objectives on your register – growth or yield?"* For the yield-based investors it is often about consistent and reliable yield with no *"bumps in the journey"*. Thus growth initiatives with short-term pain or even low risk or failure thresholds are not desirable – this is made very clear to organisations and their Boards.

Some participants were more forthright in taking a direct approach to these shareholders. An example from one participant in a growth company was given where for a particular shareholder group that was yield focused stating quite clearly to them, *"if yield is your focus then maybe this is not the right investment for you as we are a growth orientated company"*. However the reality is that the balance of power varies by investor/shareholder group, and if that power is sufficiently strong through a large holding, the comment above of being *"prepared to accept that their journey is the one that you're going to need to be on"* is not new and will always be the case. Thus the Board and CEO need to do a lot of work with major investors to be *"crystal clear on what type of company they are running"*, and therefore who is most suited to be on their register.

Although it was not all seen as one sided as one participant noted. Even when you believe investors would be prepared *"to come on the journey"* the *"Board is unwilling to have the short term downside"* as it leads to reputational risk and being remembered in the future as the ones to have presided over that downside.

Regulators

The theme of *"over scrutiny"* was by no means restricted to the media, shareholders/investors and proxy firms. Overzealous regulators were also identified as a unique aspect of the Australian business landscape that interfered with the ability of Boards to do their jobs.

"We are drowning under regulation and compliance. We get reviews from APRA now monthly on aspects of our business. We've got English regulators, Hong Kong regulators, Singapore regulators, writing to us. APRA was a principle regulator, now it's become detailed and intrusive."

"Government doesn't understand the market. There is a lot of regulation but for the medium-small business it is too onerous, there is too much red tape and we are becoming at a rapid pace the nanny state. The red tape is trivial and is nonsense, with nonsense accounting requirements. Regulators have never worked a day in their life. Regulation means greater cost for the average Australian. The cost of living is already too high, for the average business the cost of opening the doors is becoming ridiculously high."

"We have come too far in our governance and are becoming a nanny state which is too prescriptive. We just need to be sensible about risk, and if we are not careful management will walk out the door as their Directors are paralysed by risk. You cannot regulate risk. I am concerned where regulation is going and say to the regulators get out of the way."



"Never interrupt someone doing what you said couldn't be done"

Amelia Earhart

"It is draining resources to do corporate governance when you are consulting with APRA, ASIC and other bodies on a continual basis."

"Government intervention through ASIC and APRA is simply providing additional costs to business."

"Compliance is driving risk aversion and is killing the entrepreneurial spirit. Companies are terrified. There is not enough time spent on strategy and there is not enough time spent on people."

"We are pushing Boards to a governance focus and are losing track of strategy. There are a lot of legendary Board members obsessed by process. We are awash with regulation that inhibits Boards from investment decisions."

"I am becoming a fatalist about regulation. Directors are becoming obsessed with risk."

"The relentless push to more and more regulation is forcing companies to spend more and more time on it."

"Our legal system is not conducive to being anti-risk averse and people are sitting on their hands, not prepared to give it a go."

"People that aspire to go on the Board are being told that it's all about compliance. It's all about what the company is not supposed to be doing ... I'm not interested in having anybody on the Board who doesn't actually contribute to the story of what we're about and where we want to go."

Government regulators can be heavy-handed. One Director likened the experience of being called before a regulator to a schoolboy being sent to the principal's office.

"We got called in by a government minister that the (regulatory body) reported to, to haul me over the coalswe were kept waiting in the office for (minister) like a little schoolboy, you were going to go and get a hiding from the headmaster."

This overzealous approach to regulation was attributed to the misguided notion that good governance could mitigate business failure. Participants were adamant that governments cannot "legislate out risk". There is a fundamental relationship between the risk and potential growth and no amount of regulation can change this fundamental relationship.

In general growth strategies have risk associated with them – it's a competitive market that needs risk takers.

"But it's this thing about legislating the risk out, it's just if everybody wants to cluster around and say 'We didn't lose money.' but standing still is going backwards."

One participant saw the regulators themselves as being under pressure from the media and this pressure was resulting in more regulation of companies. But more regulation was not viewed as the right outcome. Rather the legislation should focus on bad behaviour as opposed to risk.

"You cannot legislate for risk but you can legislate for bad behaviour. The media punishes the regulators if they don't get a scalp and as such there is a relentless push for more and more regulation, forcing companies to spend more and waste time. As a result, Directors are playing it safe and are risk adverse. The greater loss is to the country as more business is being channelled to other countries that encourage risk or provide incentives? Ultimately in life things go wrong, it is a simple fact."

Regulators often blur the line between Directors and management in terms of accountability, often acting as if Boards run companies.

"The regulators haven't quite understood how best to affect the regulation. ... they view the Board as making bad decisions, so therefore they hold the Board accountable for the decision. Well that's fine, but we don't make the day to day decisions. Management makes those decisions."

"Ministers hate failure, I worked for a Minister, but they've got to learn that there will be some failures if you're going to be a bit adventurous and have a go."

"There is huge regulatory burden imposed on companies in this country."

"Boards spend a lot of time on governance and with an over emphasis on risk which does not necessarily reduce risk. Unfortunately, this is making companies dead scared to take a risk. Are we making enough mistakes in the Boardroom? No. Much of this is due to reputational risk. Reputation in a small pond is a major issue."

"Australia's legislation is one of the most onerous environments in the world. At the same time I would argue we have some of the best Directors in the world. The legislation creep is blurring the line between Management and Directors. We now have prescriptive legislation rather than outcome legislation which is beginning to have Directors do the Management role."

Other participants saw the regulation and compliance issues as simply a part of doing business and managing regulation as part of the role. They were more pragmatic in their approach to dealing with regulation and compliance:

"In regards to compliance, deal with it. That's the way it is. Structure your Board meetings appropriately, trust your subcommittees and don't re-hash it at your Board meetings."

"It is easy to let governance dominate. You need disciplined Board members, otherwise, there can be an obsession with governance which is a state of mind. A good Director can switch hats and go to create as well as governance. Some regulators think Boards run companies and there is a blurring of the line. Directors ensure systems are in place, management does the execution."

"There was need for further regulation and compliance and it has been good for the banking sector but now we are becoming as a business community overregulated."

Lobby Groups

Australian Boards are "fearful" of lobby groups and special interest groups which is "outrageous" compared with other countries (i.e. the US and UK).

"A small group of shareholder interest groups which influence Boards are responsible for, I think, reducing the quality of Australian companies and their growthfrankly it's outrageous when you are compared globally to some of the risk profiles that companies are prepared to take on."

Given the nature of global markets today and the need to compete and grow through these global markets the difference in risk profiles can lead some companies to abandon even the thought of competing.

Privatising

Due to the levels of scrutiny from all directions some participants even questioned the viability of being domiciled in Australia or whether the best course of action "may be the need to go private for the long term benefit". Privatising was seen as a possible option where the objective would be to "take under the covers and reinvent" the company and then possibly relist.

There was surprisingly strong support for this approach if it was possible.

"Unlisted is far easier than public."

"More pressure in a public company to perform to others' timetable."

"Listed companies are at a unique disadvantage, there is a skewed view of listed companies."

"A lot easier to be private or a subsidiary of an overseas company."

"Listed companies need to comply with domineering ASX listing rules."

"I agree with the trend to consider going private or change where you are domiciled because:

- *Publicly listed companies under the microscope;*
- *Can't satisfy all shareholders; and,*
- *With the reporting system you are on 'a hiding to nothing'"*

"One may need to go private for the long term benefit to escape the short termism of investors and markets and regulators"

"Private equity is an interesting model and a model that cuts the red tape and provides clarity. It is very attractive."

"Why not go to Private Equity – no issues like:

- *Governance;*
- *Media; and,*
- *Proxy Advisers."*

"With Private Equity:

- *Clearer;*
- *Perform or out;*
- *Goal orientated; and,*
- *'Pure' objectives and timeline."*

"Going private you are able to achieve longer term objectives."

Offshore

Some however even suggested going a step further of moving offshore and some had done so. The benefits were seen in "escaping" the burden of being a listed company in Australia.

"Alternatively try to move or even set up in another jurisdiction that is less onerous e.g. Singapore. From one who had set up in Singapore "What compliance burden?"

"Australia is losing as companies are channelling more and more business through countries, such as Singapore."

Government Inconsistency and Lack of Leadership and Longer Term Thinking

Company growth depends on good leadership, excellent product, competitive work practices and political stability. A theme which was touched on was the need from all sides of politics to provide greater leadership, longer term thinking and certainty to ensure investment and opportunity. This void in Australian Parliamentary leadership was made very clear in participant comments.

"I, and I know many other Directors are genuinely concerned about the country's leadership and the level of debate from all sides of government. Short-termism, excessive poll watching and the inconsistency in the forward thinking is alarming. There does not appear to be genuine vision. As a result the flip flopping of decisions, of budget strategies, of IR and economic reform is providing the business heads of Australia with little confidence. Unfortunately Australian business is running in spite of the government, they have got to a point and turned off. For the small companies where the majority of innovation and ideas really come from, they are fed up with red tape, with people in government with no understanding of business and what it takes to hire, manage and motivate people and build business. Parties from all sides of the divide are too far removed, their consultation with business is little more than lip service. We are seeing very little growth in the business and Australian economy. We are falling asleep at the wheel and our leadership hasn't in many business leaders' views illustrated any form of long term strategy, vision and courage."

"I have just returned from an overseas trip and have been watching from afar our political leadership. I was embarrassed by the petty focus of all parties, the short termism, the level of debate and complete failure to engage all levels of business. We have 60% of the world's population at our doorstep and we have no plan to maximise the enormous opportunities, we don't encourage risk taking to new markets, instead we sit back and wait to be the follower of the world. Where is our 'have a go' attitude? It has been kicked into touch. The willingness to want to be the best, the wanting to compete, seems to be lost. Instead we have to conform to risk and red tape guidelines which are stifling all."

"Political leadership is absent. We have had a void for a long period from all sides. It is not an excuse for business achieving incremental growth but is impactful. If you asked are the youth of today engaged with Australian politics I would say no. If you asked are the senior fraternity engaged I would say no. Business has lost faith of late, one only needs to examine the political behaviour and ask where is the game changing long term economic strategy, not the politically productive short term kick. If voting was not compulsory I am fearful the turnout would be very low. The facile debate, the lack of vision, the fact that no one can put forward a long term plan without it being destroyed because it comes from an opposing party is bordering on the ridiculous. Perhaps business is to blame in part. I am thinking through have we been good enough in getting our message to the government and if so why are they not listening? Good leaders create energy, they create excitement which stimulates others."

Based on the political rhetoric it would seem unless we demand the change, expectations will remain low."

"The economy is running itself and business is running itself despite the governments."

"Currently there is a debate being put forward in regards to taxing super and other areas in the economy. No one has stopped and challenged the thinking around growing the pie. If governments require income why don't they support business to grow their revenues and logically then grow their taxes off the back of their revenues. If we look at the business incentives in Asia they offer better tax rates that provide far more efficient support, less red tape and a can do attitude. In some cases we may be better working with benevolent dictatorship compared to the Canberra circus."

"The governments say nothing about IR and productivity."

Comment

Clearly participants feel burdened from the range of issues explored from media scrutiny to the governance burden. It must be said however that other participants were quite relaxed regarding these issues with an outlook of *"that's the way it is and we just get on and manage it"*. Regardless, it is clear from the comments that whether intended or not the levels of scrutiny and governance being placed on Australian

companies is having an adverse impact on their risk appetite. Given as one participant said, *"Growth does not come without risk"*. This tempering of the risk appetite of Boards and CEOs is impacting the growth horizons and initiatives being pursued by Australian companies. It was not as if participants wanted a carte blanche approach to risk or did not believe that accountability should rest with Boards, but rather that there was an imbalance in the system that was ultimately impacting growth.

While some were advocating a move to private to relieve themselves of these burdens, more concerning for Australia was the consideration of moving offshore to less onerous jurisdictions such as Singapore – loss of the company, the growth, the employment and the tax revenue!

This raises the issue of the lack of engagement and leadership from the Australian Parliamentary representatives from all sides of politics. The lack of focus on the big picture and what is right for the Australian economy, Australian business and the Australian people is very concerning as the lack of drive for what is best in all these areas is being hijacked by political short-termism. This short termism in the political sphere is preventing the necessary long term thinking that can shape the environment for future growth and prosperity for Australian business and the Australian people.



*"Our greatest glory is not in never falling,
but in getting up every time we do"*

Confucius