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Directors need to focus less on the risk and more on the reward

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Company directors might be too scared to really chase growth, but it all comes back to getting the right mix of interests around the board table.

The Australian Institute of Company Directors' chief John Brogden says changes need to be made to directors' liabilities. **Daniel Munoz**

by **Jemima Whyte**

"Boards are all in the business of assessing risks," says Arlene Tansey, a non-executive director of Primary Healthcare, Adelaide Brighton and Lend Lease Funds Management.

"I think the board's role is to assess proposals brought by management, and the risk embedded in those proposals needs to be well considered, analysed and appropriate for the business. It cannot be about avoiding risk."

It's a simple message and one that's hard to argue with.

But the problem, according to a growing number of reports and anecdotal evidence, is boards are becoming excessively focused on the risks, and not really considering the possibility for growth.

A 71-page report titled *The Challenges of Attaining Growth* from recruitment firm Blenheim Partners and Macquarie University's Graduate School of Management, due to be released on Wednesday, is the latest to question why companies aren't more growth focussed. It comes up with a range of contributing factors, including a lack of diversity around the board table, a cultural fear of failure through to the emergence of a professional director class, and too much scrutiny on board performance.

What sets this survey apart is that the voices it highlights are especially well qualified: 82 chairmen, directors and executives at public and private companies who spoke on condition of anonymity over the course of a year.

In June this year, Reserve Bank governor Glenn Stevens claimed corporate Australia's refusal to invest was holding back Australian growth. Ninety per cent of firms won't embark on investment if the expected return is less than 10 per cent, according to Reserve Bank of Australia research, one explanation as to why low official interest rates aren't spurring an economic recovery.

Boards can't take all the blame for the lack of growth.

Investors have favoured companies with steady dividends and punished companies for pursing growth opportunities at the expense of returning capital to shareholders.

Insurance Australia Group's decision to exit its China strategy after pressure from institutional investors, including Perpetual Investments, is just one recent example of investors influencing long-term strategy.

Chief Executive Women president and chairman of Broadspectrum, formerly Transfield Holdings, Diane Smith-Gander is one chairman who rejects the argument that boards have dismissed growth options and are becoming overly cautious.

"I think Australian companies are searching for growth, but are taking an appropriately conservative stance considering what's happened in the past, with attempts to grow offshore and be fast followers," she told *The Australian Financial Review*.

"We are in an uncertain environment with volatility within the cycle that we haven't seen before, so that naturally means that it's harder to make confident projections of the trajectory of an investment."

But she says there are areas that should be examined to improve board dynamics.

Remuneration is one area that she suggests should be re-examined, possibly including incentive rewards for directors if a company performs well.

"I don't think you can be doctrinaire about the rules that apply. I think we have been risk averse in ways we are prepared to remunerate directors, and I think it's time for a debate around the remuneration framework.

"Should there be upside for a non-executive director? How much alignment is there? You've got to balance attracting talent in NEDs, aligning interests with shareholders and maintaining independence. Have we got these three things in the appropriate mix?"

SKIN IN THE GAME

The concept of aligning directors' interests with those of investors is another debate that is constantly simmering along, and the Blenheim report questions why more directors don't have "skin in the game" in the form of shares or options.

A report by ACSI and Ownership Matters found that almost 11 per cent of ASX100 non-executive board seats are held by directors with no shares in the company.

The Australian Institute of Company Directors' chief John Brogden says that no one size fits all in terms of directors holding shares in a company, though the industry practice is that directors do usually hold stock.

The study also raises the issue of a "professional director" class – particularly younger directors – being more risk-averse because they are reliant on the salary from board positions and are conscious of needing a long-term non-executive director career.

Ultimately, it all comes back to getting the right mix of interests around the board table, a central point in the Blenheim study that stresses diversity needs to mean more than gender.

Ownership Matters' Dean Paatsch noted the way boards are self-selecting in Australia, and noted in Sweden, the four largest investors controlled the nomination committee.

He also said boards were getting older.

"One of the reasons it's happening is the pay is so good; the pay has doubled in seven years," he said. "It's a very low barrier entry market in theory, but in practice being invited in is quite difficult."

And he stressed, by and large, boards were working well in a complex system.

"It's not perfect. But by and large, boards do a pretty good job. The ones that don't that really lose their way become the poster child for everything that is wrong."

Despite concerns raised in the Blenheim study about younger, professional directors being ill-equipped for the job, the average age of non-executive directors is 63.8 years in ASX100 companies. The average tenure of non-executive directors is about six years.

But, on any number of measures, generational change is occurring. Women on boards are bringing a younger perspective, with 62 per cent of women aged 40 to 60, with 27 per cent of men in the same age bracket.

Ms Tansey says that it is crucial to have a mix of backgrounds, experience and age groups around a boardroom table. She argues it's a low-risk proposition recruiting a younger director because of the way boards operate.

"Boards are consensus decision makers; you could argue it's lower risk bringing someone younger into that environment. Even if that younger person may not have the same experience as someone with 30 years' CEO experience, they may provide a different lens. You don't want a monoculture board," she says.

DIRECTORS' LIABILITIES

Mr Brogden identifies at least two factors that are making directors focus too much on risk.

He says insolvency regulation needs to be overhauled, something he hopes may be part of the federal government's innovation package due to be released this week. And he also wants changes to directors' liabilities, which he says are too onerous.

"There needs to be reform of honest and reasonable director defence so that directors can make decisions today honestly and reasonably and based on advice, and not be punished if that business decision fails in five years' time," he says.

"By and large, the contribution of boards helps to grow a listed company."

Ms Tansey said people are more aware of the implications and the risk of directors' liabilities.

And as for the argument raised in the report about too much scrutiny from investors, proxy advisers and the media?

Ms Smith-Gander says if you can't hack it, it's time to rethink your career.

"I think transparency is your friend; if you're not able to stand the scrutiny at least to the level we're at at the moment, and discharge your responsibilities, then you are probably in the wrong trade. It may be uncomfortable but it is absolutely necessary and I personally do not think it has gone too far."