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CAPITAL

Company directors: if you can't stand the heat, get out of the kitchen

In recent years, the lobby group for directors of large companies has been increasingly whingeing about various avenues for company directors to be held accountable. It's a bizarre position; highly paid people who hold themselves out as experts, demanding protection from the consequences when they fail to act reasonably. They have seized upon the Covid-19 pandemic as an excuse to push for changes to class actions, insolvency protections and AGMs with a good deal of success. It's worth taking a look at each of these areas to understand why the lobbying of company directors should be ignored and why the rights of ordinary investors and creditors should take priority.

Class Actions

The debate over the merits of class actions has been well argued in the AFR with articles from both sides. The simple point that is so often lost is that directors of large companies have the power to virtually eliminate class actions simply by better disclosure of price sensitive information and ensuring their companies treat all stakeholders reasonably. The disclosure of material information shouldn't be difficult, experienced business people would have a basic understanding of what information is likely to move the share price of their companies. If they don't, they certainly have the budget to hire consultants to advise them.

Similarly, company directors are well positioned to ask executives for basic information and practices of the company to ensure that employees and customers are treated fairly. The example here of major banks that were (i) ripping off thousands of clients via fee for no service arrangements and (ii) had hopelessly flawed systems for monitoring suspect transactions is pertinent. The problems were widely known within the companies and were clearly of such substance the boards should have been overseeing investigations and rectifications. If the boards didn't hear about these issues before the regulatory and media attention, it raises the question of why there wasn't a whistleblowing channel that bypasses management to get this information to the board. Perhaps directors simply didn't want to hear bad news and thus become responsible for acting against it?

Insolvent trading

This issue has been simmering away for years but company directors have used Covid-19 to extract extraordinary changes to insolvency protections. Whilst previously company directors could have been financially liable when their business failed to pay creditors, now directors are basically able to get away with theft scot-free. It is particularly galling that company directors expect to continue to extract their director's fees whilst creditors are being robbed.

Despite being well paid, having substantial control over the direction of the company and having access to the information necessary to know about the financial performance of a company, company directors refuse to accept responsibility when there is financial mismanagement. They seem to consider it acceptable behaviour to steal from employees, trade creditors and other taxpayers. Instead of weakened insolvency protections, what is needed are directors with strong financial analysis skills or at least directors who will take advice from consultants with these skills. Directors worried about personal liability can always leave the board, take out insurance or get independent legal advice to protect their position.

AGMs and Shareholder Voting

Some of the arguments around AGMs makes it seem like directors want to be able to treat the owners of the business (who hire them) with disdain. An AGM is a once a year chance for smaller shareholders to ask questions and hold management and directors to account for their performance. All too often it is the only chance shareholders have to voice their concerns over poor financial performance, mismanagement or overpaying underperforming executives.

Directors like to ignore that a once a year public meeting is a small price to pay for having the access to cheap capital that public capital markets offer. They also won't acknowledge that they frequently bring criticism onto themselves by failing to consult with shareholders on major issues. Companies that perform well and that consult well have nothing to fear from the two strikes rule or shareholder questions asked in a public forum. Rather, company directors unwilling to face public scrutiny should stick to private companies.

Conclusion

What underlies each of these three areas is that some directors of large companies expect to be paid well for their work but aren't willing to be held accountable for their performance. They hold themselves out as experts but want to be protected from criticism and consequences when they make basic errors. If company directors aren't willing to take responsibility for their actions, they should vacate their board seats for more diligent replacements who are willing to take what is generally a very small amount of personal risk. If you can't stand the heat, get out of the kitchen.

Written by Jonathan Rochford for Narrow Road Capital on 15 August 2020. Comments and criticisms are welcomed and can be sent to info@narrowroadcapital.com

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