



Valuable Advice from Workshop 4

Corporate Governance as a Driver of Company Growth

Held on Wednesday 23 September 2015

Chaired by Michael Anderson, Corporate and Commercial Partner at Lowndes, the workshop was led by three speakers: Robert Sloan, Manger, Offer Information Financial Markets Authority; Simon Allan, Chairman NZ Refining Company/ Crown Fibre Holdings; and John Phipps, Chief Executive - Forte Funds Management.

Michael opened the workshop noting the increasing relevance of corporate governance in New Zealand entities due to the increasing number of shares being held by **professional investors and fund managers**. Michael noted the relationship between an independent board representation and an entity's performance and emphasised an entity's need to increase fiduciary responsibility and accountability to shareholders. In a dynamic environment, including recent Financial Markets Conduct Act legislation and the rise of shareholder activism, the significance of corporate governance has significantly **changed**.



Robert Sloan, Simon Allen, John Phipps and Chairman Mike Anderson (Partner, Lowndes)

Corporate Governance and Regulation

Robert discussed the Financial Markets Conduct Authority's role to ensure New Zealand businesses adopt core governance principles.

From a regulators perspective, if a market has a sound understanding of regulators objectives, there will be better results for customers, investors, shareholders and the New Zealand economy, by contributing to a transparent financial market. Despite significant changes in the social environment, business practice and legislative changes, the FMCA principles remain **a good** guideline.

The Financial Market Authority's role is to make sure entities conduct themselves to serve the interests of customers and investors in the market. The shift from the Securities Act 1978 to the Financial Markets Conduct Act, which took effect in 2014, has meant an increased emphasis by the FMA. Significant changes include an extensive licensing system, definitions of financial advisors and trustees, and a new disclosure regime with easy to use offer documents for investors.

Good corporate governance, determined by the board, should drive an entity towards a long term objective within the limits of regulation and will produce better results for the entity and shareholders. The board should ensure a culture of longevity is built and organised around that long term purpose by employing the right people, having the right accountability measures, and conducting the entity within the law.

Robert recommended several ways an entity can improve accountability to shareholders, including:

- A code of ethics;
- Clear processes in place to report and account for breaches of the code of ethics;
- The Chair of a board be independent to the Chief Executive;
- Financial reporting should be in terms and numbers that shareholders understand;
- Time, place and conduct of annual meetings are clear for shareholders to attend; and
- Ongoing quality information flow that presents up to date structures, goals and key governance documents.

Robert stressed using a structure where the board will report to shareholders at least annually, informing them of what the current risks are and what has been done to mitigate them. Good corporate governance practices are usually driven by potential risk. Identifying and mitigating risk early, frequent reporting to shareholders and having processes in place to hold senior management to account will ensure high performance of an entity.

Simon Allan

Simon's discussion of corporate governance focussed on the dramatic changes to our capital market and business environment in the last 10 years, including the significant rise of capital supply for growth, and the rise of institutional and retail shareholder activism. He identified that good corporate governance involves balancing the interests of many stakeholders in a company, including shareholders, management, customers, suppliers, financiers, government and the community.



Simon emphasised that shareholders need to ensure the board is developing strategies to deal with a wide range of novel issues and changes to New Zealand's economy, and to execute strategies properly. Despite annual meetings, shareholders are usually required to step in only when things go wrong. Actively reducing risk from the outset, continuously monitoring board decisions and holding the directors to account for accurate or inaccurate forecasting will mitigate long term loss.

Simon importantly recommended that a board have a diverse range of skills, age and ability and to bring in expertise where possible. Simon emphasises that the primary strategy for directors is to grow

shareholder value which is difficult in the current dynamic, fast-paced environment, where CEO's often only stay in their role for less than five years. In order for directors to be effective they must absorb and analyse more information than ever before. The level of requisite knowledge to forecast and effectively strategise in the current environment is higher.

Simon agreed with Robert that the FMCA structure demands more transparency of board behaviour which has developed a need for active shareholders. Board accountability has become an essential part of long term business strategy. The fall of the New Zealand finance companies, the re-write of the securities legislation and the global financial crisis have all contributed to an environment where good corporate governance is key to profitability.

Simon concluded with key points in relation to accountability:

- Board decisions should not be made without fierce debate, consensus and solidarity of strategy;
- Shareholder review of director performance;
- Enforcement of penalties;
- Getting authorities involved;
- Potential exposure and damaged reputation; and
- Maintaining the right company values, culture and staff that support good corporate governance.

John Phipps

John discussed the importance of improving board accountability, the limited liability structure, the need for shareholders to make sure members of the board have the appropriate skills to be on the board, and the difference between governance and management of an entity. John believes that the only constant in business is change and it is essential that directors are able to change and evolve with the dynamic business landscape.

The limited liability structure has been a successful concept which involves an interactive circle between shareholders and the board. Active shareholders must interact with a skills-based board who supply relevant and

quality data for it to be analysed by shareholders. It is important for a board to make a clear strategy, determine what skills the board needs to execute that strategy and allocate capital with a clear public explanation on how it will add value to the shareholder.

John recommended the following accountability measures:

- A board's financial data should be accurate, relevant to the business and comparable against previous years;
- Shareholders have an independent assessor of board performance;
- Shareholders having access to all directors;
- A board to clearly demonstrate where directors disagree if they cannot come to a consensus;
- Shareholders having access to all minutes; and
- CEO remuneration clearly explained and reviewed by shareholders.

John noted that defining governance and management for any company is not easy as it depends on the size, industry and market. It is important for the board to determine a strategy within a market, appoint a CEO who has or can acquire the skills necessary for effective management, monitor the company's progress and make sure data received is accurate and focussed. Boards should interact at different levels of the company for example visiting sites, following the flow of product from raw material to final product, follow the flow of money. It is not sufficient to use a tick box approach to govern a company.

John concluded by highlighting that although the chair of the board and the CEO are close, this will not always mean reliable information is given. John recommended boards being headed by a director with appropriate skills or a committee who collates data and presents to the board/management. He described it as mechanism for committees to gather and review information while the decision making is left for management. John also recommended:

- Boards should give shareholders the option of dividends in cash rather than promoting dividend reinvestment schemes; and
- Companies should make the hard decision about how to employ capital rather than simply returning capital to shareholders as a means of enhancing the share price of the company.

In conclusion, John emphasised that boards should be encouraged to take risks and ensure the board manages and mitigates that risk. It is important to give directors incentives for things they can control within an organisation, for example allowing directors to choose to purchase shares in the company they director, John believes sends a strong signal.



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