Attachment 4

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Self-examination of chaps is no standard

Let's legislate professional standards for directors, writes Peter Wilson.

AT THE end of a recent rowdy annual meeting of shareholders for an ASX-listed company, an elderly woman turned to me and said: "This board of directors is like a group of badly behaved teenage boys in their mid-60s."

She was understandably perplexed after witnessing a dismal attempt to defend a contentious remuneration report, and it brought home to me two critical characteristics that have bypassed the world of company directors: compulsory training in professional standards; and a licence to operate.

When visiting a lawyer, medical practitioner, architect or accountant, the expectation is that the person sitting opposite is thoroughly trained and has satisfied the full and continuing education requirements of an esteemed professional body. Failure to achieve the required standard will result in denial of entry to the field of professional practice, and failing to maintain the standard will result in disqualification.

Company directorships are one of the few noteworthy areas of professional practice for which no formal barrier to entry exists.

A significant informal barrier to entry exists, however, and it operates to exclude all but an intimate few. A scene from a Yes Minister television episode illustrates this. The minister asks a top British bank chairman how he was appointed. "In my walk of life, chaps look after chaps," was the reply.

While I am a strong believer in the value of personal networks and sharing experiences with colleagues, ordinary shareholders should not have to rely on that alone to safeguard their interests.

The annual reports of large listed companies reveal that about 10 per cent of directors are women. Among the major resources company boards, there are no indigenous Australians. Male Caucasians, often in their late 60s, rule the roost on top ASX boards and many are on multiple boards. Executive search firms will say they have all this in hand, but they play a part in only a minority of appointments and are inherently conflicted by the link between their source of future income and board appointments.

How different it might have been had objectively structured standards of ability, independence, governance and training been applied to the appointment of global banking directors over the past 10 years.

In the immediate and medium future, much attention is likely to be directed at the issues of executive pay and accounting disclosure standards, but any efforts in those areas risk missing the main game - how to train, select and appoint the captain and officers of the corporate vessels to whom are entrusted the welfare of workers, shareholders and the general community.

At present, directors largely recommend board appointments from their own self-selected number, supplemented by recently retired CEOs, CFOs and ex-auditors. From my experience in dealing with institutional shareholders, their capacity to provide checks and balances is limited by their reluctance, often as a matter of policy, to intervene in board appointments. That practice underpins a default bias for director incumbency that can drag on for many years.

A century ago, an English judge hearing a company law matter was reputed to have observed that the board of directors in the case was akin to a class of mediocre students who had marked their own exam papers. A hundred years later that observation still rings true.

Being a company director carries high levels of financial accountability, ethical responsibilities and fiduciary duties covering investors, employees, customers and the wider community. It should not be a club operating in accordance with an informal and discriminatory entry system where "chaps loo k after chaps".

When the financial crisis is behind us, the community will once again look to company boards to accelerate the economic recovery into continuing prosperity.

The time has come for directors to be subject to compulsory education and regular independent assessment of their competence to serve.

In the case of directors of large listed companies, the standards required and licence to practice as directors should be comparable with other professions. At present any professional development undertaken through bodies such as the Australian Institute of Company Directors is discretionary.

Compulsory education would include coverage of relevant legislation, judicial decisions and case studies to demonstrate the complexity at times of having to act in shareholders' interests. Assessment by an independent panel of examiners would be followed by the posting of results and rankings on the websites of t he Australian Securities and Investments Commission and the Australian Stock Exchange, thus ensuring transparency.

A licence to practise should be re-tested every few years and strict time limits put on holding an independent directorship with any one large company. Family-owned and small businesses where directors and shareholders are the same people would be excluded.

Ultimately, any reforms should become part of the Corporations Act, including giving ASIC the power to issue a licence for a person to operate as an independent company director and the power to revoke it when necessary.

The reforms would not change the existing responsibility of boards to recommend director appointments to shareholders, whose vote would determine the outcome. However, the recommendations would be based on transparently qualified candidates meeting the standards prescribed by law.

The outcome would be to boost the quality of board members and community confidence in them.

A reform blueprint of this order will be likely to cause dissent among many present directors who have relied on their networks alone to secure appointments. However, many directors would welcome such a reform as a way of lifting standards and purging the ranks of free riders who can imperil business decisions that have far-reaching effects on employees, customers and ordinary shareholders.

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