



Over-Engineered & Gold-Plated

How corporate compliance is killing enterprise

Corporate governance is at a pivotal junction, argues visiting professor and author Bob Garratt. Poised between the demands of conformance and performance, directors are headed for turbulent times. So what should we expect?

In the straight-talking, no-nonsense world of professor Bob Garratt, corporate governance may be “dead fashionable” nowadays, but it is fundamentally flawed. Thoughtless and slavish adherence to legislative constraints imposed since big-name boardroom bandits at Enron, WorldCom and Parmalat were made to ride out of town, has created an era of corporate conformance. Tick the boxes. Run through the drill. Comply with the codes.

In New Zealand for a whistle-stop tour and presentations at AUT University and the Institute of Directors, the London-based author of corporate blockbusters such as *The Fish Rots from the Head*, *Thin on Top* and *The Twelve Organisational Capabilities* says it's time to challenge the “increasing nonsense” of the Sarbanes-Oxley Act and revert to true professionalism in corporate governance.

The Act, he says, is “mad, bad and dangerous to know”. Even Michael Oxley, couped up at the International Corporate Governance Network conference in London during the July 7 bombings this year

“admitted that it had gone too far and that slavish adherence to SOX compliance was having negative effects on US business”, says Garratt.

“Now in extreme circumstances if a US CEO and CIO mis-sign their quarterly accounts they can be fined personally a maximum of US\$5 million and get 20 years in jail.”

The Enron case, is particularly worrying on a number of dimensions, he says, as a combination of directoral, auditor, consultant, legal, media, investment banker and analyst overview failures led to “right-minded but hasty and ill-considered legislation”.

Politicians have one obvious tool – legislation – “and are seen to be rewarded by the electorate for using it”.

In Garratt's mind, corporate governance is now set for a very turbulent time. Key considerations will be how the United States will pull back from Sarbanes-Oxley and how it will handle the separation of chair and CEO roles.

The problems are international in scope. “To be absolutely crass, most of the corpo-

rate governance problems in the United States centre around fraud. In the UK they centre around strategic incompetence.”

Continue along our current trajectory, predicts Garratt, and in two years' time corporate governance will be effectively dead – so compliant that it will have frozen everything in its tracks. Compliance has become an industry in itself, peopled by “instant experts” touting corporate governance fixes “without being aware that they are offering only one aspect of it – compliance”.

Garratt's beef is that compliance is necessary but not sufficient. “Sufficiency comes from a board balancing the continuous directoral dilemma of board compliance (prudent control) with board performance (driving the enterprise forward).

“It's a particular irony that the very people who helped get us into this mess – lawyers, external consultants, investment bankers and fund managers – are the very ones now being asked to get us out of it. They're making huge consultancy fees by creating a compliance system which I



Bob Garratt: Compliance is necessary, but not sufficient.

believe is over-engineered, gold-plated and is killing enterprise again.”

In the United Kingdom the winds of change are already blowing through the halls of corporate insurers who are increasingly pushing to see chartered directors at the helm of organisations. They are already offering better rates in these circumstances as they “feel a lot more sure about their insurees”.

This is part of a wider move – evident to a lesser degree in the United States as well – that is both putting pressure on the competence of managers and leading directors to look at ways in which they can reassure credit ratings organisations and even shareholders of their competence.

Garratt sees evidence of a widening of the connections of corporate governance. “It’s not just about the board, managers and investors. The whole system is being taken a lot more seriously now and looked at more widely.” He cites a growing examination of pension funds trustees as the developed world manifests increasing public concern over where pension and investment monies

have gone and what wealth may, or may not, remain for the future.

“As the boundaries of corporate governance become more understood, directing will become increasingly differentiated from managing. But it is not just directors about whom we should concern ourselves. If we take a socio-technical systems approach to the subject, then the induction, re-education and competence building of shareholders,

investor relations, investment bankers, venture capitalists, pension fund trustees and fund managers becomes a corporate governance necessity.

“These messages,” he says, “take a little time to work through the system but they are beginning to resound now.”

For listed companies, issues surrounding ownership are also emerging. Last year a critique of listed companies in the United Kingdom by LENS chairman and veteran corporate governance activist Bob Monks put the rate of churn of shareholder ownership as high as 90 percent. A similar study in the United States revealed churn rates closer to 60 percent.

Garratt readily admits these include some “extreme cases”. But he makes the point that as shares are traded over the course of just one day, pinpointing ownership is difficult and often meaningless. “Who then is an owner? Most importantly, who will protect the owners’ rights? Who is going to vote? None of those high-churn owners will be at all interested in voting. So there’s a whole is-

sue that really challenges the fundamental notion of governance.”

Expect too to see annual reporting transformed in the United Kingdom over the next few years as the idea of the triple bottom line continues to gain pace.

In the United Kingdom and the United States politicians are pushing to bring more company law into the criminal realm. It’s a “worrying” trend, says Garratt, as one of the differentiators between directors and managers is already the large amount of civil and criminal law which binds directoral decisions. “If this political punishment by criminalisation process continues, who will wish to be a director?”

Meanwhile in the United States, a little-known and “rather odd” legacy from the 1930s continues to trouble corporate governance reformists. It’s one of those elephants in the boardroom, says Garratt, that nobody mentions but everybody knows.

“At US quoted companies – and especially those registered in the state of Delaware, which most are – you cannot sack a director once they are appointed. While a shareholder can vote *for* a director and can abstain, they cannot vote *against*. You cannot sack a director once they are appointed unless members of the board manage to force them out, so how do you get rid of an under-performing director?” It is, says Garratt “a very big issue” not least because almost 60 percent of the Fortune 500 companies are registered in Delaware. Ironically, perhaps, the only solution will be state legislation.

Roll these undercurrents together, says Garratt, and in two years’ time corporate governance could form a very different picture to the troubled view of today. He’s hoping that by then strong board performance will rise to the fore as compliance drops back. **M**

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