

# thebigpicture

guideposts for the private investor

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*thebigpicture* guideposts for the private investor is published by *thebigpicture* Economics (ABN 71 040 787 936). The author, John A Robertson, while working in Australia, London and New York, has over 20 years experience in international financial and commodity markets, corporate strategy, financial and business evaluation and government policy. He has been Chief Economist and a director of a leading Australian investment bank. He has been a top-rated institutional equity analyst and has marketed investment advice in all the major international financial centres.

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**thebigpicture Economics**  
ABN 71 040 787 936  
PO Box 333, Malvern  
Vic 3144

## UNDER SIEGE: A NEW WORLD FOR DIRECTORS

Apparently directors of listed companies are no longer enjoying the experience as much as they once did. They need to alter the way in which they present themselves to shareholders if investors are to make their lives easier.

The Australian Financial Review, in the past week, has reported that qualified executives are becoming reluctant to accept appointments as directors because of the public pressures to which they are being subjected. They are being increasingly held responsible for the failings of many companies and, according to the AFR, resent the abuse to which they are being subjected at AGMs by some shareholder activists.

To be sure, some of the activists can be obnoxious in the way they behave but directors themselves have to shoulder some of the responsibility for the way in which they are being treated.

The biggest change is the reaction from private investors. Directors have usually had relatively little contact with those accounting for most of a company's shares, namely, institutional fund managers. Relationships with them are normally handled by the executive managers and, depending on the company, sometimes by the non-executive chairman.

Private shareholders are not accorded the same access as professional fund managers and must rely on public meetings for their principal contact. These meetings are replete with symbolism which defines the relationship.

- Directors are arrayed as if acting as a barrier between shareholders and management.
- Other than the chairman, directors play no public role with chairmen routinely denying shareholders the right to question any other director.
- The chairman also pretends to know everything there is to know about the company and exercises a complete discretion on the extent to which any executive might participate.

But these layers of symbolism mislead shareholders about the reality. Directors generally have only the broadest oversight of company activities providing advice and ensuring that there is due process undertaken when management is seeking to have decisions ratified. They have some important statutory responsibilities with respect to the financial performance of the company but these come into play at the margin when the company's demise is within view.

There is no statutory obligation on directors to provide an adequate rate of return. Nor are there minimal standards of management competence required. There could continue to be pressure from shareholders, therefore, even when directors are meeting their statutory obligations.

Under these circumstances, directors need to initiate a change in their relationships with their shareholders. They need to position themselves in the more neutral ground between shareholders and management and define more clearly their roles as caretakers on behalf of shareholders. This could be achieved with relative ease.

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*"...directors must take up the cause for which they are uniquely positioned: reporting to shareholders on performance in a rigorous fashion against benchmarks which do not change with circumstances."*

## THE WEEKLY CHART SPOT



Source: Reserve Bank of Australia and Australian Bureau of Statistics

*“Current debt levels are around 90 times higher than [the] level of savings. It would, therefore, take several generations to repay the accumulated household debt without recourse (predominantly) to the value of the family home....”*

Loans outstanding to individuals amounted to \$448.5 billion at the end of November, an increase of 13.3 per cent over the corresponding time a year earlier, according to statistics published by the Reserve Bank of Australia.

Lending growth has averaged 13.7 per cent a year since the mid 1970s so that recent growth rates are not out of the ordinary. The debt accumulation has been going on for so long that it is acquiring worrying proportions.

The increase in debt levels has outstripped the average 8.1 percent rate of household income growth since the mid-1970s. Personal debt levels are around 90 per cent of an annual household income, having risen from around 40 percent at the end of the 1980s.

Of course, interest rates are also lower and the debt servicing requirement today would still be nearly twice the interest payable on the outstanding debt during highly unusual times at the end of the 1980s.

As well as being supported by lower interest rates, the recent explosion in debt has been fostered by rising house prices, higher equity market values (until the last two years), more confidence about the Australian economic condition and some easier lending terms by financial institutions.

Individuals are more than ever reliant on their accumulated wealth to repay their loans. Savings from income can scarcely make a contribution any longer. The September quarter national accounts showed that households are saving only about one per cent of their disposable income. Current debt levels are around 80 times higher than this level of savings. It would, therefore, take several generations to repay the accumulated household debt without recourse (predominantly) to the value of the family home and, to a lesser degree, investments held directly or through superannuation.

### Directors Under Siege cont'd

*(Continued from page 1)*

Directors should report to shareholders more clearly on corporate objectives. Each year at the AGM, a chairman should outline the key objectives for the business in the year ahead and clearly enunciate quantitative targets. In the following year, he should report on any deviations from these targeted outcomes, identify clearly why they occurred, outline remedies and set new targets for the coming year.

Few companies, if any, actually do this

with any rigour. And yet it would go some way to bunting the criticism from shareholders that directors are prone to walk away from their responsibilities.

There is no new shortage of guidance for directors. Unfortunately, the plethora of corporate governance guidance from such groups as the ASX, ASIC, IFSA, Standards Australia and the government via CLERP 9 has focused too much on accounting standards, the role of auditors and other legal

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forms.

And yet, the definition of profit in the accounting standards is now so muddled that it is almost wholly bereft of meaning for an investor and auditors play no role in ensuring that the management is adding genuine value to the funds entrusted to them by shareholders. At best, they can ensure that they are not stolen.

The only way the rights of shareholders can be protected, ultimately, is if value is being added to the funds which the company employs. Looked at another way, management must be competent. And nowhere in the corporate governance discussion has competence been given the prominence it deserves.

This part of the debate has been conducted in a far too gentlemanly fashion. There should be more acknowledgement that many directors have emerged from an era in which the view of shareholder value was, at best, blurred and in which the private investor's interest in corporate performance was highly unusual.

Very typically, also, the performance of these former leaders would not have been subjected to the scrutiny it would be today. If it had been, their reputations might now be considerably diminished.

## THE RISING AUSTRALIAN DOLLAR CONT'D

*(Continued from page 4)*

ance of trade deficit which requires additional funding. Professional investors are also somewhat sceptical about the Government's fiscal rectitude. It is still flirting with budget deficits despite years of relatively strong economic conditions.

Moreover, not everyone is happy to see a higher dollar. Despite currency weakness once having been seen as a sign of national failure, the commentaries in the press about the impact of the higher dollar on farmers, manufacturers, tourists, etc. came swiftly, including a warning from the Opposition economics spokesperson.

A rising dollar does reduce some forms of income immediately if nothing else changes. But other things do change and, for investors, the benefits of a stronger dollar should not be forgotten.

- A stronger dollar creates confidence for overseas investors. Australia's equity market values are influenced significantly by the participation (or absence) of overseas fund managers. They will

We know that some of the captains of Australian industry who are now company directors have left behind some egregious examples of sub-standard executive performance. Several prominent company chairmen bequeathed strategically challenged businesses which were poisoned chalices for their successors.

In other words, there are considerable cultural and attitudinal issues at play. It is not simply a matter of legislation being inadequate. If directors grapple successfully with this new environment, they can have the contented and more tranquil lives they seek in the transitions to retirement.

For that to occur, however, directors must take up the cause for which they are uniquely positioned: reporting to shareholders on performance in a rigorous fashion against benchmarks which do not change with circumstances.

In this way, they will begin to be viewed as working on behalf of the shareholders and not as a barrier to shareholders seeking satisfaction about corporate performance.

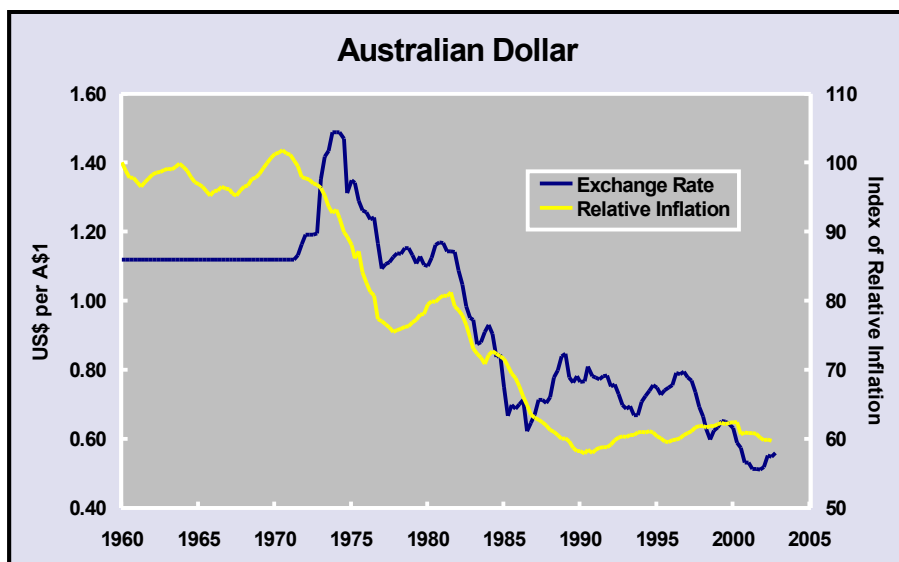
If they adopted this more transparent approach, they would also be within their rights to suggest a physical relocation to the more obnoxious of the activists attending public meetings.

be more reluctant to place funds in an Australian market whose returns are being eroded by a depreciating currency. A firmer currency implies equity market upside.

- A stronger dollar improves corporate purchasing power. The growth prospects of Australian companies are retarded by having to purchase foreign assets with a weakening currency.
- A stronger dollar makes it less likely that Australian assets will be purchased by foreign companies. Purchases of Australian businesses by foreigners might provide a brief fillip to particular share prices but, over time, as they erode the number of Australian investment opportunities, reduce interest in the Australian market, make listed companies a smaller part of the overall economy and force investors to rely more heavily on higher risk, earlier stage companies than would otherwise be necessary.

*“Small currency markets can get swamped by the large volumes of international funds pursuing the latest return idea. So, anything up to 70 US cents could be possible once the momentum is established.”*

## THE RISING AUSTRALIAN DOLLAR



The Australian dollar has been rising. In the short term, interest rates and a global readjustment by the US dollar are having an influence. But the change is also an evolution of economic events which began 25 years ago.

The chart helps to illustrate three phases in the longer term evolution of the Australian dollar. The phases largely coincide with movements in Australia's relative inflation performance which is shown as the yellow line.

- **Phase one** was the era of fixed exchange rates prior to 1972 and a period of relative stability in Australia's economic performance. Its raw material endowments were generally seen as attractive in a world growing rapidly and facing depleting resources.
- **Phase two**, which lasted until the late 1980s, was a period when the Australian economy was regarded as increasingly dysfunctional and failing to meet its potential. Its inflation rate was relatively high, its manufacturing base relatively limited and the need for it to improve its international competitiveness not a concept generally embraced lest it require structural adjustments. This was a period of prolonged currency weakness.
- **Phase three** was ushered in by a better relative inflation performance, a

broadening of the economic base, much less reliance on commodity sectors of the economy and the general acceptance of the benefits of the economic restructuring which had improved its global competitiveness.

Nonetheless, history was difficult to cast aside and, in international markets, the Australian economy retained a reputation for being more commodity oriented and less competitive than it actually was. Unlike other economies embracing new work practices and attracting new industries, Australia was perceived as a laggard and its currency treated accordingly when risks became evident.

The much improved inflation performance, however, has been an influential variable in changing expectations. Making a guess at how much is always risky for a forecaster since currency markets do tend to overshoot. Small currency markets can get swamped by the large volumes of international funds pursuing the latest return idea. So, anything up to 70 US cents could be possible once the momentum is established.

Of course, not all the risks have been eliminated. Most importantly, Australia's balance of payments still requires it to import capital and, with relatively weak international economic conditions, demand for exports is also creating a bal-

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