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More regulation won't lift directors' game

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COMMENT

For our convict forebears, there may have been some justification for arguing they had no choice in breaking the law because the law itself was flawed. But we can only hope the report Kenneth Hayne is due to present to the government next week will roundly reject the argument put to the financial services royal commission in its final week of hearings that the law of directors' duties is to blame for the misdeeds of Australian bankers.

The royal commission has shown that many of our large financial institutions engaged in systematic poor behaviour. It has shone a spotlight on a sector-wide culture that incentivises staff to the detriment of the customer. It has also exposed the problems that arise when boards fail to set a company's moral direction.

But the solution is not to change the law. With the support of more than a century of law, commentary and judicial analysis, the prevailing view is that the Corporations Act obligation on directors to act in the best interests of the company is operating as it should. Claiming otherwise is using the law as a scapegoat for financial sector-specific failures.

The Corporations Act unequivocally sets out the statutory duties directors owe to a company. Shareholders put their hands in their pockets to buy shares and appoint directors as their agents to run the company in shareholders' best interests. This is the long-established principle of shareholder primacy.

It is true that a director's primary focus in determining the strategy, priorities and direction of a company is to reap the greatest reward for its shareholders. But directors also take into account many other considerations such as industry regulation and the ASX Corporate Governance Principles, together with corporate, community and personal values, morals and ethical standards.

The duty to act in the best interests of the company already provides directors with the flexibility to consider and balance other stakeholder interests. The question of whether the law needs to be expanded to make this explicit has been examined by all manner of stakeholders over the years, and rejected each time.

A nationwide consultation undertaken by the Governance Institute of Australia in 2014 asked: "Should an explicit clause be introduced to expand directors' duties so that they must take account of the interests of stakeholders other than shareholders?"

Across the business world, academia, legal experts and shareholder groups, the response was unequivocally in the negative. The prevailing view was that directors already take into account the interests of other stakeholders. They do so as responsible people with a broad perspective on the success of the company.

Diverse stakeholders supported the legal status quo on the basis that compelling directors to take account of broader stakeholder interests would be a step too far, and inevitably result in claims from any and every group that had a gripe with the company.

The reality is that if lawmakers rewrote directors' duties to expand them to other stakeholders, directors would be lumbered with a set of unworkable conflicts that would benefit neither shareholders nor anyone else.

Who are these "broader stakeholders" in any case? If it is the company's customers, does it include foreign customers? If it is the broader community, is it primarily the local communities in which the company operates and where staff and their families reside? Is the ATO a stakeholder?

The answer will be different from company to company, industry to industry, year to year. And that's before we consider the even tougher question of how to weigh those interests and whose interests take priority when there is an inevitable conflict.

The more opportunity for conflict, the harder it is for boards to function as they should and the more we encourage box-ticking directors — rather than strategic thinkers who are prepared to take the kind of calculated risks that are synonymous with innovation, growth and success.

Boards need to lead, but that doesn't just mean driving profit. Acting in a company's best interests is clearly already understood to also involve setting the tone for a company's moral direction and purpose by creating a corporate culture of integrity, professionalism and trust. Ultimately, it is up to shareholders to ensure the directors run the company in a way that doesn't fixate on short-term rewards that undermine long-term sustainable growth and value.

Which begs the question: how many shareholders of our large financial institutions would view the practices dissected at the royal commission as having been in their interests?

When Mr Hayne's final report is released in the coming weeks, the lessons for corporate Australia will be many, including the risks of short-termism, the importance of directors setting the moral, as well as financial, direction for companies, and the danger of having a culture of complacency and unfettered risk-taking.

These lessons have nothing to do with the law of directors' duties. Changing the law won't solve the problems uncovered at the royal commission but it would almost surely create a whole lot of others.

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