

## Rob Campbell: Speech to Elevation Capital Function at The Holy Trinity Cloisters, Parnell, Auckland, New Zealand.

Thank you for the invitation to speak this evening. Chris Swasbrook and his colleagues at Elevation are an interesting option for investors, giving investors the benefits of efficient access to some of the best global value funds in the one instance and in the second to Chris' unique view of local and global equities. Elevation provides investors with not only these interesting options but also valuable commentary and other investment material. In my view they may be considered a thinking person's investment.

Tonight is an opportunity for me to perhaps lead your thinking a little further than your immediate investment options. I recall an old saying that when one is up to one's arse in alligators it is easy to forget that one came here to drain the swamp. We have no shortage of toothy and snapping such beasts when we click onto our screens on waking these days. Easy to not only forget one's purpose as an investor but to despair of the project as a whole.

Many years ago in the immediate aftermath of the 1987 stock market fall I shared a lift ride with a chap who ran a fund from the same floor as my office. In response to my casual inquiry as to how it was going he groaned "bad to haemorrhaging" and crawled into his office. He was not quite gone by lunchtime but he was certainly not still there for evening drinks and nor was the corporate jet. I recall this not to gloat, but rather the note in passing that we have been this way before and we shall pass this way again.

I imagine that most people in my position addressing the matter of the issues facing corporate New Zealand would begin with the familiar litany of lingering GFC, failing Euro, property prices and debt levels. This is the equivalent of what I think of as the "Chairman's plea in mitigation" which characterises most annual reports following poor corporate outcomes. I suggest to you that such commentary is often an early warning sign to sell a stock.

Having noted that, I had better diverge from that course for fear of provoking sales in stocks with which I have an association. In any case I have no taste for the view. If the world is indeed going to hell in a handbasket the right reaction for an investor is not to moan but to go long handbaskets, flame retardant clothing and the like and to short the heavenly realms. I assure you that the values will right themselves in due course and tip the other way.

As the New Orleans singer Doctor John called it "I hate to do this to my old friend Bill but if I don't do it, somebody else will". In the binary trades which the investment markets offer there is always someone on the other side of your bet or as Bruce Springsteen expresses it "down here its just winners and losers winners and don't get caught on the wrong side of that line".

Its not always possible, transaction costs in their wider sense being as they are, to switch one's position as easily as this implies, but the thought does suggest that retaining the flexibility to shift position to a substantial extent is sensible risk control. I can think of no investment option which has been the best in every market at every time.

But my main point here is not that markets shift and that an ability to shift with, or ideally ahead, of the markets is good for investment returns. We all know that, if often only in retrospect.

Rather my point is that market conditions will be what they will be. The Europeans and Chinese and Wall Street will do what they will. In very few instances, no matter what some conspiracy theorist in the bowels of the Green Party, Commerce Commission or Treasury may think, will the New Zealand business in which you engage have any influence whatsoever on the outcome of their actions or even their first round impact on the market in which you trade. New Zealand businesses in the main are operating at best in the land of the second or third derivative.

So not a great deal of point really, in regarding those matters as your important challenges. Global economic change is at best a spectator sport and you can read the results in the paper tomorrow. The truism that if the young chap so earnestly describing with certainty the outcomes of a G8 meeting on local markets really knew what was going to happen he would not be telling you and thousands of others on TV for the salary the Bank of Higher Fees pays him, but would be off trading that view and getting

rich, is a truism because it is true. It's a better than even bet that even the Bank of Higher Fees is not following his advice. Quite possibly they are trading against the position they hope he has persuaded you to take. Seriously, and even though, as they say, some of my best friends are bankers.

Anyway, I digress yet again. The point is that the important challenges are those which you can do something about. So let's focus on those.

With the media and regulatory focus of today one could be forgiven for thinking that the most important question for a director was "how do I stay out of gaol?". It is true that board agendas these days have a much greater emphasis on compliance issues. Hard to have an issue with that, it's an important duty of a director to ensure legal compliance. The danger is that the depth and spread of director's duties in this respect generate a "box ticking" level of compliance.

The danger in turn of this type of compliance is that it does not ensure avoidance of danger or risk but rather avoidance of the risks associated with actions which the regulators have anticipated. I think even the regulators will seldom claim omniscience. So we know that the lists exclude some, possibly a lot, of matters which could turn out to be important to shareholders, staff, customers or the community as a whole.

For the director the point is not that ticking off compliance is not important but rather that it is necessary but not sufficient. Ticking off compliance is not the same thing as leading compliance and structuring a corporate culture which sees compliance as more than a chore. Even more important is that directors have the capacity and willingness to look forward and anticipate risks which the regulators who are necessarily driving by the rear view mirror will not see.

I think that something of the same applies to other governance principles, much beloved as they are of the financial commentariat such as it is in this country. One does not often hear the governance procedures of companies which are doing well criticised, though they often diverge from the preferred norms of such observers. An investor once advised me, in regard to the tough art of thoroughbred investing, not to worry about the name because no successful horse ever had a bad name.

My view is that there is no one form of governance which is superior in and of itself. A great deal depends on the nature of the business and the people involved. I prefer that a principles based approach is adopted here, as opposed to a rules or best practice approach. The principles which should be applied are:

- the board must be appropriately skilled for the tasks it has;
- the board must control and monitor the performance and risks of the business effectively;
- the board must report to shareholders and other interested parties in a relevant, accurate and timely manner;
- the board must set a clear strategy and objectives for the business;
- the board must ensure compliance with all applicable regulations etc;

No naming names but I reckon you do not have to work too hard to find companies which have the committees and procedures to satisfy the most fastidious regulator but which might fall very short on this list, especially appropriate skills, effective control and clear strategy.

This is why so many businesses blunder into situations in which they spend a lot of time asking "what just happened to us?" rather than working on where they should be heading next. It is in the area of this forward view that I consider our main commercial weaknesses lie. We seem to generate our share of ideas (to judge from the new ventures which spring up in various fields) and at least our share of excellent professional and technical skills (to judge from the ranks of such people in global businesses and other organisations). But we struggle to export the first, and equally struggle to retain the second.

If I knew why this was I guess I would not be musing aloud on it now but leading a business to global success myself (or sunning myself on a beach having reached that point and cashed up). I have had enough experience in businesses small and large here and overseas to know that there are no easy formulae, if one excludes luck (which is helpful but only that) or karma (which may also be helpful at the personal level but should hardly be wasted on such mundane pursuits).

With that reservation it seems to me that there is a mix of factors which are seen as involved in limited business expansion from a New Zealand base. Let's look at some of the often noted difficulties:

- Regulations. We all find regulations which restrict our ability to do things which we want to do frustrating. In my view business here often bemoans regulatory structures which would be welcomed in many other, and successful, economies. The bigger problem than the regulations as such is the degree to and frequency with which they change. Its probably too much for us to expect either an unconstrained playing field or the legendary level playing field but it would be nice to at least have a field whose location, surface, markings and pitch were not subject to constant change. Its hard enough to make an investment with a 10 year horizon without constant fear of the rules changing. So here, right up front , is something the Government CAN do, i.e. nothing, or at least much less;

- Distance from trading markets. Harden up. We are, in fact, rather close to many strong and growing markets. Being a long way from Europe is not the issue it once was. There are very few genuine barriers imposed by physical distance that competitors do not face.

- Small local capital market. Certainly an observable fact this and there have been some useful suggestions made, e.g. by the Capital Markets Task Force, for improvement to the market structure. But frankly we have had a relatively strong banking sector and equity capital (while it may have its faults in some eyes) undeniably has the ability to search out opportunity and is not easily deterred where it finds such opportunity. It can be a bit shy when opportunity is seeking it, but that comes from long experience of failed relationships where opportunity turned out to be flattering only to deceive.

- Lack of state support. You can probably guess where I am on this one. I have no doubt in my mind that there is much wasted state activity, but in terms of opening trade opportunities against protection in other economies at least successive governments have done a good job. I think that subject to getting the capital and regulatory structures right the proposed mixed ownership model can at the margin improve overall economic efficiency and strengthen capital markets. (Not that you would know that from the asinine “sell and invest” justification being offered for the sales) but I have seen no evidence in my long association with state enterprises and departments as such that they should do anything other than less to help business. Its not hard to think of stand out examples in transport infrastructure where getting local government out of business operations would be a distinct advantage.

- Taxation levels. Most, at least those of us who pay tax, would like their tax burden to be lower. But levels of taxation as such do not pose a comparative problem for our businesses or for those who manage and govern them. The tax processes have various costs which range from the inconvenient to the burdensome and no doubt could be usefully streamlined but in terms of tax burden New Zealand business is not too badly off. We have relatively little, also, of the special pleading and gaming which characterises many other economies in this matter as various interests jockey for preferred position. (I exempt the film industry from this roll of honour).

Gosh, we seem to be running out of things to blame here. In fact there is a range of matters, which should rightly occupy thinking time for those of us who manage and govern businesses:

- Skill levels. We do have a skills issue. Too many people without the technical skills that their job requires, who hold the job for time served rather than contributed value, who fill some arbitrary quota or another, and that’s just at board level. I think that in New Zealand there is not much marriage of intellectual and commercial knowledge and that this is something we could well work on. Lots of directors I know do not even read widely. Yet that is essential to input the guidance managers need. This is compounded by low fee levels for directors and, remarkably, the practice of not paying directors for performance. This is not to argue against measures to improve the skills and capabilities of people across the board but to recognise that underdevelopment of skills at the board table (real commercial skills) will inevitably lead to a lack of effective demand for appropriate labour skills i.e. it starts at the board table and is not something that can be built from the bottom up.

- Economics. This may seem too obvious but it is essential that directors have a good knowledge of the economics of the firm and market with which they are engaged. A very large number do not. Hence they are unable to observe that the economics of their business do not add up until they have, indeed, not added up or at least not to a positive number. Warren Buffet famously noted to the effect that when a management team with a reputation for brilliance meets an industry with a reputation for bad economics, it is the reputation of the industry which survives. To succeed as a private enterprise economy we need more directors who are alert to opportunity, decisive in strategy and implementation and quick to recognise when the economics of their business is changing. Such people will look for the way forward not the crutch for support.

- Debate. The quality of debate around board tables is highly variable. Gone are the days when a good board was characterised by short agendas and long lunches, but even so the quality of commercial debate both in and outside of the boardroom is limited in our market. This is not assisted by the desultory nature of much media coverage on business with its emphasis on personality and limited economic understanding of issues and history. We seem to prefer the mediocrity of consensus and false unanimity to robust exploration of alternatives. Do not do or say this because the “club” will not like it, is the opposite of the embracing of difference and even conflict which lies at the heart of what makes capitalism work. We have our own mini-versions of the “crony capitalism” which has had such disturbing outcomes on a global level. Efficient allocation of capital is not something which best develops behind closed doors let alone closed minds.

I return to my point on the economics of business. The potential outcomes of most business activity are bounded by market forces and regulations. Not much of a safety net at the bottom unless you happen to be a “too big to fail” bank. That is as it should be. But the upper and lateral bounds of business success are strongly constrained. We have and need lots of businesses, which go about their activities in many cases in the hope of greater riches, but informed nevertheless by a realistic appreciation of the modest outcome, which their fundamental economics prescribes. It is good for all of us that these businesses are run properly and to their potential.

Many businesses will fail because their economics dictate that outcome, either always did or with market change came to that position. We need those failures of economics because they fuel innovation and growth in our system. Our need for governance driven failure is less obvious, and ideally we would have few of these, though even here such failure fuels the market for corporate control which seeks out the best outcomes going forward. It is important that we have no fear of this process.

It may be that such fear is one of the things holding New Zealand business back. I think that it is, to take just one example close to Chris’ heart. We have tried to defy the obvious economics in the kiwifruit industry for fear of failure for so long and in such a way that we have created new and fruitful grounds for failure. No amount of governance or management principle will make a wrong structure right, and only a relaxation from fear to embrace multiple kiwifruit varieties and paths to market can revive that industry.

It may not have escaped your notice that in a couple of recent cases I have ended up leaving a board (once voluntarily and once with less choice). Both were boards with political ownership and I feel I have learned my lesson in that respect. It is not my concern to exercise either self justification or controversialism for their own sake but both situations stem from a view that I am not interested in attending board meetings simply for the sausage rolls at morning tea.

Directors are there to do a job with energy and integrity and often the easy route is to fall into “group think” or to sway to what may be fashionable. With political shareholders such fashion changes too arbitrarily and frequently for my view of life, it may be better to direct one’s efforts to being a humble footsoldier in the army of capital, not least because as a friend pointed out recently “the only thing capital throws under a bus is money”.

However we have many assets under social ownership – if our community wants to retain this and to prosper the community must expect the capital invested in those assets to be employed efficiently. This will not happen if politics trumps economics. It is to be hoped that talented directors will not be put off such tasks because of such difficulties. They will need a tougher hide and better manners than I would seem to have.

It may be that some of you have wondered why I have not made any reference to ethics in this discussion. This is partly because I do not consider myself an ethicist but more because what I do have to say may be, unlike my musings to this point, a bit controversial. It is true, as Crosby, Stills and Young put it that “you, who are on the road, must have a code that you can live by”. Company directors do not have such a code, I guess partly because directorship does not in itself amount to a profession which might have such an oath. Some directors might even find themselves caught between a Hippocratic style oath and a hypocritical oath in any event.

This has made the encroachment of “stakeholder” language into business very easy. This concept is now found throughout corporate language though interestingly it has no specific base in company law. Of course, company directors are required to have regard for legal requirements and to the impact which their company’s actions may have which may cause distress to others (and not just because others may sue). But in all of this rush to express corporate board social responsibility and make senior management and boards feel good about themselves I rather fear that the shareholders are sometimes relegated too far. The

“poor old residual claimant”, who has placed capital at risk in the endeavour cannot be treated as a leper at every turn if the system is to prosper.

Mao Tse Tung expressed the view, though he did perhaps not always live by it, that “the people are the real heroes while we ourselves are often foolish and ignorant”. Not a bad mantra for a politician in my view, but an adaptation to “the shareholders are the real heroes, while we ourselves are often foolish and ignorant” would not do badly for directors. It nicely combines appropriate responsibility and the oft neglected virtue of humility (not a common commodity in boardrooms).

After humility I place honesty and openness as virtues . (I distinguish virtues from skills). The regulatory systems are imposing greater disclosure requirements on directors. I think that this is to the good as an informed market is good for efficient capital allocation. I am not sure that all directors share this view. In general and unless a genuine commercial interest is adversely affected I think that the question we should ask about disclosure is not whether we have to disclose, but rather something like what the referee asks the TMO “is there any reason why I should not award a try” or in disclosure terms “is there any reason why we should not disclose this matter? ”.

This is a very small economy in global terms. In some areas we have to take calculated risks to progress. I mentioned before that there were, subject to some caveats, efficiency gains to be made from the proposed part privatisations. But these do not seem to me to be the glaring areas where changed ownership structure can produce gains. Take the ports – rationalisation between the ports at Auckland, Northland and Tauranga is very obviously desirable for both importers and exporters. Subject to appropriate support infrastructure the potential efficiency gains are immense. Local body ownership, especially in Auckland but also to a degree in Northland and Tauranga, has been an impediment to this. The Commerce Act may not have been helpful either but seems to me a secondary issue. Incidentally this is important only at the operational level, and does not require any release of land or water from social ownership. To adapt a famous quote from Leon Trotsky “ You may not be interested in the economics, but the economics is interested in you.”

In closing, it does us all good to remember that while there are many things which could be run better, and while business is one of those, there are many things with which we are blessed in terms of freedoms and surroundings. More reasons for us to do well and be happy by far than there are reasons for us to fail and lament. Anyone who thinks seriously about the processes by which we enjoy the physical conditions of life we do will be struck by the amazing levels of voluntary co-operation between people required. Our biggest obstacle may be the type of thinking which sees business as inherently exploitative rather than co-operative at its heart.

May all be well.

Rob Campbell  
13.06.12

Note: These are the views of Rob Campbell they are not necessarily the views of Elevation Capital Management Limited (including its executives and directors).

Elevation Capital Management Limited hosts these events to encourage wider thought and debate about many issues. Should you wish to attend future events please contact Elevation Capital Management Limited at +64 9 379 6493 or [info@elevationcapital.co.nz](mailto:info@elevationcapital.co.nz)