IS THE PINNACLE HOLDINGS DEBACLE AN EXAMPLE OF A CORPORATE GOVERNANCE JOKE?

The recent collapse of the Pinnacle Holdings share price as a result of the announcement of the arrest of one of the Executive Directors for corruption has inadvertently shown some glaring holes in South Africa's corporate governance culture. I am not a shareholder of Pinnacle but I think the shareholders have a right to be furious with management, the JSE and all the Corporate Governance "gurus" that are responsible for this situation. Shareholders have three reasons to be angry: shocking communication by management, Directors hedging their shares and the role of Non-Executive Directors in listed companies.

In my view, the company and its management feel that they have ticked all the corporate governance boxes (they probably have) in their handling of this issue but this does not mean that they treated shareholders fairly. It seems they took a legalistic, 'cover our backside approach' to their shareholders, which I find unforgivable. I'm afraid to say that the recent share purchases by the CEO after this debacle does nothing to change my view – the horse has bolted.

MISALIGNMENT OF INTERESTS

One of the biggest problems in the investment industry as a whole is the misalignment of financial interests. Warren Buffett talks about this regularly. If the management of a company are not correctly incentivised to look after shareholders, they will often act to their detriment. If we look at Pinnacle, the CEO stated on 702 Radio that the "bank" sold his shares because of a "zero-cost collar". This was in response to Bruce Whitfield asking why he sold shares after the arrest but before the public announcement. In essence he hedged his bets on his own share price so that he would not lose too much money if the share price went down. In my limited understanding, a zero cost collar means that you are prepared to give up some of the potential growth in your share price in exchange for protection against potential losses.

The CEO is legally entitled to do these hedges and I'm sure he won't fall foul of any other regulations but I still feel this hedging is unfair to shareholders. If I were a shareholder, I would have been hoping to benefit from a rise in the share price over time. I cannot see how my interests are aligned with a CEO who is giving away upside so that he can hedge against losses, thus, his financial motivation is now different from mine as a shareholder. I strongly feel that all directors should be prevented from hedging their own shares.

CORPORATE GOVERNANCE GONE WRONG

The regulatory burden on listed companies is enormous. The amount of reporting that they have to do on a range of topics has caused the cost of running a listed company to skyrocket. In theory, this is being done to protect investors but I think the inmates are now running the asylum. If corporate governance was really effective, it would not have increased the compliance costs for companies in any way. If you want a clear illustration of how ridiculous the situation has become, we need only look at the role of Non-Executive Directors (Non-Execs). In theory they are meant to be experienced business people who need to ensure that management are running the business in the interests of all shareholders. They should also be a great source of guidance to management and in particular the CEO who can call on their wisdom in difficult situations. I feel the CEO of Pinnacle was badly advised to keep this quiet for such a long period and has been made to suffer the consequences. In this instance, an experienced business person who understands shareholders might have advised him differently than a lawyer would have.

Sadly, Non-Execs are now largely glorified compliance officers who troll through endless reports to ensure that the company has met all the necessary standards required by regulators. The fact that these regulatory hurdles might be bad for the company, and therefore shareholders, is not relevant because the Non-Execs are more worried about non-compliance. I believe the Pinnacle situation clearly illustrates this point – shareholders suffered here, not the Non-Execs.

I have spoken to various experienced business leaders about this and most of them are stepping down as Directors of listed companies at the earliest opportunity. As one Non-Exec said, "80% of our time is spent on compliance and 20% on business issues." This cannot be a source of comfort to shareholders because it means there is a massive loss of experience that management should be able to call on, that is no longer available to them. In my uneducated view, the only real beneficiaries of this wave of additional corporate governance are those lawyers who specialise in this field and other "experts" who can now charge enormous fees for training courses to company directors.

SHAREHOLDER COMMUNICATION

I feel that Pinnacle's management should have approached the communication around the arrest of this Director completely differently. Their first call should not have been to a lawyer. I believe the CEO should have put out an announcement saying that a director has been arrested and the company is unsure of the reason for this. They will inform shareholders when they have more information. To hide behind the excuse that they did not want to speculate misses the point. Shareholders had a right to know and it must have been obvious that this MIGHT have related to Pinnacle. When shareholders found out, they punished the company in the only way they could, by selling it.

In summary the financial industry is carrying a heavier financial burden as a result of increasing regulation across all aspects of the industry. While the intentions behind the regulations are good, the unintended consequences are massive. Ultimately, lawyers and compliance people will benefit massively while shareholders and investors will suffer as a result of the increased costs. If you need to advise your child about the choice of a good career, regulatory compliance seems like a real growth industry at the moment.