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More false narratives to trick investors

An "experienced board" and "skin in the game" are further examples of widely cited corporate attributes whose standing as value drivers depends on blind repetition.

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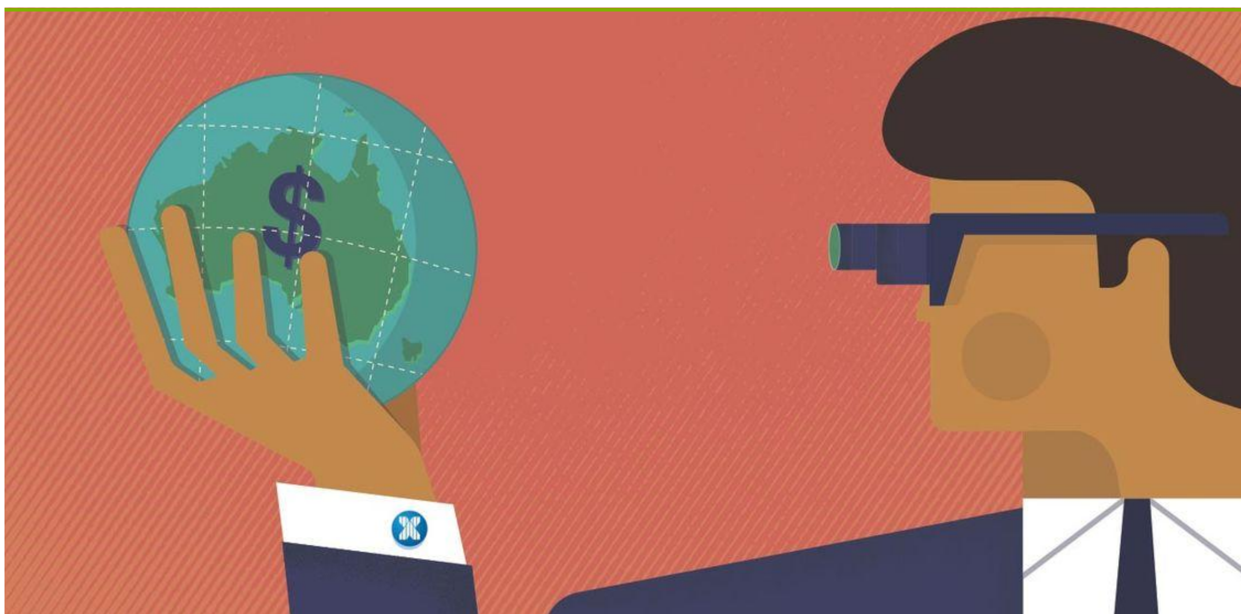

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A From the Capital column on June 11 questioned whether so-called tight capital structures produce superior investment returns. It also pointed out how company promoters ignore empirical evidence in frequently used valuation comparisons.

The benefit of an experienced board is a third example of a dubious claim, waved through without substantiation, designed to excite investors about the chances of business success.

No doubt, lessons about the sources of success and failure would have been learnt by today's board incumbents in past roles but mining is an industry for which timing is a critical ingredient. Fortuitously, being in the right place at the right time transforms investment outcomes. A rising gold price due to central bank policies, the onset of demand for battery metals or delays in recontracting uranium deliveries may overwhelm the effect of experience as a future investment driver.

Directors may have displayed unique technical insights or superior management skills in past roles. That still leaves unaddressed how earlier successes may be relevant to the current business objectives of another company.

Of course, directors are supposed to ensure adoption of sound governance practices rather than direct operational matters. In practice, the distinction between executive and non-executive members of junior mining company boards is heavily blurred.

Some chief executives describe their boards as "highly supportive". Having directors locked in behind a chief executive could just as easily be a sign of corporate weakness if they are neglecting their oversight duties.

At face value, having an experienced board appears unquestionably sensible but only rarely do executives explain how directors are able to contribute to the development goals being outlined.

The simple assertion of an experienced board ducks three important investment questions: How is any historical experience relevant to the current goals of the company? What roles do the experienced directors play (and how much time do they commit) in deciding operational issues critical to investment success? Does operational impact come at the expense of corporate governance oversight?

“ **Far from aligning the interests of shareholders and executives, remuneration policies universally foster double dipping in a way which is not available to ordinary shareholders**

These questions usually go unaddressed despite the effort to equate board experience with future investment success.

Almost universally, company directors are acknowledged briefly in investor presentations before business plans are outlined. More logically, if board composition mattered, the plans would come first, leaving executives to emphasise how the qualities of incumbent directors will enhance the chance of success.

In practice, the backgrounds of directors are simply used to pique investor interest. The roles directors actually play are left to the imaginations of individual investors. Whether and how they impact investment potential goes conveniently unaddressed.

Having ‘skin in the game' is universally accepted as another desirable corporate attribute, without substantiation. Share ownership among executives and directors is said to align their interests with those of shareholders.

Implicitly, without share ownership, business strategies or operational outcomes would somehow be different. The flip side of the ‘skin in the game' proposition is that executives would produce inferior outcomes if they had to rely solely on cash salaries for their rewards.

Of course, there was a time when a cash salary represented an entire remuneration package. Any shares owned by employees or directors were purchased from their own incomes. Notwithstanding the remuneration slogans peppering today's annual reports, there is no evidence of one form of pay driving superior mineral discovery rates or speedier development outcomes.

Far from aligning the interests of shareholders and executives, remuneration policies universally foster double dipping in a way which is not available to ordinary shareholders.

The sizes of executive pay packages vary with discovery and development success. So, for example, Mike Jones at exploration company Impact Minerals received a base salary of A$246,879 in the year ended June 2020, accounting for approximately half his total reported remuneration. The balance came in share-based payments.

The top earner at Bellevue Gold, a company making the transition from exploration to development, is entitled to a A$400,000 base salary. At Pilbara Minerals, the chief executive receives a minimum of A$600,000. The Sandfire Resources boss, one step further along the development path, gets at least A$1.1 million. The Fortescue Metals Group chief executive is guaranteed A$1.85 million.

Salary benchmarking ensures these gradations persist.

Executives in junior companies pretend shares and options provide their financial upside from business success. In fact, they get two bites at the cherry. In the event of development success, salary growth potentially worth millions of dollars is assured.

Straight salary gains, it turns out, are among the biggest and most certain incentives to get the job done. Contrary to conventional wisdom, share based remuneration bells and whistles can click in well short of the ultimate success which drives salaries higher.

Ordinary shareholders do not have the equivalent of a salary safety net in the event that the share price,

for whatever reason, fails to track development success. The interests of executives and shareholders are rarely truly aligned.

The misalignment of management and shareholder interests may be aggravated when non-executive directors participate in the same share plans as executives. Any conflict between the interests of shareholders and executives is more likely to be resolved in favour of executives when the incentives point in that direction.

Matching the financial incentives of directors with those of executives endangers the corporate oversight role boards are supposed to have in public companies.

The connections between investment performance, on the one hand, and board composition and corporate remuneration practices are complex. Researchers are continually discovering unexpected results and examples of seemingly perverse outcomes from emerging executive pay data across a full spectrum of industries. Awkward governance questions abound.

Simplistic labels like "experienced boards" and "skin in the game", accepted through common usage, are handy ways to neatly sidestep awkward governance questions from sometimes cranky investors.

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