BRI Ferrier

INDUSTRY INSIGHTS

By Peter Krejci

What company directors need to know in today's volatile market

With Australia experiencing a volatile market environment, it's up to company directors to deliver the rigorous corporate governance required to protect shareholder and creditor value.

Market volatility is a situation in which markets are liable to change rapidly and unpredictably, especially for the worse.

No matter how robust a company may appear, adversity or disaster can strike quickly, particularly in times of volatility. Directors and management can soon find themselves on a precipice.

A sound corporate governance regime is fundamental to ensuring the rights of all stakeholders (including financiers, customers, management, employees and the community) are adequately protected.

Corporate governance and directors' duties in times of volatility

The clichéd perception of company directors goes something like this:

- They attend four meetings each year
- They listen carefully to presentations
- They sit on committees and collect their fees

Today there's nothing simple about directorships in an environment in which the formality and complexity of board roles and interactions with management have increased dramatically. Directors now know their roles will be active, business matters will be urgent, and their decision-making will be highly scrutinised.

In the face of financial challenges, it's useful to consider the fates of companies like HIH and One-Tel.

Amidst scrutiny, criticism and potential liability, what should a board do?

The answer – be vigilant. In two ways.

First, directors need to fundamentally understand the business. They have to learn every nuance of the company's operations as if they had to manage it one day. Consequently, in times of volatility, a board needs to take a more active role in challenging management.

Directors can achieve a deeper understanding by reading relevant publications, following trends, asking the right questions and understanding the business's key metrics. They can also study the competition, to understand their company's strengths and weaknesses in a comparative context.

The second way directors can be vigilant is to assume they're only receiving partial information from the company's management. They should presume that management is providing them with information selectively and that they're not getting the full picture.

They will then be inclined to ask more questions and make more requests.

At the same time, they should avoid putting the CEO and management on the back foot.

Boards need to achieve a delicate balance with management. Companies rarely benefit from a situation in which a CEO believes the directors are not in his or her corner. This can be problematic.

While board vigilance may produce a degree of tension with management, it should be a healthy form of tension. Directors should avoid crossing the line and creating an antagonistic environment.

Checks and balances can serve to foster a sense of mutual respect that, along with trust and candour, are the essential ingredients of healthy corporate governance.

How a board should respond when the business faces challenges

When a company's performance begins to decline, particularly in times of volatility, directors must be (and must be seen to be) even more vigilant and engaged.

Businesses in this situation can unravel at lightning speed. The timing of a board's intervention in this situation may mean the difference between a soft landing (business reconstruction) and a hard landing (insolvency).

When signs of trouble appear, directors need to answer four fundamental questions:

- Do we have the right management team?
- Do we have the right strategic plan?
- Have we protected our access to capital?
- Should we hire an outside adviser?

The first question involves initially assessing the performance of the chief executive. The character and actions of the CEO are the most important factors that determine a company's success or failure.

The board needs to identify, therefore, whether the current CEO and his team are the right people for the task ahead. The CEO has to demonstrate the agility and decisiveness required to lead the company through difficult times.

Directors should also recognise there are different types of CEO.

Some are sales-focused, which is appropriate when the business is growing and performing in a positive environment.

In a weak market, however, companies need to aggressively reduce the overhead cost base that was built during the growth cycle. The CEO, in this case, must demonstrate a survivalist temperament, focusing on liquidity and cash flow. They need the fortitude to stretch out payments, renegotiate contracts and reduce employee head counts to reduce overheads.

The second question boards must ask when the company faces financial distress – 'Do we have the right strategic plan? – involves the viability of the core business.

In this situation, rather than the problems reflecting a broad-based decline of an industry, the individual company's strategy may be flawed.

The board must therefore ask detailed questions, challenge assumptions and perhaps recommend outside consultants or advisers to help guide the planning process to improve the company strategy and core business direction.

The third question – 'Have we protected our access to capital?' – requires the board to direct management to ensure sufficient liquidity to sustain the business in a worst-case scenario.

This activity can take various forms, potentially including new debt or a capital raise.

Directors must therefore be familiar with the company's long-term liquidity situation.

For financially distressed companies, it's not uncommon for management's relationship with lenders to become strained or fatigued. The intervention of directors in such situations may prove beneficial.

To answer the fourth question – 'Should we hire an outside adviser?' – directors must collectively decide on the extent

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to which they feel comfortable with the information they're receiving from management and other sources.

If the board is hesitant about the quality of this information, it should engage an outside adviser for an alternative opinion.

Management may resist, of course, citing costs as a reason. However, the board should be aware of the potentially catastrophic costs of acting on incomplete or unreliable information. Asking for a second opinion should therefore be viewed as a sound investment.

An outside adviser can provide objectivity, credibility and experience in similar situations, all of which can be reassuring through the decision-making process. An external consultant can also negotiate effectively with banks and creditors, who typically become antagonistic with financially distressed businesses.

Disaster cannot always be avoided, but it can be managed.

At the first signs of trouble, by maintaining a proactive posture, practicing vigilance and focusing on the four questions outlined above, boards can be in the best possible position to avoid a collapse.

About BRI Ferrier

BRI Ferrier is a unique affiliation of expert business recovery, insolvency, forensic accounting and advisory firms. We provide practical, innovative services that help financially distressed businesses to recover or at least minimise the negative impacts of insolvency.

With over 160 staff and eleven practices in Australia, New Zealand, Hong Kong and the United Kingdom, we work with clients of all types – from individuals, sole traders and small businesses to public corporations and government entities.

We also work with financiers, solicitors, accountants and creditors to address the needs of all stakeholders when businesses face financial challenges.

How BRI Ferrier can help

BRI Ferrier can assess your current situation and advise on a path forward to minimise further risk.

Early intervention is often the key for a successful restructure of your business. If you or your client is experiencing financial challenges then don't delay, contact us today.

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The initial consultation to your client is free, strictly confidential and without obligation.

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