



**Profile: David Webb**

## **Not Serving on the Board at the Pleasure of the King**

*Remarks of a free market, free enterprise shareholder activist*

### **Intro**

“As long as controlling shareholders dominate, then their directors serve on the board at the pleasure of the king, so to speak,” says Hong-Kong based investor and shareholder activist David Webb about so-called *independent* directors. Mr. Webb himself does everything but serve on the board at the pleasure

of the king. Instead, he holds strong and clear views on the workings of the capital markets, as well as on individual companies and stakeholders in those markets, and is happy to speak out on them. His main communication channel is his daily updated, not-for-profit website, [www.webb-site.com](http://www.webb-site.com), where Mr. Webb provides an independent commentary on

corporate and economic governance, business, finance, investment, and regulatory affairs in Hong Kong. Also in this interview, he shares some of his thoughts on what is wrong, and how to get it right, in the areas of corporate governance, financial reporting, the audit of financial reports, and the usefulness of financial reports.

#### **David Webb: A brief bio**

After he graduated with a degree in mathematics from [HExeter College, Oxford University](http://www.exeter.ac.uk) in 1986, David M. Webb spent 12 years in investment banking, first in London, then moving to Hong Kong in 1991. He was a corporate finance director for BZW Asia Limited, conducting equity issues and advisory mandates throughout Asia until 1994, when he became in-house adviser to Wheelock, a locally listed conglomerate. He retired in 1998 and now divides his time between non-profit governance advocacy, including his website [Hwww.webb-site.com](http://www.webb-site.com), and researching the Hong Kong market, particularly smaller companies, in several of which he holds substantial disclosed stakes. His public roles include membership in Hong Kong's [HTakeovers and Mergers Panel](http://www.hkex.com.hk) and the Takeovers Appeal Committee. He was an elected independent director of Hong Kong Exchanges and Clearing Ltd and is former Chairman of Hong Kong Mensa. As a teenager he wrote books and games for early home computers.

### **Independent shareholders should elect the independent directors**

*What key steps should be taken to further improve corporate governance?*

“One of the key questions in the area of corporate governance is, ‘Are the independent directors really independent and who gets to appoint them?’ The problem is that many jurisdictions that imported the concept of independent directors from the UK, such as Hong Kong, didn’t adjust it to take into account the fact that most of their companies have controlling shareholders. As long as those controlling shareholders are allowed to vote on the election of non-executive directors, then these directors serve on the board at the pleasure of the king.

“At the moment, regulations requiring companies to have independent directors give investors a false sense of comfort, so I have been pushing for the following changes to the current system:

- Either require all the controlling shareholders, executive directors, and their associates to abstain from shareholder voting in the election of independent directors, so that the independent shareholders elect the independent directors; or
- Give up on this charade all together. Remove the requirement to have any independent directors and let companies justify to their shareholders the composition of their board. They should stop pretending that their non-executive directors are independent.

“In the first scenario, which I favor of course, independent directors would be independently elected, with a mandate and accountability at the ballot box. The board could still nominate candidates, but it would have to nominate people who are acceptable to the independent shareholders, because the independent shareholders could replace them with their own candidates if they were not satisfied. That would be the best outcome.

“Independently elected directors would be able to ask difficult questions without facing the threat of being kicked out by the controlling shareholder. They would have more authority in the boardroom. They would have an obligation and a mandate to look underneath the rocks and find the snakes, and that would improve the system. Unfortunately, however, as far as I am aware, there is no sign of this happening here or anywhere else.”

## **Independent shareholders should approve material remuneration increases for conflicted directors**

*Did lack of shareholder power also influence the (over)payment of remuneration?*

“In the majority of controlled-company environments, excessive remuneration is usually only a problem in the case of directors who are controlling shareholders. They don’t overpay their hired hands. They pay market rates for their CFOs and so on, who are usually outsiders and not family members.

“The issue again is for the controlling shareholder who often is also the CEO and/or chairman. They use their voting power to perpetuate their position and award themselves excessive pay packages and get the so-called independent directors to approve anything when necessary through the board vote. The excess amounts to an effective preferential dividend.

*“Independent directors ... are there to provide the eyes and ears that investors can’t have for reasons of commercial sensitivity and practicality.”*

“Here in Hong Kong I proposed a solution to rein in the power of controlling shareholders: after their company has gone public, they need independent shareholder approval for any increase—or potential increase when it is linked to performance—in their remuneration if it exceeds a certain percentage in any given year.”

*What about the remuneration issues in large financial institutions and other multinationals?*

“Regarding widely held companies and the debate that is going on over banks, I don’t think there is much merit in trying to regulate or legislate executive remuneration. That is not a free market approach. What the regulators need to do is ensure that financial institutions properly account for their profits and that shareholders have a say on pay.”

## Executive remuneration not cause, but symptom of the financial crisis

*Do you also see a relation between executive remuneration and the financial crisis?*

“A lot of what we are seeing is political. It is populist stuff because a lot of people lost their jobs or homes and they don’t like reading in the newspapers that someone is being paid five million pounds for running a bank. However, I don’t think that executive remuneration is a cause of the latest financial meltdown. It is rather a symptom. If you let the free market function, if shareholders are actually involved in corporate decision making, and if shareholders investigated whether they were rewarding management simply for markets going up, or for their relative performance in their sector, then you would get a very different outcome.

*“It is not pretty out there, but it is not the director’s job to make the accounts look pretty, or to protect investors on a ‘see-no-evil, hear-no-evil’ basis.”*

“The issue is that the shareholder participation model has broken down, especially in the US, where shareholders have almost no say over who runs their company (see also ‘Shareholders have little say in the USA’).

### Shareholders have little say in the USA

“The US has its own separate issues largely because of the breakdown of corporate control there. The competition between 50 state jurisdictions resulted in a race to the bottom for shareholder rights in corporate constitutions. Boards have been able to reduce the shareholder participation to almost nothing. In addition, the Securities and Exchange Commission (SEC) is still dragging its heels on giving shareholders the right to even nominate directors for election.

“You actually have companies and their boards who say with a straight face, ‘Well, we don’t think that shareholders should be able to do this because it is up to the board to appoint new directors. So the boards have entrenched themselves, and you see that reflected in the massive pay differential between, say, the US and the UK, which are otherwise quite comparable markets and economies.”

“Also, if some companies or entire sectors are consistently and exceptionally profitable, facilitating very high pay, then there is probably something wrong with the system, such as a price-fixing cartel or other anti-competitive practice that keeps margins fat, or even because of some government policy or subsidy. Lawmakers and regulators need to examine these macro issues rather than try to micro-manage pay structures.”

## Causes of the financial crisis

*What then were the main causes of the financial crisis and what should be done to prevent such a crisis from happening again?*

“If you look at the financial meltdown, there were many issues outside of the boardroom that were much bigger factors in causing the crisis:

- There was the mortgage securitization system, where banks did not keep the loans they created;
- There were the government-sponsored institutions, Fanny Mae and Freddy Mac, which artificially

lowered the cost of funding by providing guarantees for anything smaller than a certain size of mortgage loan;

- There were the rating agencies who were able to rely on these implicit government guarantees when slapping a lot of triple A ratings on the securities, and who, in other cases, were conflicted by being paid by the issuers rather than the investors;
- There was Basel II—comprising what I call the ‘capital inadequacy’ rules—which allowed banks to run their own risk models and lowered the amount of capital they were required to hold, thereby increasing the risk of systemic failure; and
- There was the Federal Reserve’s interest rate policy after the dot-com crash, which is, in my view, far too generous because like the policies of other central banks, it focuses only on consumer prices and not on capital asset values.

“So there were multiple contributors to that situation. Not only did we have rates artificially lower than they should have been, because of the federal guarantees, but also we actually had absolute rates that were too low. And that combination transferred effectively a surplus of liquidity from the dot-com bubble into the asset/property markets.”

*But, prior to the financial crisis, didn't many shareholders encourage financial institutions to excessive risk taking and punish their more conservative peers?*

“Different banks will take different strategies, but the problem at the moment is that more conservative financial institutions, such as the US-based bank Wells Fargo, might feel that they have been punished for being sensible. That is what happens when governments intervene in the markets to prop up banks. It rewards bad management. It is a moral hazard basically. What US Treasury Secretary Hank Paulson did in the final months of the Bush administration was disgraceful. It was basically bailing out his former employer Goldman Sachs and other Wall Street firms by bailing out AIG.<sup>1</sup> They should have let AIG, Fannie Mae and Freddie Mac fail, and have let the cards fall where they would afterwards in terms of the consequences to commercial banks. Their only duty to the public was through the FDIC system for bank deposits<sup>2</sup>—nobody had a savings account with Goldman Sachs or AIG. The insurance subsidiaries of AIG were solvent, so there was no policyholder issue there.”

## **Governmental savings accounts as alternative for deposit protection**

*You don't believe in the “too-big-to-fail” concept?*

“You do need to have some level of deposit protection system that will provide retail depositors with peace of mind, but my favorite solution to that is actually to go back in time a little bit and say, ‘look, if depositors want the benefit of a government guarantee—which is effectively what they are getting through the deposit protection schemes around the world—then they are only to get paid the interest rate on government debt.’ So we actually need to reopen postal savings banks in an online format,

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<sup>1</sup> Goldman Sachs and others had made big bets with AIG (American International Group) as the counterparty, which could be honored (only) with the help of the bailout money AIG received.

<sup>2</sup> The US [Federal Deposit Insurance Corporation](#) (FDIC) is an independent agency created by the US Congress to maintain stability and public confidence in the nation's financial system by insuring deposits, examining and supervising financial institutions for safety, soundness, and consumer protection, and managing receiverships.

where people who want to have a risk-free deposit facility for their savings, can lend it directly to the government. Those deposits would be taken by the government, guaranteed and lent into the free market to the commercial banking system at market rates, earning a spread to compensate for the risk.

“Such a savings system by the public sector would make governments the biggest holders of deposits around, but there is still enough of a market left for people who want to take more risk. What would remain is a commercial banking system, and people like me—who are willing to take risks—would be told very clearly, ‘Ok, you can deposit your money with Barclays, HSBC or whatever bank, and you will probably get a better interest rate, but it is your risk and we are not going to come and bail you out.’ That would put both shareholders and depositors on notice. You can’t have it both ways: banks paying you higher competitive interest rates, backstopped by the government guarantee.”

## **Financial reporting has changed for the better by and large**

*No doubt you read many financial reports to determine which companies you want to invest in. What is your view about the development of financial reporting?*

“Financial reporting has changed for the better by and large. For example, in the annual statements, we now have proper valuations of all investments, not selective investments. Now all valuation changes have to be included in a comprehensive income statement, and we have started to move toward including the fair value of investments, rather than directors saying: ‘We don’t plan to sell it, so we will keep holding it at cost.’”

## **To make them comparable, companies need to provide fair value**

*You would like to see even more fair value than we have right now?*

“Yes, certainly on the fixed-assets side. In terms of mark-to-market—and there has been a bit of backtracking on that recently—I think that fair value accounting is very important because we need comparability between companies in a sector, between companies in a market, and between companies in different markets. I don’t want to have to figure out when a company bought its assets before I can compare it to another company, which is otherwise identical, but bought its assets yesterday and has them all in at recent cost (see also: ‘We still haven’t gotten fair value accounting right’).

### **We still haven’t gotten fair value accounting right**

“If you look at the big assets of the retail company [Dairy Farm](#), for example, it probably still has a lot of its old Hong Kong properties in the books. Because their premises are at cost minus depreciation, it doesn’t have to revalue. When I have to compare that with a hypothetical identical supermarket that bought all of its properties yesterday, that balance sheet would be quite different. But economically and financially, I would be taking the same risk by investing in either one. So we still haven’t gotten fair value accounting right. I would think that self-occupied premises should be fair valued as well. It doesn’t matter when the properties were purchased.”

“If you could program computers—as we will in the future with XBRL—to analyze companies across a specific industry and if you imported all their financial data, the computer could compare them and find which one is the best priced. Computers are quite good in doing that if they have good input.”

*And XBRL would help you in doing that?*

“Using XBRL would be a much more affordable way to bring information to investors, rather than the current manual process of reading printed accounts and typing them into databases. But it still follows the GIGO principle: ‘garbage-in, garbage-out.’ If we are still stuck with the historical cost problem in the financial accounts, a computer is not capable of adjusting for that. It cannot say, ‘I am looking at drugstore company X that bought all its high-end shops in the 1950s, which is different from company Y who bought its stores in the 1990s.’ To make companies comparable then, companies need to provide fair value accounting across the balance sheet.”

## **Don’t use fair value for current assets or goodwill**

“The only areas where the use of fair value would be excused would be current assets and goodwill:

- With respect to current assets, you can’t expect to mark up the value of your raw materials all the time. It is too complicated. It is not realistic to say to a manufacturer, ‘What would your raw materials be worth if you sold them today, rather than use them to produce your products?’ So, I am not saying we should change that part of the balance sheet, apart from the usual requirement for writing down impaired inventory and receivables, of course.
- Fair value should not be used for goodwill, because goodwill should not appear on the balance sheet. We should let the market decide what premium or discount the company is worth relative to its net tangible assets. Goodwill is just the director’s or valuer’s assessment of what future earnings are worth—and investors, through markets, are better at deciding that. Also, goodwill normally only arises on acquisitions of subsidiaries, and distorts comparisons. Hypothetically, you could have two identical companies, one of which got there by acquisition and one organically. They should be worth the same, but one of them would have goodwill in its balance sheet, and the other would not (see also: ‘Markets and investors determine what companies are worth, not directors’).”

### **Markets and investors determine what companies are worth, not directors**

“Where I think that money is being wasted is on requiring directors to value the business through the goodwill line in the accounts. That is what markets are supposed to do. Markets and investors determine what companies are worth and, implicitly, what the goodwill in their balance sheet is worth above or below their net tangible assets.

“We waste shareholder money requiring a company to revalue its goodwill based on the things it has purchased. I would rather see goodwill eliminated from the balance sheets altogether. It is almost an artificial comfort to some simpler investors if they see a big, strong balance sheet and the company can say, ‘We have net assets of X,’ while in reality they have net liabilities when you disregard the goodwill on the acquisition that they overpaid for!”

## **Directors should tell the truth, so investors can make informed decisions**

*What about the psychology of fair value accounting? Might including fair values in key figures make market participants anxious and cause them to overreact?*

“It is the job of directors to tell the truth, to provide the information that investors need to make informed decisions. Accounting at fair value, which often means using a market price, is better than sugar coating the truth by refusing to recognize that your assets aren’t currently worth what you paid for them. It is the job of investors to recognize, for example, that we are in a crisis and that those who have a cash reserve or who are more bullish about the world being a going concern will step in. Differing views of the future, based on the present facts—that’s what makes a market. And we do have in such markets boom-bust cycles and crowd-like behavior, and some people are more susceptible to crowd-like behaviors than others. It often comes down to human character, how much one will just go with the fashion.”

## **You need very good arguments to depart from mark-to-market**

*And what if the market does not have a view because it has completely frozen?*

“I think that with regard to banks, they should only depart from mark-to-market if they can put their hands on their hearts and, in writing, say, ‘We believe that the market does not provide an accurate price for the following reasons, and therefore...’”

*Was this the case at the height of the credit crisis?*

“Well, they would still have to justify why exactly they thought that the market was dysfunctional. It might have been the case that markets were telling the truth. It is not pretty out there, but it is not the director’s job to make the accounts look pretty, or to protect investors on a ‘see-no-evil, hear-no-evil’ basis. I hate hearing people say, ‘Well, these assets are actually still worth what we paid for them because we don’t plan to sell them.’

“Regulators might reasonably say, ‘We are going to cut some slack here because we recognize that they are only technically insolvent if they had to liquidate everything today. But they are not going to be, because we are going to provide them with huge lines of credit.’ Then also regulators are taking a different point of view on the numbers of a specific bank. Once again, that is for them to do, and not for the companies or their accountants.”

## **Auditors could do more to detect fraud**

*Speaking of accountants, what is your opinion on the audit report?*

“I have written about audit failure cases such as Akai, EganaGoldpfeil, Ocean Grand, Moulin, Peace Mark, Tack Fat, and there have been numerous other cases in the last few years, all audited by Hong Kong firms, some of them big, other ones small. The result of these cases is a decrease in investor confidence in the audit, and for good reason. The only real comfort that I get from an auditor signing off is that *if* they have been told the truth by the directors, then the accounting standards have been properly applied. And the whole point of having the audit is to tell the outside world that the auditors have formed an opinion that the accounts actually are true and fair.

“Truthfulness is all about whether the statements are fraudulent or not. If the purpose of an audit were only to state whether or not the accounting standards have been properly applied, it would be a much simpler job. There is a lot more that auditors could do to detect fraud, such as better verifying purported sales by calling customers directly and asking for written confirmations, and better verifying with banks whether the deposits claimed by the client are correctly stated.

“Fraudulent accounts are a risk for both private and institutional investors. They are not doing the audit. They pay the auditors to do it for them through their shareholders’ funds. The auditors are supposed to provide some central quality assurance for all investors.”

## **In preparation for an IPO, companies should retain their auditor for three straight years**

“A specific fraud-sensitive event is when a (Chinese) mainland firm seeks a listing on the HKEx. They often engage a new auditor who jumps in six months before the listing, signing off on the final audit before the initial public offering (IPO). These auditors haven’t done the audit in the previous two years, and then you find out later that the books have been cooked.

“In respect to IPOs, I have said that the entire three-year track record of a company that seeks a listing should be audited by the same audit firm. Companies should not switch to a big name auditing firm in the third year to do the final pre-IPO audit. A firm that has been auditing the whole track record—counting inventory in warehouses, verifying facts with banks and customers, two, three years ago, and not relying on rehashes of the accounts—is more likely to detect false accounting.”

*But isn’t it often the case that in preparation for an IPO, the IPO consultants advise the company to use a big name audit firm to avoid risks in that area?*

“There is nothing wrong with changing an audit firm from time to time, but when companies are preparing for an IPO—and you pretty much know that you are aiming for that if you are growing a business, it is not a sudden shock that you are going public—they should be capable of retaining an auditor for three straight years. If they are going to bring someone else in, then they should at least have the original auditor jointly sign off, so he or she is also on the hook for the listing. Investors should be made aware that another, less-known auditing firm conducted the audit in the first two years instead of camouflaging the final report with a big name.”

## **Auditors need to push legislators for statutory duty of care to investors**

*What should auditors do going forward?*

“Although it may sound as if it goes against their own interests, auditors do need to speak up and push legislators to impose upon auditors a statutory duty of care to investors, so that we can get over the Caparo ruling.<sup>3</sup> And some countries have done that, but many others haven’t.

“Now of course that means that auditors would be at greater risk, which means that they would have to do their job more thoroughly, and they probably would have to charge higher fees for doing the job properly. But that would be a better outcome than the current situation, where the auditors don’t provide much assurance, so they race to the bottom and cut corners to lower fees. Maybe in the future, we will see quasi-class actions on the (Chinese) mainland. If so, investor remedies might actually get a little bit better for dual-listed companies using mainland auditors than for Hong Kong companies, using Hong Kong auditors.”

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<sup>3</sup> The [Caparo case](#) basically ruled that there was no common law duty of care between the auditors and the shareholders, but only between the auditors and the company.



## **Increase the frequency and timeliness of financial reports**

*We've talked about how corporate governance, financial reporting and auditing can be improved to strengthen financial reports. What about the reports themselves? What would make financial reports more useful to you?*

"The utility of financial statements is twofold: one is content (that we already discussed) and the other one is timeliness. There are two sets of disclosures we get here in Hong Kong, one unaudited interim statement and one audited year-end statement. These interim statements should be done three times per year, and within 45 days of the quarter end, because they are only useful if they are fresh.

"Right now, for example, some companies don't report until four months after their year-end,<sup>4</sup> so just before they report, the most recent information we have on them is almost ten months old! That makes for speculative markets and greatly increases the value of inside information. That is the reason why some large institutions with access to management of the companies they invest in feel that they actually don't want quarterly reports. That would take away some of the edge they get from company visits and briefings from road shows and so on. Most other investors, though, recognize the benefits of more frequent and more detailed reporting. Not all of them can read 100 pages of financial statements, but some are able to assimilate this information. That will help improve market efficiency by putting that information into the share price.

"Also, the tycoons and conglomerates have been resisting more frequent reporting. They have no particular need to keep their minority shareholders informed. Hong Kong has a controlled-company environment. There is no risk of a hostile takeover. Therefore, they don't feel the need to maintain a high share price and reach out to investors in a way that widely held companies do. And so they regard financial reporting as a chore, as a burden, and something that should be done with minimal effort and minimal disclosure.

"After a lot of pushback from the tycoons here, the HKEx is now talking about having some sort of narrative statements for the remaining two quarters, but requiring management to comment on things without numbers is not very useful. For example, the [interim management statements](#) of the UK-listed<sup>5</sup> [Jardine Matheson Holdings](#) told me nothing at all! It was basically, 'Our performance is in line with our own expectations.' See also the [article](#) I wrote about this issue of more frequent reporting, as well as the results of a [poll](#) among investors visiting [Webb-site.com](#)."

## **Independent directors should express their concerns in the narrative**

*What about the (independent) directors' report?*

"If we had an independent election system for independent directors (see earlier in the interview), then they would have more authority. In that case, I would favor giving them their own section of the annual report and an obligation, a two- or three-page report, in which they have to report any issues that they are concerned about, and any issues on which they have disagreed with the rest of the board. As I said, I would like to see a report from truly independent directors."

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<sup>4</sup> The reporting deadlines are being reduced to three months for years ending December, 31 2010, or later.

<sup>5</sup> The UK requires a sort of narrative commentary to be released every three months, in the two quarters of the year that aren't reported upon.

*Isn't that more or less the situation in jurisdictions with a two-tier board: one of directors and one of (independent) supervisors?*

“Whatever you call them, supervisors or independent directors in a unitary board, the point is that they are there to provide the eyes and ears that investors can't have for reasons of commercial sensitivity and practicality. It only really works if they are accountable to independent shareholders and not beholden to management or controlling shareholders.”

### **More frequent reporting motivates companies to optimize their systems**

*Back to increasing the timeliness of financial statements, an argument often heard is that increasing the reporting frequency takes company management away from other important activities.*

“With regard to the argument that management would be distracted if they had to keep reporting to their stakeholders, well, financial reporting is not the job of the chief executive. It is the job of the CFO, not the chief executive, not the marketing director, not the sales director, or whoever else there is.

“Big multinationals like Coca-Cola or Hewlett-Packard are perfectly capable of producing quarterly corporate reports, even when they have subsidiary companies in more than 100 different jurisdictions. So, I just don't buy the argument that it is impossible to do or detracts from other business—there is no evidence that US companies are less successful because they report 'too often.' Faster and more frequent reporting motivates companies to get their internal financial information systems working properly in order to provide such reports promptly and at the lowest possible cost. Improving the internal information flow should benefit management's decision making too.”

### **Companies should be prepared to correct or withdraw their earnings guidance**

*What are your views on quarterly forecasts or earnings guidance?*

“I have no problem with management stating their honest expectations of the future, as long as they either withdraw or correct those statements if they later decide that their expectations were wrong. So, if companies give earnings guidance, they need to be prepared to keep an eye on it and correct or withdraw it when necessary. And, if they don't have a clear view of the future, then they should just say so: 'We can't replace that prediction with another view.' As long as directors are giving honest predictions, then they should be protected by their right to the freedom of speech.

“The US, for example, has the safe harbor provision on forward-looking statements and that is a good thing. It is pretty obvious that when someone uses words such as *might*, *shall*, *would*, or *may* that they are talking about the future. They are not talking about the past!”

*Would quarterly earnings guidance not stimulate suboptimal short-termism?*

“There is little evidence that it does, except in very extreme cases where company management might have some share options about to expire, and they are trying to pump up the profits or something like that. It is a classic and hackneyed argument of those who oppose quarterly reporting by saying, 'This will make the markets speculative and too short term.' What could make them more speculative than not providing information? If results leak out slowly, then of course you see a smoother adjustment as the

information gradually informs the market, as insiders gradually impart their knowledge. That's not fair, though, to the people that don't have such inside information!"

## **Sustainability should be addressed through global regulation**

*How useful is sustainability reporting?*

"Some parts of business reporting, such as sustainability reporting, are of no real value to investors. I would think in particular of the push for carbon disclosure. By the way, I do believe that climate change is a threat. I don't think, however, that disclosure of CO<sub>2</sub> produced is of any great value to an investment decision, unless the company has to pay for its emissions. Most companies don't have to. And if you are an activist trying to persuade companies to reduce their CO<sub>2</sub> output, you are wasting your time. You should be persuading governments to pass legislation requiring them to do so.

"So-called corporate social responsibility (CSR) is upside-down. That is to say, societies are responsible—through their governments—for setting laws and regulations by which companies must behave. So the reality is SCR: social corporate responsibility. If a government does implement a cap-and-trade scheme for CO<sub>2</sub> emissions, then companies will comply with that and price it in their business in a competitive fashion, because then it is a cost for the purchase of pollution rights. If a transport company is required to provide access for the disabled in its facilities, then it will do that and factor it in as a business cost."

*Couldn't embracing corporate social responsibility also create an internal momentum for many companies to further improve their own sustainability?*

"It is in companies' rational self interest to maximize their profits. If that involves consuming less energy, or if they are in the forestry industry, making sure that they still have some forests to farm by using proper crop rotation, that is what they will do. But we shouldn't expect companies to try to make the world a better place at the expense of the shareholders. If they did that, then they would have to charge more for their product and would soon become uncompetitive. Then somebody else would take them over, or they would lose business to those companies that don't do these good deeds. Besides, shareholders might also sue the directors for breaching their fiduciary duty to maximize shareholder value.

"On the other hand, if everybody is required to clean up their waste, they will and it will be economically priced into their products. However, if only one of them voluntarily does that, it won't last long! You need global solutions.

"I have always said, if you want to make the world a better place you have to start at the top, and impose regulation through your government and internationally through global agreements. Otherwise, if one country were to unilaterally change its laws and require all of its factories to produce drinkable water as their waste water, then it would price itself out and the business would move elsewhere.

"So what you need is some sort of United Nations treaty that every company on earth has to comply with through local legislation. It has been achieved in some areas, via the [International Labor Organization](#), for example. There is, for example, a treaty that requires governments to protect children from labor. And by and large that has worked, although obviously there are some countries that don't fully comply with that!"

### **Key recommendations from David Webb**

1. Controlling shareholders, executive directors, and their associates should abstain from shareholder voting in the election of independent directors, so that (only) the independent shareholders elect the independent directors.
2. To rein in the powers of the controlling shareholder, independent shareholders should approve remuneration increases beyond a modest threshold if the director or employee is also a substantial shareholder.
3. To make them more readily comparable, companies should provide fair value accounting across the non-current assets and liabilities in the balance sheet.
4. Goodwill should be eliminated from balance sheets because it is for the market to decide what premium or discount the company is worth relative to its net tangible assets.
5. Auditors could do more to detect fraud, such as better verifying purported sales by calling customers directly and asking for written confirmations, and better verifying with banks whether the deposits claimed by the client are correctly stated.
6. A company that seeks a listing should have its entire three-year track record audited by the same audit firm.
7. Auditors should speak up and push legislators to impose upon auditors a statutory duty of care to investors. The consequent increased risk would compel them to do a more thorough audit.
8. Increasing the frequency and timeliness of financial reports would help improve market efficiency. Faster and more frequent reporting also motivates companies to get their internal financial information systems working properly in order to provide such reports promptly and at the lowest possible cost. That improved internal information flow should benefit management decision-making too.
9. The independent directors should have their own section of the annual report in which they have to report any concerns and any issues on which they have disagreed with the rest of the board.
10. As long as directors are giving honest predictions, then they should be protected by their right to freedom of speech when giving earnings guidance and other forward-looking statements, but they should update such statements if they later change their view.

***We welcome your feedback on these recommendations. To provide us with your feedback, please complete this brief [survey](#).***