# Chanticleer

*For crowing there was not his equal in all the land...*

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## Lessons from forced CEO exits

It looks as though Australian boards of directors need to redouble their efforts to understand the culture, governance and environmental issues bubbling away inside their companies.

That is one conclusion to be drawn from a study of 300 chief executive departures from ASX-listed companies over the past 10 years by global management consulting firm Kearney.

The study, shared exclusively with Chanticleer, compares CEO exits over two five-year periods – from April 2011 until March 2016, and from April 2016 to March 2021. The total number of exits remained flat over the two periods, but the number of exits was relatively high compared to global trends. About three-quarters of CEOs transition in a five-year period.

The study found the number of involuntary exits increased by 27 per cent over the two periods, and the share of involuntary exits of all exits is now 34 per cent.

The forced exits were put into two buckets – financial performance and non-financial (environmental, social and governance) reasons. Over the two periods, the number of involuntary exits for non-financial/ESG reasons rose almost fourfold. Non-financial reasons now account for 37 per cent of all involuntary exits.

Analysis of the share price impact of CEO exits found that most CEO exits seem to refresh investor confidence and boost the share price. But when it came to involuntary exits caused by non-financial/ESG reasons, the share price underperformed the broader index by about 5 percentage points one year after the transition.

The findings are pertinent given that several commentators in the past month have labelled ESG as the work of the devil. It is allegedly taken seriously only by lily-livered directors who have lost sight of the primacy of shareholder interests.

Gerd Schenkel, who co-authored the study with fellow Kearney senior partner Alasdair Johnston, says forced CEO transitions due to ESG reasons tend to reflect deeper structural issues within the organisation.

He says social media is becoming an important factor in the forced CEO transitions, which are happening due to a broad spectrum of ESG reasons. "Social media echo chambers are playing a key role in amplifying stakeholder indignation in an unpredictable way and making it harder to anticipate where the hazards lie," he says.

Schenkel says boards are facing an increasingly complex landscape which requires increased sophistication in the tracking of ESG risks and the way in which companies respond.

"ESG is likely to undergo a journey similar to workplace safety – change will only come from strong leadership, better processes and a fundamental shift in culture from the boardroom to the front line," he says.

"All the issues so far fall broadly under the social and governance aspects of ESG. We predict that environment will be next."

As community expectations change, boards are going to have to reflect that in their deliberations and the way they hold CEOs accountable. "There has been a sharpening of CEO accountability around issues that occur a long way from their office; they are on the hook for the culture of the organisation they lead," he says.

Schenkel predicts boards will need to include a much broader set of risks in their risk management frameworks in order to avoid high-profile events that can lead to CEO departures.

"Boards need to be prepared for a forced CEO exit, as it is likely that this occurs at least once during a non-executive director's tenure at an organisation," he says. This preparedness, including mature succession planning, involves having the right mix of people sitting around the board table so that its diversity reflects Australian society.

"'The Friedman Doctrine to maximise shareholder value no longer holds when shareholders want financial returns delivered under a set of ESG conditions," Schenkel says.


### Backlash against new super performance index

A global provider of indices measuring the performance of a range of superannuation assets has highlighted weird anomalies in the federal government's choice of index for tracking unlisted infrastructure returns.

EDHEC Risk Institute has pinpointed several performance measurement issues relating to the MSCI Australia Quarterly Private Infrastructure Index, including its bias towards transport assets, its volatility and the lengthy lag involved in the inclusion of its component parts.

Analysis of the performance of the benchmark over the past eight years shows outsized returns that most super funds would struggle to beat. This means there is the potential for funds to take significantly higher risks in order to match, or beat, the index.

The institute has also expressed concern that combining the unlisted data in the index with listed data, as proposed by the federal Treasury, could be unsound and potentially misleading.

The MSCI Infrastructure Index has been chosen as the benchmark for tracking the performance of infrastructure assets in the government's Your Future, Your Super reforms. The inclusion of the MSCI index was initially greeted as a victory for common sense because it measured the performance of unlisted assets and not just listed infrastructure assets as originally proposed by Superannuation Minister Jane Hume.

But there is now widespread concern about the use of the MSCI index, according to a survey of industry participants conducted by EDHEC Risk Institute.

The survey, which targeted the chief investment officers of leading industry super funds, found 95 per cent of participants thought the index was not sufficiently granular and representative of unlisted infrastructure assets held by super funds. Also, about 90 per cent of participants thought it was not acceptable for an index in a time-based performance test to change retrospectively because of the inclusion of new data.

The institute's analysis of the performance of the MSCI index found the composition of the index had changed many times and this had affected reported returns. The inclusion of a new fund in the index in 2019 resulted in a 19.94 per cent increase in the overall net asset value of the index.

A change in the composition of the index was triggered in May 2020 after seven funds that had not provided data to MSCI were excluded from it. This resulted in a 69 per cent fall in the overall NTA of the index.

One significant anomaly in the MSCI index highlighted by the EDHEC Risk Institute is the lagged inclusion of the performance of funds that make up the index. On several occasions over the past three years, the performance of the MSCI index has been updated later because information was not available.

Draft regulations published by the government would allow MSCI to include the "assumed index for Australian Listed Infrastructure" when unlisted data is not available. This injects another level of uncertainty into the process and could lead to returns being reported that do not reflect the performance of unlisted assets.

Another issue raised by EDHEC Risk Institute is around the performance of the index, which would be used to measure the performance of super funds over a rolling eight-year cycle.

The index showed an annual return over the eight years to March 2021 of 12 per cent. This is probably because of survivorship bias, which refers to the exclusion of poor performing funds that shut down or are no longer included. The institute says it would be extremely hard for a fund manager to beat this performance without increasing leverage or investing in riskier assets.

One obvious anomaly in the index is the 8 per cent return achieved in the year ended March 31, a period covering the COVID-19 disruption to a range of infrastructure assets, including toll roads and airports.

EDHEC Risk Institute is proposing the government use its own Infra300 Index that covers 300 investments in 22 countries. It uses a bottom-up data collection strategy to capture a sample of unlisted infrastructure and include data on the latest transactions available in the secondary market.

The Infra300 Index returned less than 10 per cent post-fees over the past eight years and was negative in the year to March 31 because of COVID-19's impact on critical infrastructure assets.

The EDHEC index is offered free to super fund clients, whereas MSCI charges for the use of its indices.

MSCI was not immediately available for comment.

The federal government is going through a consultation process before adopting the MSCI index.

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# Rear Window

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### John Wylie farewelled at State Library of Victoria

Melbourne's great and good gathered at the State Library on Tuesday evening to farewell outgoing chairman (and Tanarra Capital founder) **John Wylie**, who is moving on after nine years.

Addressing the crowd, Wylie compared chairing the august institution with his former role heading the Melbourne Cricket Ground trust.

Both public venues offered a sense of belonging to all people, but "it's a bit like the difference between a Big Mac and slow-cooked lamb". The MCG obviously offered "instant gratification", while the Library, to repurpose **Paul Keating**, would "do you slowly".

Not that cricket was far from the freshly restored Queens Hall. Wylie's favourite innings during his tenure as SLV captain was clearly scoring a loan of The Ashes urn from the Marylebone Cricket Club in London for a three-month exhibition. Our spies lost count of how many mentions that particular coup scored.

Tanarra Capital founder John Wylie.

Another triumph: Wylie's shepherding of the $83 million renovation of the 165-year-old library, that triumphantly stayed open throughout the four-year construction job only to be cruelly forced to close four months later for the pandemic.

The renovation drew $28 million in donations from Melbourne's wealthy, and many of those donors were present on Tuesday, including **Maria** and **Allan Myers** QC, businesswoman and library board member **Christine Christian**, **Rupert** and **Annabel Myer**, and investment banker **Jane Hansen** and ex-Toll chief **Paul Little**. Liberal grandee **Charles Goode**, present with wife **Cornelia**, represented the Ian Potter Foundation, which kicked in $10 million.

Premier **Daniel Andrews** is still convalescing, but former premiers **John Brumby** and **Ted Baillieu** made up the deficit. mingling with the city's bookish and artistic types, including Miles Franklin winner **Alexis Wright**, Melbourne University vice-chancellor **Duncan Maskell**, La Trobe counterpart **John Dewar**, book-loving former judge **Graham Anderson** and wife **Anita**, Melbourne Recital Centre chairwoman **Andrea Hull**, NGV chair **Janet Whiting,** National Portrait Gallery director **Karen Quinlan**, businessman and former AFL chairman **Mike Fitzpatrick** and wife **Helen**, and philanthropist **Krystyna Campbell-Pretty**.

The evening gave little clue as to how

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