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Trusting executives

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One of the saddest consequences of the global financial crisis is the loss of public trust. Warren Buffett famously said that it takes 20 years to build a reputation and five minutes to ruin it. 2008 proved him right.

Public trust in financial markets and in business leaders has been shaken to its core as the scandals of years ago – Enron and WorldCom – have new bedfellows in Bernie Madoff and the Wall Street executives who received multi-million dollar bonuses even as they were losing investors' money. New Zealanders also saw millions of dollars wiped off their investments by finance sector executives now facing court hearings. These so-called business leaders are a deserved target for anger and disillusionment. They have won while others have lost; they have breached the relationship of trust which is important in every facet of life, but especially so when money is involved.

But it's important to remember that there remain many sound investments and many sound companies, run by good executive teams that are currently just caught up in the global economic storm.

Can we trust again and how do we know if an executive is worthy of our trust?

A good investor will, through experience, learn to know what to look for, know what to avoid, and know what makes an executive trustworthy. Global financial crisis or not, there will always be reliable executives. And tempting as it is right now, it would be wrong to lump all business executives into the same untrustworthy category.

I have met business executives over the years who I found to be untrustworthy, inconsistent, unrealistic ... call it what you will. But for every disappointment, I have found many more executives who communicated candidly and fully, enabling me to know what to expect and monitor their delivery against expectations. And that is what trust is about ... being able to verify that the information received can be relied on. It is also about being comfortable that the executive has the same interests as me and other shareholders, rather than being motivated by self-interest.

The most valuable business tool in our office is not our library of textbooks, but rather our files containing notes of all conversations and visits that we have had with our portfolio companies over the years. These notes give us a roadmap, a framework for each company and its management team that we can monitor. If a chief executive delivers what he said he would, when we met him six months ago, or two years ago, then we start to believe that he is sincere and can be trusted. If he demonstrates that his decisions are driven by a focus on shareholder value, rather than a desire to maximise personal reward, we can be fairly confident of his authenticity.

If he doesn't deliver because circumstances have conspired against him, we won't necessarily write him off. After all, if a company's sales have fallen, along with all its competitors, leading to lower-than-expected profits; does that make the chief executive untrustworthy or was his timing just out? If a company has had a superb relationship with its bank for many years, but due to a global credit crisis, the bank changes the rules and insists on tougher terms; does that



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mean the chief executive has mismanaged the company's capital or is he a victim of circumstance?

A good executive may make mistakes early on but if they learn from their mistakes they can go on to establish a track record of success. Mistakes shouldn't disrupt a trust relationship, but wilful decisions or actions that are not in the interests of shareholders are most certainly a trigger.

We don't trust readily. Trust, like respect, needs to be earned and we have built buffers into our investment process to protect us from being too trusting, too early.

For example, when we first invest in a company, we begin with a small holding, and then wait to see if the company is what we think it is. If we get it wrong, we can quickly move on without major impact. But if a company delivers to expectations, we can confidently build our position. Trust is fragile, and like a piece of china, once cracked is never the same. The public will be more wary in the future and executives will have to be more accountable and subject to more scrutiny, but is that such a bad thing?

The important thing is that ultimately, in time, trust will again be rewarded.

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