Munich Personal RePEc Archive

In Lombard we trust: The value of independent celebrity directors

Cardow, Andrew and Wilson, Willam

Massey University, Albany Auckland New Zealand,
MasseyUniversity,Albany Auckland New Zealand

21 August 2014

Online at https://mpra.ub.uni-muenchen.de/58111/
MPRA Paper No. 58111, posted 25 Aug 2014 10:51 UTC

In Lombard We Trust: The Value of Independent Celebrity Directors

Andrew Cardow

School of Management, Massey University Albany, Auckland New Zealand
a.cardow@massey.ac.nz*

William Wilson

School of Economics and Finance, Massey University Albany, Auckland New Zealand. w.r.wilson@massey.ac.nz

*corresponding author.

Abstract

Purpose –This paper addresses corporate governance issues around the use of celebrity independent directors in closely held financial institutions.

Design/methodology/approach – The authors employ the failure of Lombard Finance, a closely held New Zealand finance company to illustrate the agency conflict between directors, who were nominally independent, and outside debt holders. This approach is taken as New Zealand finance companies were unique in that they are predominantly closely held bank like firms who sourced the bulk of their funds from retail fixed term deposits.

Findings The research highlights the conflict inherent when utilising independent celebrity directors as spokespeople for closely held finance companies in a small loosely regulated market.

Originality/value This research contributes to the discussion surrounding independent celebrity directors and their influence in the collapse of closely held finance companies at a particular time in recent history.

Keywords Independent directors, finance companies New Zealand

Paper type – Research paper

Introduction

The New Zealand Government has for many years been a leading proponent of the light-handed regulation of financial institutions. New Zealand investors are solely responsible for their investment decisions, unable to rely on official government regulators/examiners or

the perverse crutch of deposit insurance[1]. Instead, armed with disclosure statements New Zealand investors are expected to apply market discipline to ensure the safety and soundness of their investments. Wilson, Rose & Pinfold (2012b) demonstrated New Zealand's disclosure regime in Registered Banks[2] worked well in moderating excessive risk taking, concluding that bank directors and managers applied self-discipline. However this was not the case in New Zealand finance companies[3], where Wilson (2009) judged disclosure to be of such a poor standard it was of little value. Further, Wilson, Rose & Pinfold (2012a) found some finance companies paid lip service to any code of corporate governance, as their boards were dominated by inside directors who appeared more concerned with their own investment than that of outsiders.

Unsurprisingly, New Zealand suffered a systemic failure of the finance company industry, with over 48% of its 200 finance companies failing since 2006. In all over $6 billion of depositor funds were placed at risk, the bulk of which came from unsophisticated retail investors. As a result funding to non-bank deposit-takers, from New Zealand residents, dropped from a high of $13.578 billion in June 2009 to $6.430 billion in June 2013 (RBNZ, 2013). This paper utilises the failure of Lombard Finance and Investments Ltd (this and the various other related companies are generically referred to in the remainder of the text as Lombard) in 2008, to examine issues of trust.

An unusual feature of the Lombard case was the high calibre or pubic profile of its board of directors, which on formation included three well respected former Ministers of the Crown, as directors[4]; Rt Hon Sir Douglas Graham, the Hon William Jefferies and the Hon Hugh Templeton[5]. Graham, Jefferies and Templeton would, at the time of appointment to the Lombard board have been ranked as among the most trustworthy of New Zealanders, due to

[1] In October 2008 the NZ government introduced a temporary deposit guarantee. This was not primarily designed to protect depositors but was justified by the perceived difficulty for NZ financial institutions to raise capital on international credit markets. The NZ government felt it was necessary to introduce the temporary deposit guarantee as the Australian government was intending to introduce a similar guarantee which would have disadvantaged NZ institutions.

[2] Financial institutions wishing to use the name "bank" in New Zealand must be Registered with the Reserve Bank and meet minimum prudential standards.

[3] NZ finance companies are unique in that the bulk of their funding comes from retail fixed term deposits called debentures.

[4] Lawrence Bryant was the fourth independent director, Alan Beddie was an executive director (Lombard Finance and Investments Ltd, 2002) and Michael Reeves joined the board in December 2002 (Phillips Fox Lawyers, 2002).

[5] Hugh Templeton resigned as a Lombard director 31 March 2007, a year before the Lombard receivership. As he was not charged by the FMA we make no comment on his actions.

their celebrity status and years of service to the New Zealand public. While other finance companies failed and some even had celebrity promoters[6], Lombard was the only one where the celebrity directors sat at the board table and despite their trustworthiness an agency conflict is evident between investors and directors. These directors were later charged under laws they had either played a part in drafting or subsequently applied as Ministers of the Crown. The question posed in this paper is; what, if any, value did these *independent and celebrity* directors bring to investors in Lombard?

Literature

Trust is paramount in business transactions and there is an extensive strand of academic literature examining the concept of independent and celebrity directors. The following review identifies those aspects of the literature that are relevant in the discussion relating to the failure of Lombard. Court documents, from the trials of the Lombard directors, along with required disclosure documents published by Lombard and its parent company are used to identify how investor trust was abused at Lombard. The actions of Lombard directors are linked to relevant literature regarding celebrity and independent directors. The findings from this investigation into the actions of the Lombard directors are presented in the conclusion and should guide future policy making around the nature of independent directors. As part of the discussion, questions regarding agency conflict apparent in the board representation of closely held public companies are raised. Ultimately, investors need to realise that directors are likely to put their own interests first and as we shall describe, regulations need to be strengthened regarding the nature of independent directors in closely held public companies.

The directors of Lombard attempted to differentiate themselves from other finance companies on the basis of the composition of their board. For example in a DVD Lombard released in 2006, a great deal of the 11 minute presentation is given over to expressing the independent nature of the non-executive directors and their previous backgrounds. Directors, Hugh Templeton, William Jefferies and Douglas Graham were all well-known at the time as ex Ministers of the Crown. Both Jeffries and Graham had served as Ministers of Justice,

[6] Provincial Finance who failed in 2006 was endorsed by, ex-all black rugby player, Colin (Pinetree) Meads and Hanover Finance who failed in 2008 used Richard Long, a well-respected television news reader, to promote its products.

albeit for two different regimes[7], these past positions were enough to engender some degree of trust in the minds of perspective investors (Tantiseneepony, Gorton, & White, 2012).

Traditionally, the celebrity endorser was drawn from the arena of popular culture. They included such people as actors, singers, sports personalities or well-known spokespeople. In short they were, as McCracken (1989, p. 310) in his seminal work on celebrity endorsement stated, “A person who is known and enjoys wide public recognition”. The power of the celebrity endorser relies on the twin aspects of high public recognition in the mind of the receiver – described as the concept, transference of meaning (Halonen-Knight & Hurmerinta, 2010; McCraken, 1989). Transference of meaning is the key attribute for an organisation expecting to utilise the ‘power’ of a celebrity endorser. McCracken (1989) outlined the minimum criteria for a successful celebrity endorsement campaign. They are credibility, trust, and recognition, all attributes which played a part in investment decisions made by Lombard investors. These are critical attributes as they distinguished Lombard from the other 200 finance companies asking the public for deposits. These attributes, are illustrated when discussing the events surrounding the growth and collapse of Lombard. In particular we concentrate on the relationship between investors and the personalities of Doug Graham and to a lesser extent William Jeffries and their involvement as independent directors with Lombard.

An effective meaning transfer takes place when the public recognises important aspects in the endorser. The first of these is source credibility. In essence this is the impression that the endorser is seen as a person who has a high level of expertise and experience in the area being endorsed (Tantiseneepony et al., 2012). In addition the endorser is seen to be trustworthy in relation to the statements being made about the product. Finally the endorser needs to embody aspects that the viewer recognises in themselves (McCraken, 1989).The aim in the use of a celebrity endorser is to build confidence in the mind of the public and impart an aspirational feeling in their mind. To this end the organisation utilising the endorser is attempting to transfer the positive ‘meaning’ the endorser brings onto the product or service being promoted (Bryne, Whitehead, & Breen, 2003)

For success, the choice of endorser is therefore a significant marketing decision that needs to be made. This decision will reflect the type of image that the organisation wants to

[7] Jeffries served as a Labour Minister of Justice while Graham was a Minister in a National party cabinet.

project. In particular the organisation will be seeking to reflect an archetype (Campbell, 1949), which can be easily identified by the viewer. For example the producers of a cooking show indicate the type of audience they are after by their selection of say, Jamie Oliver, Gordon Ramsay or Nigella Lawson as their chef. A concrete example of how the above discussion was played out in New Zealand, was the choice of Kevin Milne, a well-known "consumer champion" as a spokesperson for The Carpet Mill, a manufacturer of carpet. Mr Milne has source credibility based upon his long career as a consumer advocate in New Zealand. This has ensured he is known and respected as a person given to making 'objective' reviews of consumer products and with a history of 'standing up' for the common person. The two examples we have mentioned have arguably come from popular culture; a television journalist and accepted celebrity chefs. However we argue that celebrity endorsement has moved outside of popular culture and in respect of Lombard now includes the past politician as a celebrity endorser. Politicians have of course been long standing patrons of one cause or another.

The main difference between celebrity directors and political patrons rests in payment. The public fully expects that a sports person or entertainer is being paid for his or her endorsement. Indeed at times this has caused a conflict with the personality and the product. One such example is the Chef Jamie Oliver who endorses farmed salmon while declaring that farmed salmon are not as desirable wild salmon. However, in many instances a politician will ensure that their name is 'lent' without any expectation of direct financial reward, instead they are seen as 'independent' albeit celebrity voices.

So far we have briefly outlined the suggested attributes of a celebrity endorser. As it will become clear celebrity endorsement was only one aspect of the Lombard case that will be discussed. The second aspect that will be discussed is that of the independent director and the role of the board in the governance of Lombard. Early in the 21st Century, commentary on the composition of boards and the propensity for investors to value prestige of the individuals concerned in the governance of the organisation was raised by Certo (2003). In his article Certo (2003) demonstrated a wide favourable public perception of an individual was one of the deciding aspects for future investment; particularly in a new business.

In the following discussion we move to the question of independent directors and how the independent directors of Lombard while trading on their celebrity status were able to assert "independence" from Lombard. We explain how Graham and Jeffries, apart from being seen by investors as celebrity endorsers, were also independent directors of Lombard.

However unknown to most investors these independent directors were also shareholders of Lombard with Graham for instance holding around 4% of the equity of Lombard. Although they were technically and within the law 'independent' as they each held less than 5% a great deal of the future wealth of Graham and Jeffries appeared to rest with the future success of Lombard. New Zealand Institute of Directors defines independent directors as fulfilling the following criteria. "*Independent means independent of management and free from any business or other relationship or circumstance that could materially interfere with the exercise of a director's independent judgment*" (NZID Staff, 2014).

In addition the New Zealand Stock Exchange describes the nature of an independent director as being "*a director who is not an executive of the company and who has no disqualifying relationship. A disqualifying relationship means any direct or indirect interest or relationship that could reasonably influence, in a material way, the director's decisions in relation to the company*" (Staff NZX Ltd, 2014). The New Zealand Institute of Directors further clarifies the definition of independent director as being someone who has a "*substantial interest*", that is over 5% of the issued stock. (NZID Staff, 2014). Substantial interest is further explained as being such that the director is likely to derive in the current company year a substantial portion of his or her annual revenue as a result of his or her interest in the company.

One of the purposes of a board, and in particular the use of independent directors, is to attempt to overcome the agency effects of having a governance body that has a strong material tie to the organisation. In the case of Lombard as we demonstrate, the organisation goes to some effort to explain that the majority of the board is independent. However it is apparent that prior to the back door listing on the NZX all shares in the company were held by board members – both executive and independent. Debt investors in Lombard would have been unaware the independent directors of Lombard had purchased shares in Lombard, for one cent each, from March 2003 as it was not disclosed in earlier prospectuses (Lombard Group Ltd, 2006b).

Such a claim reflects recent research regarding independent directors and the potential for agency conflict. For example Persons, (2012) found that when an independent director is rewarded in stock options then they are more likely to place a higher emphasis on short term, rather than strategic goals for the company. In addition the existence of stock options for independent directors leads to less questioning of high risk activity by company management (Persons, 2012, p. 56). A more concerning result of Person's work, and one that has some

relevance for the current discussion, was an independent director primarily compensated with stock options was more likely to engage in fraudulent reporting in regards to the company (Persons, 2012, p. 60). Although the independent directors in Lombard did not hold stock options they did only pay one cent for shares nominally valued at one dollar and did stand to gain large benefits if their decisions in 2006 to 2008 were ultimately successful.

The issue to be considered in the Lombard case is one of perception. The role of the independent director is to provide a check on the management of the company. Their role is to provide governance, oversight and ensure that the management of the company act in the best interests of the shareholders. However, the Lombard Trust Deed and various Prospectuses resulted in an explicit fiduciary duty to the Lombard trustee and all depositors. Such a role could be difficult if the board is also comprised of shareholders. There is also the tacit intent that independent directors specifically, would question the actions of the company management. In the Lombard case as we outline, there was perhaps a tendency to concentrate on immediate returns at the expense of long term strategic goals of the organisation. A particularly worrying tendency in an organisation that made specific mention of the benefits that could be derived though long term investment in Lombard.

Throughout our discussion of Lombard investment we demonstrate how the independent directors, Doug Graham and William Jeffries embody the attributes of celebrity endorsers and will illustrate that a transfer of meaning took place that encouraged a feeling of trustworthiness in minds of prospective investors. In addition statements made by Graham in a promotional DVD could be seen as celebrity endorsement.

The method utilised to examine the phenomenon of how independent celebrity directors can have an effect on investor's impressions of security is essentially through a case study examination of Lombard investments from the inception of the company to the eventual collapse and court action that followed. Lombard was chosen as the vehicle due to meeting a number of criteria. Although Lombard was only one of 200 finance companies that failed since 2006 it was the only one that was actively trading on the high profile of the directors. In addition Lombard was one of the few finance companies that were making a virtue of the independent nature of the majority of the directors. In relating the action that is outlined in the discussion we have ensured that the adopted methods used to place the stated experiences of the individuals have been placed within a bounded context. In this respect a story, their story, including court transcripts, emails and publicity material can be read and bounded by a number of constraints. One such constraint is the time frame; all the

information gathered relates to a period of time when property based finance companies were very popular in New Zealand. The period also relates to the time when Sir Doug Graham was highly regarded as an ‘elder’ statesman in New Zealand. Another constraint is an organisational constraint. That is all the activity relates only to the property investment market. By placing the case within such a time and context boundary it allows for examination of the specific case rather than an assumption of generality. This was deemed necessary in order to provide a common context for the resulting discussion. Following (Czarniawska-Joerges) (1998), such an approach allows for time and place comparisons that provide a theoretical framework from which the words gathered could be interpreted.

The resulting discourses, drawn from the court documents publicity material and email communications are stories constructed by our interpretation of the stated words, which when placed alongside extant literature provide a vehicle for the application of an interpretive lens, an alternative interpretation which results in a vertical, rather than a more traditional horizontal, interpretation of the text (Monin & Monin, 2003). A vertical interpretation attempts to gain an understanding of the subtext. The subtext is a situation which can be considered as plausible but that has not been expressly stated. In effect we are applying a critical discourse method in interpretation of the case. The critical discourse method adopted therefore, aims, in essence to convert the subtext to text, in other words making the implicit, explicit. In this way the analytical discourse method adopted aims to assist the reader in locating the underlying ideological premises that have helped shape the investors perception of ‘safety’ or ‘security’.

The individual investors and Directors could be considered part of the New Zealand ‘middle class’ and being involved in a property investment company was a part of their social reality of the time (Carr, 2000). Finally, the above approach was chosen as it aims, above all, to establish plausibility. In this regard the method chosen provides a mechanism by which action within a defined institution may be interpreted and understood. It is the means by which we as and the interpreter and the reader, as the viewer, may make sense of the investors’ world. In presenting the discourses that follow it is intended to illustrate how the actions of the Directors, in particular Graham has had a significant influence upon the desires of individuals to invest with Lombard investments. The words used in the publicity material of Lombard and the words the Judge used to describe such publicity material are grounded in the impressions that a researcher or interested reader may gain from either applying their own interpretations or accepting the researcher’s interpretation of reality. It is a process of

discovery (Glaser & Strauss, 1999, p. 23). In addition, in conducting this research we are following the theories of Ragin (1987), Walton (1993), Montuori & Purser (1995) and Eisenhardt (1989) in that a case can also be seen in terms individual actors who, when placed into an organisational or institutional setting, form a case of a firm, or of an historical event.

Further, the use of case methods in this study is considered appropriate, in that the reader can trace, through the discussion that follows possible justifications for the actions of the investors and Directors in the story(Schatzman & Strauss., 1973, p. 110). In addition it is intended that the method adopted will allow the reader to identify the connecting links that have enabled us to build the discussion that illustrates the participants' beliefs. The adoption of the case study method is therefore, by its very nature, an attempt to understand the individuals within the particular bounded social setting.

Lombard Investments Limited

Lombard Finance and Investment was first established in 2002 and began taking deposits from the public when its first prospectus was registered at the end of November 2002. Their initial prospectus (Lombard Finance and Investments Ltd, 2002) called for $25 million of secured and unsecured debt. No information was given as to the ownership[8] of Lombard but directors were listed as Graham, Templeton, Jefferies, Bryant and Beddie. The first three being former politicians while business experience was provided by Bryant and Beddie., Byrant had 10 years as CEO of a UK listed company, while executive director Beddie had 30 years with the National Bank before he established his own consultancy business in 1997 (Lombard Finance and Investments Ltd, 2002). As Lombard was newly established no financial history could be given, though as required, a summary of trust deed provisions was provided.

[8] Ownership details were available from the Companies Office Register which shows the sole owner to be Solomon Nominees Ltd (Phillips Fox, 2002).

Table 1 - Lombard Summary of financial statements

	Year	Year	Year	Year	Year
	ended 31	ended 31	ended 31	ended 31	ended 31
	Mar-07	Mar-06	Mar-05	Mar-04	Mar-03
	$000	$000	$000	$000	$000
Total operating revenue	32,678	27,369	24,889	9,940	706
Interest expense	16,046	15,488	11,744	5,702	279
Other expense	7,931	6,942	5,924	3,368	520
Net Surplus (deficit) before	8,701	4,939	7,221	870	(93)
taxation	2,866	1,700	2,634	390	-
Income tax					
Surplus (deficit) retained at end	5,835	3,239	4,587	480	(93)
of period					
Total Assets	188,566	194,715	165,543	99,005	23,949
Total Tangible Assets	188,066	194,215	165,543	99,005	23,949
Total Liabilities	164,537	179,732	159,732	98,118	23,542
Total Equity	24,029	14,983	6,016	887	407

Note: Total Equity includes Capital Noted of $8.039 million in FYE 2007 and $5.128 million in FYE 2006.
Source : (Lombard Finance and Investments Ltd, 2007a)

The initial offer was extended in February 2003 when an amended prospectus was issued calling for $50 million of deposits (Lombard Finance and Investments Ltd, 2003a). This amendment also added Michael Reeves as a second executive, but contained no further financial information. Its first published financial information was in May 2003 (Lombard Finance and Investments Ltd, 2003b). This shows Lombard was able to easily attract investors and was growing rapidly. Its financial statements (summarised in Table 1) show that by the end of March 2003 its liabilities had grown to $23.5 million. Over the next four years liabilities grew to $164.5 million. This was supported on an initial equity investment of $500 thousand which was subsequently bolstered by retained earnings of $8.213 million in prior years and a surplus of $5.835 million in the 2008 year till December (Lombard Finance and Investments Ltd, 2007b). Coincidentally, $500 thousand was used to purchase the Lombard Trademark from Meridian Capital (Lombard Finance and Investments Ltd, 2006). This was a reported as a related party transaction as Michael Reeves was a director of both companies.

Following their early success the directors of Lombard sought a listing on the NZ Stock Exchange (NZX), which they achieved in December 2005 via a reverse takeover of NZX listed Pure New Zealand Ltd (PUR) (Lombard Group Ltd, 2006a). PUR owned interests

in various other companies, but by 2005 these had all been either struck off or sold, leaving only the Greater Bendigo Gold Co (GBG) as the only asset with any potential value (Pure New Zealand Ltd, 2005). Difficulties at PUR were resolved by the reverse takeover of Lombard. In this transaction PUR acquired Lombard by issuing two billion shares at 2.5 cents each to Lombard's owners. This transaction was registered with the New Zealand Companies Office on June 26 and shows Lombard Group Ltd was the new owner of 50 million shares in Lombard previously owned by Templeton (1.5 million shares), Bryant (2 million shares), Graham (2.5 million shares), Solomon Nominees Ltd[9] (42 million shares) and Jefferies (2 million shares) (Lombard Group, 2006). As part of the reverse takeover by PUR, all other existing assets of PUR (including GBG) were sold for $500 thousand, with 2 years deferred payment, to a new company which was 51.8% owned by Ian Wilson Smith (the Chairman of PUR) and 48.2% held by PUR to be distributed on a pro rata basis to PUR shareholders at the time the transaction was approved (Pure New Zealand Ltd, 2005).

Following the listing as Lombard Group Ltd, shares in the new entity traded in the range of 1 to 3 cents each, until there was a 100% share consolidation in June 2007. After which they began trading at $2.10 before falling to 11 cents per share when its main subsidiary Lombard Finance and Investments Ltd was placed in receivership on April 11 2008. Prior to the listing of Lombard Group on the NZX it was not possible to determine the ownership of Lombard

Although the company was a second tier lender they did not offer extreme levels of return to the investor. Comparing interest rates in archive data from interest.co.nz show interest rates for Lombard from 2004 to 2006 were only 2.5% higher than New Zealand's largest registered bank ANZ. Lombard's interest rate along with other New Zealand finance companies rose in 2007 to give a 3.5% premium over bank rates (probably in response to the collapse of Bridgecorp Finance in 2007 see (W.R. Wilson et al., 2012a) for background on the collapse of Bridgecorp).

[9] It is not possible to determine the beneficial owner of these shares though in 2006, in its annual report, Michael Reeves is reported to have a joint ownership of 65% of Lombard Group Ltd (Lombard Group Ltd, 2006a).

Table 2 Lombard & ANZ Bank selected deposit rates

	December 04	December 05	December 06	December 07	April 4 2008
Lombard	8.75%	9.6%	8.5%	9.75%	10.2%
ANZ	6.1%	6.1%	6.1%	6.1%	6.1%

Source: interest.co.nz

Like Bridgecorp, a great deal of Lombard investments was in residential property. At the time of their collapse the loans book of Lombard Investments comprised over 96% property (Fisk & Waller, 2008). Lombard initially solicited investments through print and television media. However by 2006 Lombard investments limited had become more sophisticated in soliciting funds from the public and, along with their prospectus documents and public presentations in mid-range hotels, had also released a DVD which explained the background of the company. The Directors denied in court that the DVD constituted an advertisement. The DVD opens with the following words in white on a black background.

> "*Lombard is about people, the people involved in our governance, management and team are all committed to the people who entrust their investments to Lombard*". (Lombard Finance Staff, 2006)

From the beginning of the DVD it is clear that Lombard is utilising the DVD as an advertisement and is attempting to utilise the past experience of the high profile directors in such a way as to secure trust. In addition it is also clear that from the beginning, Lombard Investments Limited was a closely held company.

Discussion

The initial appeal Lombard had for investors may have been the past experience of the ex-cabinet ministers – two Justice Ministers and one Finance Minister – on the board of Lombard. Certainly this theme is reinforced within the previously mentioned publicity DVD, with one investor telling the viewer "*when I read about the board of directors I knew the names from my business life and dealings with foreign affairs. I knew the names and trusted them*". Another client said "*I thought the background of the Directors was better than most* [finance company directors]". These two comments reflect the concept of source credibility as outlined by McCracken (1989). It is also telling that within the DVD, the Chairman of the board, Douglas Graham casually mentions "*while at the same time* [as a cabinet minister] *I was responsible for all of the company law reforms and Financial Reporting Act and matters of that kind ...I have a reasonable grasp of what the rules around that are*". This is an

interesting statement for Graham to make, as he is clearly suggesting that he has both the credibility to be a director and that he is aware of the role of a director. Yet during the court case that followed the collapse of Lombard the directors suggested that they relied on the information given to them by the management. Such an assumption goes against the purpose of having a board in the first place. For example Hoitash (2011) writing in the Journal of Business Ethics clearly states that the role of the independent director in particular is to be a check on the management of the organisation (Hoitash, 2011, p. 400). Dobson J appears to agree as he had this to say regarding such reliance "Directors are appointed to exercise judgement and that extends to testing the competence of management within areas in which managers are relied upon" (Justice Dobson, 2012 para 35). It would appear on the face of it that Justice Dobson at least understood the purpose of a board was to provide oversight and give direction, not the other way around. Other examples of celebrity and an apparent lack of independence from the Directors appear when viewing the DVD.

Throughout the DVD the words "trust" and "experience" appear often. These words are spoken by both the Directors and the current investors. Again this assists in the construction of the ex-cabinet ministers performing the role of an archetype (Campbell, 1949). In this case they can be described as archetypical celebrity endorsers in that they fulfil the various elements of celebrity endorsement as suggested by McCracken (1989). Although there are only two sets of customers that appear on the DVD both sets give credence to the argument that the public reputation of the Directors a primary reason for investing. Finally to reinforce the assumption that Doug Graham (in particular) was acting in the style of a celebrity endorser is evidence from the fraud trial of the Lombard directors. During the trial one witness suggests that it was Doug Graham, the personality, which encouraged them to invest in Lombard. More recently the Greens[10] of Wellington provided us with the following reasons for investing with Lombard

> "*We started investing in Lombard in 2006, in their Capital Notes, we realise we were taking extra risk but felt easy with Mr Grahams*[sic] *summary at the front of the prospectus. His final comment, I commend investing in Lombard Finance to you.[sic] When Bridgecorp collapsed we rang Lombards* [sic] *and were told that there was absolutely no chance it would happen to them,* [that is the risk of collapse] *as their portfolio was quiet[sic] different and we were at no possible risk. Also at this time their name was on the start of a very good TV program screening at 8.30 on a Sunday night*."

[10] Not their real name. Original source document is retained with the authors.

Notably in the sentencing notes of Justice Dobson, in the High Court of Wellington the following remarks are made in respect of Graham and Jeffries.

> "[57] There is no doubt that those good reputations have been relied on by Lombard as a powerful tool in soliciting funds from investors. Sir Douglas, I am satisfied that your reputation was a very important, and possibly the single most important, factor relied upon by investors in Lombard. That is consistently demonstrated by the terms of the offer documents, incidentally by the DVD, by the witness statements admitted without challenge, and by the victim impact statements. The comfort that investors could rely on you was supplemented to a material extent by the additional assurance from the presence of Mr Jeffries on the Board". (Justice Dobson, 2012 para 55 & 57)

For the Greens and other unnamed witnesses who gave evidence at the fraud trial of Graham and Jeffries, the very inclusion of Graham as an independent director on the board of Lombard, and the fact that Lombard was sponsoring a "good" television show was all the endorsement they needed to invest. During the court case it becomes clear that Graham in particular has been seen by some of the investors as both an 'endorser' for the company and clearly identified as a prime mover within the company. The transcript below raises questions of agency when an independent director stands to substantially benefit from the future earnings of the company. Again from Justice Dobson.

> [55] In addition to these statements, the parties agreed pursuant to s 9(2) of the Evidence Act 2006 on the admission of facts relating to the circumstances of another couple who were actual or potential investors in LFIL and who attended a presentation at the Crowne Plaza Hotel in Christchurch in September 2007. That couple recalls Sir Douglas Graham as the main speaker being supported by senior management of LFIL and they recall Sir Douglas speaking very positively about LFIL. Promotional materials available included copies of the DVD.

It is a recognised concept that the role of the board of directors is to provide oversight and governance to the organisation (Boulton, 1978; Kosnik, 1987, p. 163). In many cases an organisation will ensure that the board is comprised of 'independent' directors in an attempt to overcome possible agency conflicts that may arise. However, at least one recent publication has questioned the truly independent nature of 'independent' directors (Misangyi & Archarya, 2014). Instead they suggest the predominance of independent directors has more to do with legitimacy concerns. In this regard they are positing an institutional reason for the growth of independent directors on boards. Regardless of independent, Executive or non-executive Directors their role remains the same, as pointed out in a New Zealand Financial

Markets Authority publication for Directors. “Directors direct, managers manage. That is the essential difference between governance and management” (NZID Staff, 2014, p. 4). Whilst the shareholding of Graham and Jeffries was not a substantial amount, it is arguable that they stood to derive a substantial portion of their *future* personal wealth from the activities of Lombard. Given this, perhaps the rules regarding the nature of independent directors need to be revised.

Such a suggestion is made on the basis of the following evidence presented at the trial of Graham and Jeffries. “The minutes of LFIL’s Board meeting on 26 September 2007 report the CEO (Mr Reeves) as: express[ing] his concern at the future viability of finance companies which relied on funding from the issue of debenture stock. He said that he believed the lack of investor confidence following the failure of so many finance companies over the past 12 months was serious and unlikely to be restored for some time…” (R v Graham Reeves Jeffries 2012) Yet Lombard continued to solicit deposits into 2008 and continued to persuade investors that there were no concerns with company. As late as March 2008 as the following excerpt claims, potential investors were being given the DVD which featured Graham, Jeffries and Reeves all suggesting the solid and firm nature of the business.

> [53] Evidence for the Crown included statements from six investors in LFIL. Mrs Hooker of Hamilton gave evidence but was not cross-examined. She had decided in March 2008 not to renew an investment in LFIL debenture stock when it matured. She was contacted by an LFIL employee in early March 2008 and was persuaded to change her mind, thereafter renewing her investment with LFIL. She projected that she would earn $300 more per annum on her $30,000 re-invested with LFIL than if it was invested as a term deposit with Kiwibank. In the course of her dealings with LFIL in early March 2008, she requested and was sent copies of the DVD, which is the subject of count five, and the investment statement for secured debenture stock.

Conclusions

Lombard didn’t fail because its directors issued an untrue prospectus at the end of 2007. The only investors who suffered from this were those who invested or re-invested in the period from December 24 2007 and April 1 2008. This amounted to $10.45 million of which $1.7 million was new investments (High Court of New Zealand, 2012). Draft and unaudited financial published in the receivers’ first report give total liabilities of $127.257 million on 31 March (Fisk & Waller, 2008). With the value of hindsight, these deposits were probably at risk from the day they were first made. The receivers’ most recent report (13th) on the affairs of Lombard reports payments of 22 cents in the dollar to 3,900 secured debenture holders, with the receivers now believing the final return to secured debenture holders will be

24% to 25% (Fisk & McCloy, 2014). As the balance of secured debentures was $111 million as at 10 April 2008 (Fisk & Waller, 2008) this quantifies the cost of the agency issue at Lombard between directors and investors at $83 million.

Losses at Lombard can be attributed to a number of factors; some of which the directors of Lombard could argue were beyond their control, such as significant change in the commercial and residential property market which occurred in 2006 and 2007. Even if a deteriorating property market was beyond the control of directors, they still had a responsibility to disclose this material change to investors in their prospectus. For effective market discipline, investors, disclosure statements such as prospectuses need to be truthful and not misleading. The directors of Lombard appear to have buried their heads in the sand, believing they could weather a declining property market. They were wrong.

However, other, controllable factors such as the ‘independent’ nature of the directors are worth considering as causes of the collapse, especially in a closely held business such as Lombard. There has been a growing trend for an increase in the number of independent directors on all boards (Hoitash, 2011). Indeed the latest listing rules for the New Zealand stock exchange call for half the board in their new “high risk” market to be independent. However independent directors are not a panacea for all ills. Independent directors need to bring transferable skills, which add value to the firm. In the case of Lombard, questions can be asked as to the degree of independence of the independent directors, and the applicability of their skill sets to financial decision making. While they were judged independent if one follows the guidelines of the NZID or the NZX it was not until the backdoor NZX listing of Lombard occurred that investors would have been aware the independent directors of Lombard had an ownership interest in the firm. While a 3% or 4% is below the suggested independence threshold of 5% it could have resulted in a considerable increase in the personal wealth of Lombard’s directors if Lombard had ultimately been successful.

However there were also some fundamental reasons why Lombard may have failed. They include a lack of equity. Lombard was established with $500 thousand of paid in capital and while questions remain regarding the purchase of the Lombard name from Meridian Capital, controlled by Reeves, for $500 thousand the bigger question is if 10% capital is sufficient for a property financier. The lack of diversification in the loan book could also be a further contributing factor to collapse. As previously mentioned 96% of their assets were in their property loan book and only a few had first ranking security. Finally the majority of loans made by Lombard were interest only which although Lombard was reporting profits

from its second year of operation very little of this was represented as cash in their financial statements. As result retained earning which were added to their equity to bring it to the required 10% level did not eventuate.

Ultimately, questions remaining unanswered are; did the independent directors have so much of their personal wealth invested in Lombard Group shares that they were not making decisions in the best interests of Lombard or its stakeholders, most of who had more invested than the independent directors. What if any value did these *independent and celebrity* directors bring to investors in Lombard?

References

Boulton, R. (1978). The evolving board: A look at the board's changing roles and information need. *Academy of Management Review, Oct*, 827-836.

Bryne, A., Whitehead, M., & Breen, S. (2003). The naked truth of celebrity endorsement. *British Food Journal, 105*(4/5), 288-296.

Campbell, J. (1949). *The Hero With A Thousand Faces*. New York: Pantheon Books.

Carr, A. (2000). Critical theory and the management of change in organisations. *Journal of Organisational Change Management, 13*(3), 208-220.

Certo, S. (2003). Influencing initial public offering investors with prestige: Signalling with board structures. *Academy of Management Review, 28*(3), 432-466.

Czarniawska-Joerges, B. (1998). *A narrative approach to organization studies / by Barbara Czarniawska*: Thousand Oaks, Calif. : Sage Publications, c1998.

Eisenhardt, K. M. (1989). Building theories from case study research. *Academy of Management Review, 14*(4), 532-550.

Fisk, J. H. F., & McCloy, C. (2014). Receivers' Thirteenth Report on the State of Affairs of Lombard Finance & Investments Limited. In PricewaterhouseCoopers (Ed.). Wellington: NZ Companies Office.

Fisk, J. H. F., & Waller, J. A. (2008). Receivers' First Report on the State of Affairs of Lombard Finance & Investments Limited. In PricewaterhouseCoopers (Ed.). Wellington: NZ Companies Office.

Glaser, B. G., & Strauss, A. L. (1999). *The discovery of grounded theory : strategies for qualitative research / Barney G. Glaser and Anselm L. Strauss*: New York : Aldine de Gruyter, c1999.

Halonen-Knight, E., & Hurmerinta, L. (2010). Who endorses whom? Meanings and transfer in celebrity endorsement. *Journal of Product and Brand Management, 19*(6), 452-460.

High Court of New Zealand. (2012). The Queen v Douglas Arthur Montrose Graham, Michael Howard Reeves, William Patrick Jeffries and Lawrence Roland Valpy Bryant *Sentencing Notes of Dobson J.* (Vol. NZHC 575). Wellington: Registry.

Hoitash, V. (2011). Should Independent Board Members With Social Ties to Management Disqualify Themselves From Serving on the Board. *Journal of Business Ethics, 99*, 399-423.

Justice Dobson. (2012). The Queen V Douglas Arthur Montrose Graham, Michael Howard Reeve, William Patrick Jeffries, Lawrence Roland Valpy Bryan. In H. C. o. N. Zealand (Ed.), *Reasons for Verdicts of Dobson J.*

R v GRAHAM (Vol. HC WN CRI-2010-085-2538). Wellington.
Kosnik, R. (1987). Greenmail: A study of board performance in corporate governance. *Administrative Sciences Quarterly, 32*, 163-185.
Lombard Finance and Investments Ltd. (2002). Lombard Finance and Investments Ltd Prospectus. Wellington: NZ Companies Office.
Lombard Finance and Investments Ltd. (2003a). Lombard Finance and Investments Ltd Ammended Prospectus.
Lombard Finance and Investments Ltd. (2003b). Lombard Finance and Investments Ltd Prospectus.
Lombard Finance and Investments Ltd. (2006). Lombard Finance and Investments Ltd Prospectus Wellington: NZ Companies Office.
Lombard Finance and Investments Ltd. (2007a). Lombard Finance and Investments Ltd Prospectus Wellington: NZ Companies Office.
Lombard Finance and Investments Ltd. (2007b). Lombard Finance and Investments Ltd Prospectus Extension. Wellington: NZ Companies Office.
Lombard Finance Staff (Writer) & Lombard Finance and Investments Ltd (Director). (2006). Lombard Meet the People DVD. New Zealand.
Lombard Group. (2006). Particulars of Shareholding. Wellington: Companies Office.
Lombard Group Ltd. (2006a). Annual Report. Wellington: NZX.
Lombard Group Ltd. (2006b). Prospectus for the Offer of 350,000,000 Ordinary Shares. Wellington: Companies Office.
McCraken, G. (1989). Who is the celebrity endorser? Foundations of the endorsement process. *Journal of Consumer Research, 16*, 310-321.
Misangyi, V., & Archarya, A. (2014). Substitutes or complements; a configurational examination of corporate governance mechanisms
Academy of Management Journal, (in press) ACAD MANAGE. doi: 0.5465/amj.2012.0728
Monin, N., & Monin, J. (2003). Re-navigating management theory: steering by the star of Mary Follet. In B. Czarniawska & P. Gagliardi (Eds.), *Narratives We Organize By*. Amsterdam: John Benjamins.
Montuori, A., & Purser, R. E. (1995). Deconstructing the lone genius myth: Toward a contextual view of creativity. *Journal of Humanistic Psychology, 35*(3), 69-112.
NZID Staff. (2014). A Directors guide . Wellington: New Zealand Institute of Directors.
Persons, O. (2012). Stock options and cash compensation of independent directors and likelihood of fraudulent financial reporting. *Journal of Business and Economic Studies, 18*(1), 54- 74.
Phillips Fox. (2002). Consent of a Shareholder. Wellington: Companies Office.
Phillips Fox Lawyers. (2002). Consent and certificate of Director or Directors. Wellington: NZ Companies Office.
Pure New Zealand Ltd. (2005). Annual Report. Wellington: NZX.
Ragin, C. (1987). *The Comparative Method*. Berkley: University of Southern California.
RBNZ. (2013). T1 Non-bank lending institutions: Balance sheet. Retrieved 11 November, 2013, from http://www.rbnz.govt.nz/statistics/tables/t1/
Schatzman, L., & Strauss., A. (1973). *Field Research Strategies for a Natural Sociology*. Englewood Cliffs: Prentice Hall.
Staff NZX Ltd. (2014). Main board/Debt market listing rules. . Retrieved April, 2014, from https://www.nzx.com/market-regulation/rules/nzsx-and-nzdx-listing-rules
Tantiseneepony, N., Gorton, M., & White, J. (2012). Evaluating responses to celebrity endorsements using projective techniques. *Qualitative Market Research, 15*(1), 57-69.
Walton, J. (1993). Making the theoretical case. In C. Ragin, and Becker, H. (Ed.), *Exploring the Foundations of Social Inquiry*. Cambridge: University of Cambridge.

Wilson, W. R. (2009). *New Zealand's Experiment with Prudential Regulation: Can Disclosure Discipline Moderate Excessive Risk Taking in New Zealand Deposit Taking Institutions? PhD Dissertation.* PhD, Massey University, North Shore City.

Wilson, W. R., Rose, L. C., & Pinfold, J. F. (2012a). Best Practice Corporate Governance? The Failure of Bridgecorp Finance Ltd. In Mayes David & Wood Geoffrey (Eds.), *Reforming the Governance of the Financial Sector* (pp. 80-106). London: Routledge International Studies in Money and Banking.

Wilson, W. R., Rose, L. C., & Pinfold, J. F. (2012b). Moderating risk in New Zealand retail banks: Disclosure as an alternative regulatory regime. *J Bank Regulation, 13*(1), 4-23.