In Lombard We Trust: The Value of Independent Celebrity Directors

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Introduction

New Zealand has for many years been a 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 bank and non-bank depositors are expected to apply market discipline to ensure the safety and soundness of their deposits. 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 quality 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 (NBDTs), from New Zealand residents, dropped from a high of \$13.578 billion in June 2009 to \$6.430 billion in June 2013 (RBNZ, 2013). The failure of finance companies in New Zealand began prior to the global financial crisis (GFC) and continued after the GFC. While New Zealand finance companies felt the impact of the GFC; the GFC was not the cause of the collapse of the New Zealand finance company industry. This paper utilises the failure of Lombard Finance and Investments Ltd (this

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[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.

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 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. Agency conflicts are common in business, normally occurring between managers and shareholders. In financial institutions depositors, who don't have representation at the board, are able to free-ride on agency protections enjoyed by shareholders. What was unknown to depositors, when Lombard was first formed, was all the shareholders of Lombard were also board members of Lombard. This resulted in a significant agency issue for Lombard depositors.

The remainder of this paper includes a brief literature review looking at three areas; agency conflict in financial institutions, the benefits of independent directors and lastly the use of celebrities as directors. The following discussion utilises public disclosure documents, receivers' reports along with Court documents from the trials of Lombard directors, to detail events at Lombard from its formation in 2002 to its collapse in 2008. Throughout the discussion these events involve agency issues and highlight the actions of Lombard's celebrity and independent directors. The question posed in this paper is; what, if any, value did these *independent and celebrity* directors bring to investors in Lombard?

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[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.

[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.

Literature

Trust is paramount in business transactions and there are extensive strands of academic literature examining agency problems and 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.

Whenever you employ another party, to whom you give decision making authority, you face agency issues and costs. Agency issues are related to information asymmetries. In business, the managers of the firm have superior information to that held by investors. There is an academic history looking at both agency theory and the closely linked moral hazard (where the agent uses the funds supplied for a different more risky purpose) (Ross, 1973) (Fama & Jensen, 1983). In banking type organisations this is further compounded by the presence of adverse selection, where lenders (in this case depositors) are unable to accurately measure the risk of a financial product settle for an average rate of interest. Average interest rates are not appropriate as low risk borrowers (who are able to demonstrate their risk) seek alternate financing, leaving only high risk borrowers for which the average interest rate is no longer appropriate.

Asymmetric information has long been recognised by researchers as a problem with attempts made to curb its negative impacts (Sharpe, 1990). Sharpe’s (1990) findings’ reflect the comments of Selznick (1947/1966, p. 49) in his study of the Tennessee Valley Authority Bank type organisations are unique in that generally they employ low levels of equity, often less than ten percent, and regulators attempting to address this have resorted to official bank examiners to check on mandated minimum levels of capital, public disclosure of relevant risk information and compulsory deposit insurance. Although Lombard was not a bank, the fact that it took fixed term deposits from the public, its depositors faced issues similar to bank depositors. Depositors in finance companies, such as Lombard, don’t enjoy the protections afforded to bank depositors (see (W.R. Wilson et al., 2012b) for an overview of prudential regulation of New Zealand banks).

In the period covered by this study (2002 to 2008) all non-bank deposit takers (NBDT) fell under provisions of the Securities Act of 1978 and its subsequent regulations. Under New Zealand legislation NBDTs are required to negotiate a trust deed with a trustee company which acts on behalf of all depositors. Before taking deposits from the public, NBDTs must register a prospectus containing relevant financial information which is available to depositors. Prospectuses are required to be updated on an annual basis or sooner if the information becomes misleading. The trustee monitors the NBDT on an ongoing basis to ensure compliance with the trust deed. The Securities Commission, also established under the Securities Act 1978, was charged only with ensuring NBDTs complied with provisions of the Securities Act. So, New Zealand depositors were reliant on the management of NBDTs, trusting they would respect their interests and follow accepted corporate governance principles.

In the following discussion we move to the question of independent directors. 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 (Campbell, 1949). Indeed Konsik (1987, p. 163) notes that as early as 1965 the United States SEC required a minimum of three 'independent' that is outside or non-executive directors on the board. This was done so as to try and ensure some 'independence' from the organization at board level. In the 21st century it has been argued by Lee and Wang (2014) that the role of the independent director is to provide a check on the management of the company. In effect they argue, the independent director performs a monitoring role. Their role is to provide governance, oversight and ensure that the management of the company act in the best interests of the shareholders. However Lee and Wang (2014) go on to suggest that independent directors cannot adequately perform this role when faced with a board that consists of controlling shareholders.

In a Similar vein Persons, (2012) previous to Lee and Wang (2014) 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). 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. As this discussion involves not only the independent director but also the aspect of celebrity it is to this aspect that we now move.

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. 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, Gorton, & White, 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, with the chosen celebrity a good match with the product being advertised (Ding, Molchanov, & Stork, 2011). This decision will reflect the type of image that the organisation wants to 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. The work cited above by Ding et al., (2011) provides several illustrations of the different elements of celebrity endorsement. 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.

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 how the Directors of Lombard investments relied upon their celebrity status to solicit deposits. The examination is from the inception of the company to the eventual collapse and court action that followed. Following Piekkari, Oxlheim and Randoy (2014, p. 4) Lombard was chosen as the vehicle due to meeting a number of clearly identified criteria which had an appreciable impact upon the reasons the depositors were attracted to the Lombard brand. 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 below, we have ensured that the adopted methods used to place the stated experiences of the individual depositors 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 an ex Justice Minister and respected “treaty of Waitangi Minister” was highly regarded as an ‘elder’ statesman in New Zealand, and his co-director, William Jefferies had recently completed a term as Justice Minister. In fact both men when Ministers of the Crown were responsible for drafting and applying the rules under which Lombard would later operate. Another constraint is an organisational constraint. That is all the activity relates only to the property investment market. This bounding of time and place follows closely the method adopted by Piekkari et al., (2014) in their investigation of the role a common language plays in successful Board operations. 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 discussion, drawn from the court documents publicity material and email communications are stories constructed by our interpretation of the stated words of the individual depositors. When these words are placed alongside extant literature, they provide a vehicle for the application of an interpretative 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. This way the 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 examples 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 method 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.

Discussion

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. The 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 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.

In the Lombard trust deed (Phillips Fox, 2002) covenanted that they would not permit the total liabilities of the charging group to exceed twenty times shareholders' funds. In other words shareholder funds would not be less than 5% of total liabilities. Lombard's first disclosure of financial information was contained in a prospectus (Lombard Finance and Investments Ltd, 2003b) dated 28 May 2003 which reports equity of $406 thousand, after a loss in the first four months of operation of $93 thousand, indicating Lombard started with $500 thousand of equity[7]. Although the summary of financial statements in **Table 1** close suggest

[7] Coincidentally, $500 thousand was used to purchase the Lombard Trademark from Meridian Capital (Lombard Finance and Investments Ltd, 2006b). This was a reported as a related party transaction as Michael Reeves was a director of both companies.

total liabilities well and truly breached the twenty times limit over shareholder funds, financial statements (Lombard Finance and Investments Ltd, 2003a, 2004) subsequently published show subordinated unsecured notes $2.235 million and $10.641 million in 2003 and 2004. Presumably the subordinated notes are counting as shareholder funds though the 2002 Trust Deed for Lombard (Phillips Fox, 2002, p. 77) "*defines shareholder funds as the extent total tangible assets exceed total liabilities*", with no mention of subordinated debt. These subordinated notes carried an interest rate of 10.57%, though this was unpaid.

Table 1 - Lombard Summary of financial statements

	Year ended 31 Mar-07 $000	Year ended 31 Mar-06 $000	Year ended 31 Mar-05 $000	Year ended 31 Mar-04 $000	Year ended 31 Mar-03 $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 taxation	8,701	4,939	7,221	870	(93)
Income tax	2,866	1,700	2,634	390	-
Surplus (deficit) retained at end of period	5,835	3,239	4,587	480	(93)
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
Unsecured Subordinated Notes	7,337	11,268	15,187	10,641	2,235
Capital Notes	2,911	6,829			

Source (Lombard Finance and Investments Ltd, 2003a, 2004, 2005, 2006, 2007)

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[8] (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).

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

[8] 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).

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.

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 endorsement 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. Upon reflection of the celebrity endorsement literature this can been seen as an example of 'source credibility, (Ding et al., 2011; Tantiseneepony et al., 2012). As indicated 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, albeit for two different regimes[9], these past positions were enough to engender some degree of trust in the minds of perspective investors (Tantiseneepony et al., 2012). The ex-positions held by th4e

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

independent directors in particular was one of the major pieces of propaganda that convinced at least one of our informants to invest in Lombard.

The presence of Jeffries and Graham on the Board of Lombard 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 at the time. These attributes, are important 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. In doing so 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 the use of celebrity by the directors and political patrons rests in payment. The public fully expects that a sports person or entertainer be 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. Or the example of Tiger Woods and the loss of contacts once he had been 'disgraced' (Bartz, Molchanov, & Stork, 2013) 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. The independent directors were able to assert their 'independence' in that they did not individually own more than 5% the stock (NZID Staff, 2014)(NZ Institute of Directors, 2014, NZX 2014).

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. 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 (Lee & Wang, 2014; Persons, 2012) For example, 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. 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. Such actions are best seen in the promotion DVD released by Lombard. The comments, which are indicated in several places below, can be seen as a transference of meaning or as a a illustration of endorser 'match (Ding et al, 2011).

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, fulfilling the requirements of being a good 'match' for the product (Ding et al 2011). 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 eleven minute DVD appeals to "trust" (17) and "experience" (13) 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*."

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.

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

> "[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.

Graham and Jeffries were charged under laws they had either played a part in drafting or subsequently applied as Ministers of the Crown.

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?

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