

Managing conflicts of interest

Directors must develop the skills to identify and appropriately deal with conflicts of interest, writes James Dunn.

Conflicts of interest are everywhere in the business world. It could be something as simple as recommending a family member to human resources to fill a vacant position, arranging to direct a supply contract to a friend's business or voting as a director for a course of action that will benefit another company in which you have an investment.

The duty to avoid conflicts of interests is derived from both general law and statutory provisions found in the Corporations Act 2001 (the Act), which requires directors to avoid conflicts of interest. Under the Act, directors must:

1. Exercise their powers and discharge their duties with a reasonable degree of care and diligence (section 180).
2. Act in good faith in the best interests of the company or for a proper purpose (section 181).
3. Not use their position to obtain an advantage for either themselves or a third party, or to cause detriment to the company (section 182).
4. Not improperly use information gained through their position as a director to obtain an advantage for either themselves or a third party, or to cause detriment to the company (section 183).

At its simplest, a conflict of interest occurs when a person is in a position to be influenced, or appears to be influenced, by their private interests – or other interests – when doing their job. But it is not always about the lining of pockets.

Dr Simon Longstaff AO, executive director of the Ethics Centre, says conflicts of interest aren't wrong in themselves. It's how they are managed and disclosed that is the issue.

“Conflicts are part of life, we each have multiple duties; each of us is a parent, or a sibling, or a friend. We each have a lot of relationships, but they don’t always line up perfectly. It’s not because you’re greedy or indifferent to your duties that these things arise. The problem only occurs when they’re not adequately addressed,” he says.

Longstaff says there are two types of conflict that get bundled under the term ‘conflict of interest’, but they differ slightly. “I differentiate between a conflict of interest and a conflict of duty, which are often put under the same heading.” Conflicts of duty are more common.

“These arise where you’ve got a duty to two parties, whose interests are not compatible, in relation to a particular matter. You might be on the board of another company, or you might owe a duty to someone who’s an associate, which is incompatible with discharging the interests of the company you serve. Both have to be taken into account, and it’s helpful to think of them differently,” says Longstaff.

Much of what constitutes conflicts of interest is common sense.

Over the last ten years, there has been more effort put into defining and recognising what constitutes a conflict of interest, but many people still find this quite confusing.

There are always going to be some situations where there is no conflict, as well as other situations where there is conflict but it’s blatantly disregarded by some. It’s worth understanding that conflicts come in different shapes and sizes – it is not possible to have a neat tick a box approach.

Conflicts of interest are well defined in the law, but what in actuality meets that test is in the eye of the beholder, says Helen Wood GAICD, chief executive officer at business management consultancy TMS Consulting.

“It comes down to directors having a strong moral compass and being prepared to call potential conflicts of interest for themselves and others. When in doubt, directors should always ask the question,” says Wood.

If the organisation’s culture is strong enough, conflicts of interest are common sense, she says. “It is hard to get wrong if the culture is such that it is OK to call a potential conflict of interest – or when the chair genuinely encourages it – as opposed to a culture that doesn’t support it. In my opinion, the lines are rarely blurry – it is more the culture and conduct that

might be. Conflicts of interest can arise, not with intention to mislead necessarily, but rather a lack of pressure to check first.”

In other words, apathy leads to mistakes, says Wood. “On the other hand, identification of conflicts requires discussion, clarifying questions and a strong sense of integrity.”

Kevin Dwyer, managing director of change management and business transformation consultancy Change Factory, believes conflicts of interest in the corporate sphere are well defined in the Corporations Act, but adds that each organisation should have a conflict of interest policy, which clearly defines a conflict of interest in the organisation’s context, and what to do when one arises – with options open to the director with the conflict of interest and the board, depending on the nature of the conflict.

Identifying conflicts

Dwyer says there are the really obvious conflicts of interest, for example:

- Having shares (or having relatives or friends with substantial shares) in a company to which your organisation is contracted to supply a service.
- Having a relative or close friend apply for a senior role at the company, for which the board has oversight.
- Dating your executive assistant.
- Providing services to a customer or supplier in your own right.
- Accepting gifts of more than nominal status (nominal has to be defined) from staff of another company, from which the organisation currently orders (or in the future may order) products and services.

On this basis, Dwyer says there are three types of conflict for which directors should be self-assessing:

- Actual conflict, where a director is likely to gain a personal advantage for themselves or a relative or a friend, because of their position as a director.
- Perceived conflict, where others may reasonably perceive a conflict, and that perception may create a risk for the organisation with regard to reputation or financial assets.
- Potential conflict, where a process has been set in train that, in the future, may create a conflict of interest.

There are also less obvious examples of conflicts of interest such as offering public comment, as a director, on an issue with which you are associated, that relates to the organisation's field of interests. Dwyer says this can be difficult to define and may be in the eye of the beholder.

These lead to three areas to examine in identifying whether you have a conflict of interest. First, work out whether a relative or a close friend could gain personal financial advantage now or in the future, or be perceived to gain such advantage, from any action the director takes.

It's also important to explore whether there any personal non-financial interests that may be advanced by participating in an activity, now or in the future. Additionally, examine whether it's possible to damage the reputation of the organisation through any action or affiliation.

Dwyer says people who get caught often use the defence that the boundaries are so muddled, people can fall foul of conflicts of interest without necessarily knowing it. But he says that defence doesn't really wash. If a conflict is not defined by the board in a policy, he says, that is poor governance, and it needs to be fixed.

The first thing organisations should do to show best-practice defence against conflicts of interest, he says, is to create a conflicts of interest policy, and publicise it. Compliance with the policy should be audited at all levels in the organisation – with higher weighting to sampling rates at higher levels in the organisation.

In the case of major activities that have a material impact on an organisation, its shareholders, the public or regulators, the organisation should “run the fine-tooth comb” over them, looking for any conflicts of interest. Finally, Dwyer says companies should internally publicise instances where directors have stood aside because of a conflict of interest.

“Demonstrate that conflicts of interest will always arise and that dealing with them in a professional manner is the norm,” he says.

Staying focused

An organisation's conflict of interest policy should not be set-and-forget. There is an ongoing need to understand what constitutes a conflict; to understand the ethical dimensions of the role and to fully appreciate what fiduciary duties mean on a practical level. For boards, this is

likely to mean that there is some time dedicated to the issue for the board as a whole so there is a shared understanding; that there is a regular process for updating changed circumstances; and that each meeting asks for and records any conflicts as they relate to the day's agenda.

Because we most often talk about conflicts of interest as a financial issue, says Longstaff, directors will often assess potential for conflict based on whether they will benefit financially. "They'll say, 'there's nothing in this for me financially if we make a decision one way or another,' so they miss seeing what is actually the deeper issue, which is best captured by that notion of 'conflict of duty,' where they actually owe an obligation to someone else," he says.

"They're not going to be personally better off as a result of a decision, but it puts them in a position where they can't bring a disinterested mind to bear that a company director needs to have, where they're only working for the well-being of the company. Of course, the law makes it really clear, and outlines the basic duty for the director to act diligently, competently and free from any conflict – but it helps to make it clear that the kind of conflicts a director needs to avoid are not just ones of personal enrichment, but these conflicts of duty," he says.

Conflicts of duty arise because, while people are organised in entities, they have all sorts of personal relationships. "That's where the conflict of duty comes up, it much better captures that sort of thing, where you have a prima facie obligation to your friends, and you've got that duty to the company. There's no money in it, but you realise immediately, the fact that it might be good for your friend doesn't mean that something ought to be done, because the company's interests may not be consistent with that," says Longstaff.

He says another major issue can arise around conflicts of interest, even when the people involved think they're doing the right thing by removing themselves from the situation if they've identified a conflict.

"For most people, it seems pretty straightforward to say, 'of course, you've got to draw attention to a conflict of interest, and then you've got to step back and let other people resolve how the matter is going to be dealt with' – there's not too much complicated in that. But what's much more difficult is what happens when you have a conflict that stops you being able to act at all," says Longstaff.

This can occur where the director is involved on the other side of a transaction, and decides to step outside of board consideration of the transaction. "That's what's expected of them, and they think they're doing the right thing, but it becomes a different problem if the transaction

becomes so large that effectively, they're having to step aside from doing anything significant on the board. At some point, you have to recognise that you can't just keep a seat warm while the business of the board goes on without you," says Longstaff.

A director has a duty to recognise conflicts of interest, but also has a duty to the organisation to bring his or her skills and capacities to bear to serve the company, he says. "If you're basically on the sideline for a long period of time, you're not going to be able to do that. There's an infrequently discussed ethical question as to whether or not, if the conflict is serious, you should actually step down completely," he says.

Filed Under

- DUTIES AND RESPONSIBILITIES

© Copyright 2020 Australian Institute of Company Directors (AICD)

version: 4.13.6.0