Australian Institute *of* **Company Directors**

A NEW LINE OF SIGHT

AUSTRALIAN GOVERNANCE SUMMIT 2020

READER

The Australian Institute of Company Directors is committed to strengthening society through world-class governance. We aim to be the independent and trusted voice of governance, building the capability of a community of leaders for the benefit of society. Our membership includes directors and senior leaders from business, government and the not-for-profit sectors.

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Introduction

This year, the Australian Governance Summit delivers an event program based around the theme "A new line of sight". As we begin not only a new year but also a new decade, we consider the fundamental role of the director, how its application is both accelerating and widening, and what are the biggest issues facing boards in 2020. These considerations will shape the governance conversation for the coming twelve months and set the agenda for the coming years.

The Australian Governance Summit provides a critical opportunity to network with leading governance minds and reflect on the leadership our organisations require as we prepare for the future. Discussions will explore digital and workforce transformation, resetting organisational culture, the board's role in setting social purpose, dealing with climate-related risk, how director skills must evolve, governance issues in the not-for-profit sector, rethinking diversity, board and executive remuneration and regulatory change. Attendees will also explore the shifting technological and geo-political landscapes and the reform needed in Australia.

As in past years, this *Australian Governance Summit 2020 Reader* follows the summit program and provides a selection of expert presenter submissions and recently published articles and extracts from the Australian Institute of Company Directors. The purpose of this collection is to enhance attendee's participation by providing contextual background to the current director and governance landscape as it relates to the themes explored in this year's summit.

CHAPTER 1.

What will the board of 2030 look like?

The board of 2030

Ben Heap GAICD
Executive Chairman, H2 Ventures

We are navigating the so called fourth industrial revolution and, make no mistake, it is a revolution. We are in an age of rapid — often disruptive — technological change. This change offers significant benefits for consumers and society more broadly; the power in a modern smart phone is frankly mind-boggling. But disruptive change also brings challenges for companies and indeed for directors who are charged with governing companies — listed, public & private, large & small, for-profit and not-for-profit. Managing change is the future and it is the future that directors must embrace.

> "What we need to do is always lean into the future; when the world changes around you and when it changes against you — what used to be a tail wind is now a head wind — you have to lean into that and figure out what to do because complaining isn't a strategy."
> — Jeff Bezos

Given this dynamic outlook, here are some of the key responsibilities for directors, over the coming decade:

- First, to navigate change, often disruptive change;
- Second, to be flexible and adaptable, without losing sight of lessons from the past;
- Third, guiding company culture as the foundation for good conduct; and
- Fourth, clearly articulating a vision for stake holders — customers, shareholders, employees, government and the community — in order to earn and retain trust.

Navigating change

Change is not new, but the pace of change has increased dramatically, and will continue to do so. The next ten years may feel less like evolution and more like revolution. Directors will be required to consider, to a greater or lesser extent: technological innovation (with positive and negative implications); the rise of Asia (in an economic and a geopolitical sense); the paradigm shift in attitudes to climate change; demographic shifts; and the role each company plays in the community (noting the increasing influence of social media).

Flexible and adaptable

Given the future landscape I have postulated, directors must be forward looking — they must adopt a long-term view. Above all, they must be proactive, decisive and willing to embrace bold action. Technological innovation will play a greater role and emerging technologies, such as cloud computing, 5G networks, blockchain and artificial intelligence, will impact many companies, indeed all companies, directly or indirectly. Technological innovation is not a new challenge for directors, but it does highlight the obligation on directors to have sufficient understanding of these emerging technologies in order to be able to ask the right questions. Creativity and entrepreneurship, new products and services and new ways to do business will underlie our changing economy and will be imperative to the long-term success of companies.

Fostering culture

Culture is a curious thing – difficult to define but unequivocally impactful in defining an individual or an organisation. While a conversation about culture could traverse many issues, directors ought to be particularly interested in fostering a culture that supports ethical behaviour within an organisation. The board of a company clearly has the responsibility to set the culture of a company. They are the guardians of ethical behaviour, if this is not the responsibility of the board, then whose responsibility is it?

Articulating a vision

The role that companies play in the Australian community has come into sharp focus in recent time. Recent royal commissions offer lessons for all companies and for all directors. It is clear that government, and the populous, expect companies to meet a broader set of responsibilities within the community. As an example, the social impact of disruptive change, and the consequent ethical responsibility of directors, cannot be ignored. It is the role of directors and boards to determine the role a company will play and to clearly articulate that role to its stakeholders: customers, shareholders, employees and society at large.

The board of 2030

These responsibilities are not new, and the board of 2030 will not be so different from today; however, we will see some shifts in board composition and prioritisation.

Diversity will continue to improve across multiple dimensions. New directors will bring specific skills, experiences and perspectives from newer companies or different industries that may be further down the path in an area, such as data management or digital distribution, that will assist boards to oversee strategy and to navigate change. Outside consultants are not a substitute for carefully chosen directors, appointed by shareholders, with appropriate continually updating skill sets.

Compliance has been a priority for many boards over the past 24 months and appropriately so. There is more work to do over the next year or two, but over the course of the decade, we will see the pendulum swing back to a place where boards balance their responsibilities to oversee compliance, strategic performance and long-term value creation. This will require a more agile approach to issues and opportunities, and a clear focus on the right priorities for that company at that time.

> "Governance arguably suffers most... when boards spend too much time looking in the rear-view mirror and not enough scanning the road ahead."
> — McKinsey Quarterly

Company strategy will be increasingly challenging over the coming decade, and directors can expect this part of their role to become more time consuming. With new technologies, new business processes and new competitors presenting a constant disruptive threat, companies can no longer merely extend and exploit historic strategies. Furthermore, the increasing pace of change means that strategic assumptions must be re-evaluated constantly.

There is a general understanding that the time obligation of a high performing director today is greater than it might have been in the past. This comes with the territory, and the time and commitment required from directors is likely to increase rather than to decrease. Consequently, effective directors must be deeply committed to the companies they govern.

UK governance developments seek to increase accountability

Sally Linwood MAICD

14 January 2020, "UK governance developments seek to increase accountability", *The Boardroom Report*, Volume 18, Issue 1, AICD.

The UK Institute of Directors (IoD) has launched a Manifesto on Corporate Governance that calls for sweeping governance changes contained in ten policy proposals.

Into 2020 and against the backdrop of multiple royal commissions, scrutiny of board practice and governance remains intense in Australia.

We are not alone, however. Corporate collapses and misconduct have set the scene for a global governance debate, especially in the areas of the US and UK. In the US, Senator Elizabeth Warren's Accountable Capitalism Act proposes a remake of capitalism based on recognition of broader obligations to society, and in the UK, a new manifesto on corporate governance has been released.

Given the focus on governance will continue into 2020, it is timely to consider the views of various stakeholders on approaches to lifting standards and practice in the UK. History has shown us that developments there are often, in time, mirrored here.

As in Australia, we see fundamental policy issues including climate change, income inequality and audit regulation fuse with governance principles including the role of the board and board composition, accountability and board decision making.

Here's what the UK Institute of Directors, the UK Conservative Party and the UK Labour Party had to say in 2019.

UK Institute of Directors

Prior to the UK general election, the UK Institute of Directors (IoD) released its 'manifesto' on corporate governance outlining ten policy proposals intended to:

- increase the accountability of the UK corporate governance system to stakeholders and wider society;
- improve the competence and professionalism of UK board members; and
- enhance the ability of board members to pursue long-term, sustainable business behaviour, including addressing the challenge of climate change.

The proposals are briefly outlined below:

1. Support the development of an industry-led, formal Code of Conduct for Directors of significant corporate entities to guide their activities/behaviour as a professional group. The 'absence of a professional framework of conduct or ethics — which goes beyond mere compliance with the law — is of particular concern at a time when public trust in directors and business more generally remains fragile', the IoD write.
2. Deliver proposed reforms to the regulation of auditors and create The Audit, Reporting and Governance Authority (to replace the Financial Conduct Authority (FRC)) to ensure more robust regulatory oversight over the external audit process.
3. Establish an independent Corporate Governance Commission to oversee the UK's corporate governance and stewardship codes framework.
4. Prioritise upgrades to the operation and functioning of Companies House including measures to better scrutinise the accuracy of UK company data and reduce the likelihood of identity theft.
5. Mandate minimum requirements for director training including introducing a requirement for all newly appointed directors of significant entities to fulfil a minimum requirement in terms of director training and professional development.
6. Encourage the adoption of a Code of Practice for board evaluation to support improved consistency in independent board evaluations.
7. Create a framework through which companies 'can project their Business Purpose', including by encouraging companies to adopt clearly defined 'business purpose' clauses/business purpose statements, either in their constitutional framework or elsewhere in their annual report, to enable companies to communicate their expected social impact beyond 'merely maximising profits'.
8. Encourage a consistent approach to Climate-Related Corporate Disclosures noting that consistent with the government's Green Finance Strategy, asset owners and listed companies are expected to report in accordance with the requirements of the Task Force on Climate-Related Financial Disclosures by 2022.
9. Explore opportunities to establish an ESG-oriented Sovereign Wealth Fund to invest in 'the green and sustainable companies of the future and in doing so embed the highest standards of corporate governance across the economy'.
10. Establish a newly-defined corporate form — the Public Service Corporation — through which the outsourcing of public services and related activities could be delivered. It's proposed that such a vehicle would have shareholders and operate on a commercial basis, but its underlying legal framework would require a balance to be maintained between the interests and obligations relating to its various stakeholders, including its shareholders, employees, pensioners, creditors and public sector clients.

UK Conservative Party general election manifesto

The Conservative Party manifesto — which, as expected, was light on corporate governance reform (certainly compared to its opposition) — included promises to:

- strengthen the UK's corporate governance regime and reform insolvency rules and the audit regime so that "customers and suppliers are better protected when firms like Thomas Cook go into administration";
- study the results of the ongoing investigation into the Thomas Cook collapse; and
- improve incentives to attack the problem of excessive executive pay and rewards for failure.

The party committed to "striving to achieve the right regulatory balance between supporting excellent business practice and protecting workers, consumers and the environment" including through a "Red Tape Challenge" intended to ensure regulation is "sensible and proportionate".

UK Labour Party general election manifesto

Despite the Conservative Party's clear election victory, it is worth also reflecting on the Labour Party's corporate governance and accountability manifesto proposals – not just because they represented a push for a radical shake-up by a major political party, but also because aspects of them are likely to continue to attract support from certain stakeholders.

The Labour party's manifesto pledged to "rewrite the rules of the economy, so that it works for everyone" and "take on short-termism and corporate greed, making sure good businesses are rewarded, not undercut."

Notable proposals included the following:

- Require one-third of company boards to be reserved for elected "worker-directors", enabling workers to have more overt control of executive pay;
- Require large companies to set up "Inclusive Ownership Funds" (IOFs), with 10% of a company to be owned collectively by employees, with dividend payments distributed equally among all (capped at £500 a year);
- Amend the Companies Act to require companies to prioritise long-term growth, while strengthening protections for stakeholders, including smaller suppliers and pension funds;
- Amend the London Stock Exchange (LSE) listing criteria so that any company listing on the LSE that fails to contribute to tackling the climate and environmental emergency will be delisted.
- Introduce a broader "public interest test" to prevent hostile takeovers and asset-stripping;
- Allow struggling companies go into protective administration, so they can be sold as a going concern rather than collapsing into insolvency;
- Separate audit and accounting activities in major firms and impose more robust rules on auditors; and
- Tackle late payments that leave small businesses waiting to be paid, including banning late payers from public procurement.

Criticism of Labour’s policies was loud from various quarters, particularly business leaders and investors. Certainly, they would have represented a radical change in corporate governance and a very significant government intervention in a major developed economy.

Edwin Morgan, director of policy at the UK Institute of Directors, was quoted as arguing that there was too much “stick” and not enough “carrot” in the manifesto. He also noted there were “clear potential downsides” to some of the headline policies.

Regardless of the politics, changing community and government expectations and declining public trust in institutions mean that governance will continue to be debated over the coming years.

ACSI issues new governance guidelines

David McElrea

9 December 2019, "ACSI issues new Governance Guidelines", *The Boardroom Report*, Volume 17, Issue 12, AICD.

The Australian Council of Superannuation Investors (ACSI) — the peak body for institutional investors focused on ESG issues — has recently released its revised Governance Guidelines.

Many industry superannuation funds, in particular, will take direction from ACSI on how to vote their shares, so ACSI's importance as a stakeholder for directors of listed entities is growing. ACSI includes as its members fund managers like IFM investors, large industry funds like AustralianSuper, CBUS and HESTA and state-based not for profits such as First State, Vic Super and QSuper.

ACSI has a director engagement strategy and holds around 250 meetings with directors of ASX 300 entities a year. The AICD also regularly engages with ACSI over its views on ESG issues and how they relate to directors.

ACSI's revised Governance Guidelines set out the issues it will focus on in engagement work with companies and factors it will take into consideration when determining voting recommendations. The revisions to the guidelines include new sections on:

1. Accountability — in light of the Financial Services Royal Commission, an emphasis on directors making decisions based on long-term sustainability and demonstrating a culture of accountability, being prepared to acknowledge responsibility for actions and decisions and engage with shareholders.
2. Risk management — ensuring that the board actively manages ESG risks with strategies for engagement with stakeholders, regular monitoring, updates and reviews of ESG risks and incorporates ESG risk management into assurance and remuneration practices.
3. Corporate culture — clear expectation that the board is responsible for corporate culture, with regular assessment and disclosure of culture and metrics and a consideration of culture when selecting the CEO.
4. Social licence to operate — requiring boards to disclose how they deal with stakeholders and maintain their social licence. This includes clear ESG disclosures which identify how they are managed and how the company evaluates whether its management is effective.
5. Gender diversity — a minimum of 30 per cent of a board being women with a time frame to achieve gender balance (40:40:20) on the board.
6. Remuneration — a concern that short-term incentives (STIs) may be paid for performance at target and the need for evidence that variable remuneration is applied consistently (for example, when it fluctuates) from year to year and clear explanation of remuneration practices in a narrative form. No vesting of STIs when performance is below the median of peers.

The guidelines also highlight other factors that ACSI will consider when recommending votes to its members. These include:

- When approaching director re-election, ACSI will consider factors relating to performance and accountability of each director as well as overall board composition.
- Ensuring directors are not over committed with board work, in particular the chair.
- Detailed criteria to assess independence of non-executive directors.
- Non-executive directors should be paid by fixed fee or shares, not by options.
- Climate change risks to be identified and managed in accordance with the Financial Stability Board's Taskforce on Climate-Related Financial Disclosure.
- Where companies are members of industry associations that advocate on climate change, an indication of whether the board agrees with that association's advocacy and how it intends to respond to those differences.
- Compliance with the terms of the Modern Slavery Act.
- Transparency around health and safety data, including disclosure of workplace fatalities.
- Disclosure on other workforce metrics including culture, workplace diversity and discrimination, labour relations and whistleblowing and grievance mechanisms.
- Disclosure of tax policies with proper governance of tax risk including any aggressive approach to tax planning.
- Non-audit fees paid to a firm to generally be less than 50 per cent of audit fees to the same firm.
- Rotation of audit firm every 10 to 12 years on an if not why-not basis.
- Equity capital raising to be conducted in a manner that allows shareholders an opportunity to maintain their interest or be compensated for dilution.

AICD comment

The ACSI guidelines illustrate rising governance expectations of listed companies, especially in the wake of the Financial Services Royal Commission. In particular, investor groups such as ACSI are expecting to see greater disclosure around company's stakeholder impact and more individual director scrutiny and accountability.

Looking ahead to 2020, remuneration frameworks will continue to attract significant focus from investors, with companies needing to demonstrate a clear correlation between pay and performance, both financial and non-financial. With ASIC expected to release its report into board oversight of variable remuneration in early 2020, and APRA set to finalise a new prudential standard on remuneration around the same time, the governance of pay will remain in the headlines.

Taking companies in new directions

Tony Featherstone

14 November 2019, *Taking companies in new directions*, Governance Leadership Centre, AICD.

Boards need to lead innovation that combats disruptive competition.

Ralph Norris FAICD makes a telling observation on why some boards struggle to govern innovation and why industry is littered with large companies crushed by disruption.

"It's hard to make an elephant dance," says Sir Ralph, referring to the challenge of getting big organisations to engage in radical innovation, "creatively destruct" parts of the business, and be prepared to take risks and go backwards, so that they move forward.

"Large organisations are usually wedded to legacy systems, processes and people," says Norris. "Their boards are generally risk averse and do not want huge asset write-downs from company transformations. Management is incentivised to beat last year's profit and does not want to make transformational changes. The share market wants next year's profit and shareholders want a steady dividend stream. That acts as an impediment to innovation."

Norris' view is timely. Technology-driven disruption is spreading like wildfire across industry, destroying incumbent companies and fuelling insurgent competitors. Canadian governance expert Professor David Beatty has described this as a "digital tsunami", arguing that the majority of boards worldwide are unprepared for the potential damage. In Australia, just over half of directors said innovation had never been, or was only occasionally, a board item, according to a recent survey by the University of Sydney Business School, in partnership with AICD. And 57 per cent of director respondents did not know how much their organisation spent on R&D and innovation.

The study found: "While Australian directors accept the importance of innovation to their organisation's strategy, too often competing priorities, limited resources, and a lack of awareness of the need for change mean the topic does not receive the urgent attention it deserves."

Norris says some boards focus on the wrong innovation signals. "They talk about the organisation having a culture that supports incremental innovation, but that's really just business as usual because companies should always strive to become more efficient. Or, boards look at the company's R&D spend relative to competitors, or the number of patents filed. Plenty of firms that had lots of patents and looked innovative have failed over the years."

Boards of large listed companies, says Norris, should focus on transformative innovations: the type that can combat disruption from emerging competitors and take the organisation in new directions, creating a step-change in growth and shareholder returns.

"Boards should ask: If management was starting the organisation from a blank sheet of paper, what would it look like? If it's very different from today, they need to work with management on how the organisation can transition to a new structure, while minimising damage to legacy operations and profits. That's hard to do because company transformations often create a level of risk that boards find unacceptable, so the status quo remains. Boards often don't like the idea of a profitable low-growth business being destroyed, so capital can be reallocated to higher-growth, higher-risk opportunities."

New Zealand-born Norris is well versed in company transformations. During a distinguished executive career, he developed a reputation for turning around underperforming organisations.

He turned ASB Bank in New Zealand from a second-tier bank into one of that country's four major banks through deploying innovative technology and a focus on customer service that saw ASB grow at double the market rate every year during his 10-year tenure.

Then, Air New Zealand, which Norris salvaged from near financial ruin, and then the Commonwealth Bank, which was known for customer-service problems when Norris became its CEO in 2005. In conjunction with the CBA board, Norris oversaw a billion-dollar project to replace and upgrade the bank's core technology systems – an innovation that would give CBA an advantage over its rivals and contribute to its outperformance during his tenure as CEO (until November 2011).

Norris believes the starting point for boards on innovation governance is understanding how their company is responding to the digital environment, its current and future competitors, and if its products are appropriate today and in the future.

The next step is people, says Norris. "Does the board have the right skills to support a higher rate of innovation and a company transformation? Is the executive team capable of understanding what the industry will look like in the future? Is it capable of creating and implementing change and bringing the entire organisation along on the transformation?"

Governing the migration of the legacy business to a more innovative structure is a key board challenge, says Norris. "It's one thing to have a strategy for change. The harder part for boards is ensuring risks are well defined and capital is allocated appropriately; that the strategy is being implemented; and that the market is brought along on the transformation."

Boards, says Norris, must be prepared for the organisation to be marked down by investors during its transformation. "Investors discount the company's value because risks are higher. Boards need to look through short-term problems and focus on the future shape of the organisation and how it will get there. If they don't do this, or become too focused on minimising risk, the organisation could pay a heavy price from disruption and lack of innovation."

Increasing board focus on innovation

Roger Sexton AM FAICD says the biggest impediment to innovation governance is boards being swamped by recurring compliance tasks and other duties. "Boards need to separate innovation discussions from their regular duties and free up time to focus on strategy, innovations, competition and what the future of their industry looks like." Dr Sexton's view was reinforced in the University of Sydney/AICD innovation study. It recommended that "having regular conversations on innovation via periodic board agenda items can help make innovation a more mainstream boardroom topic".

Sexton chairs emerging listed food innovator Beston Global Food Company and is president of the AICD South Australia/Northern Territory division. He is the former chairman of financial services group IOOF Holdings, having retired from the board in 2016.

At IOOF, Sexton arranged a separate meeting the day before the main board meeting for directors and management to discuss organisation strategy, innovation and industry trends. Growth in financial technology (fintech) firms and their disruption potential was high on the agenda.

Sexton says the meetings were a key part of the board's innovation governance. "We decided to separate discussions about innovation from the main board agenda, so we had more time for them and could hear from management and industry experts. Deeper discussions on innovation can easily get lost when the main board meeting's agenda is packed."

The innovation discussions before the main board meeting, some of which extended into dinner with directors and management, helped inform IOOF's strategy and acquisitions, says Sexton. "I found the separate session a great way to focus on future trends and innovations. The discussions challenged the board and management on organisation strategy and driving growth in our industry."

At Beston, a smaller company that listed on ASX in 2015, the focus is on constant innovation. The Beston board has a strong back-ground in start-ups, private equity and high-growth businesses.

"The board has regular discussions with management about latest global technologies that can be deployed in the business to make it more efficient, or product or customer innovations," says Sexton. "In some ways, the board's role is to ensure the organisation is always kept out of its comfort zone, and that pursuing constant innovation and improvement is embedded in its culture."

Culture and innovation

Dr Nora Scheinkestel FAICD says boards must be willing to "disrupt themselves" when governing innovation. Scheinkestel, one of Australia's most experienced company directors, chairs Atlas Arteria International and is a non-executive director of Telstra Corporation, AusNet Services and OceanaGold Corp.

"Directors must be alert to trends in their market," she says. "Boards worry about giving up too early on high-margin legacy businesses but if the organisation is a day too late in responding to disruption you can find vast chunks of your business disappear overnight."

She adds: "Boards must be aware of the latest thinking, the changes in their industry's ecosystem, from the nature and behaviours of customers to the changing identity of competitors, suppliers, distributors, the use of new technologies and so on. You need to be following what's happening in your industry and in other sectors."

Determining the organisation's risk appetite is a key element of innovation governance, says Scheinkestel. "There may be some areas of the operation where there is little tolerance for risk but others where more risk can appropriately be taken. Sometimes, the board has a higher risk appetite than management. Being clear on the risk appetite helps determine the type of innovation the organisation will pursue, how much capital is allocated to them and their alignment with strategy."

Innovation can mean different things to different people, says Scheinkestel. "In my experience, people can get hung up on defining innovation as requiring a breakthrough or life-changing discovery. But innovation should be part of an organisation's DNA and can be incremental. It should be deeply embedded within organisational culture.

She says every employee should feel a positive obligation to innovate and that their organisation empowers them to do so, and rewards them for innovation success and for failure, provided there are learnings from it. "The culture must encourage staff to look for ways to do things smarter and better, to proactively address customer pain points. If it's part of the culture, innovation just becomes part of how you do business."

Scheinkestel says a culture of incremental innovation across the organisation can underpin more material breakthroughs. "If day-to-day innovation is not part of the mindset, it will be that much harder to undertake the innovations that can transform companies. The board needs to support a culture which actively strives to find smarter and more efficient ways to run the core operation, to take innovation risks. The reality is that many innovations fail, and boards must be prepared for that and encourage the learning that comes from it."

Boards should look at innovation as an element of organisational culture, says Scheinkestel. "Directors can gain insights on how staff view innovation through culture surveys, asking management to present on innovations at the firm or their analysis of customer data and how management responds to identified needs or pain points; how complaints are resolved. Listening to feedback from suppliers and distributors can also throw light on how the organisation is using innovation. It's about boards finding ways to understand the views of different stakeholders on how management is addressing the organisation's challenges."

Executive team and innovation

Peter Hay FAICD, Chair of Newcrest Mining and Melbourne Airport Corporation, and former Chair of Vicinity Centres, says a board's main contribution to innovation governance is choosing a CEO who can lead change in the industry and the organisation.

"The board must ensure the CEO is a change agent who is comfortable with uncertainty and deeply understands where their industry is headed. And that the CEO is capable of building and developing a team around him or her who can drive innovation – and an organisation culture that encourages higher rates of innovation, both defensive in terms of incremental gains, and offensive in terms of larger breakthroughs."

The organisation's innovation efforts must be supported by appropriate R&D investment, says Hay. "I would be disappointed if organisations I chaired lagged on R&D spending. I've seen how great innovations, such as block-caving technology at Newcrest, create value. Directors need to form a view on the R&D spend in their company, how that compares to rivals globally, and how that investment is being allocated. They should be aware of key innovations underway and keep track of their progress through regular management presentations to the board."

Hay says boards should encourage management to keep up with latest innovations in their global sector. Vicinity directors and executives, for example, attended a study tour of major shopping centres, and met with industry experts and innovation thought leaders, in developed and developing countries and reported their findings to the board. "It really got the board thinking about the future of shopping centres, and how data and technology will create new opportunities and threats in the sector."

Directors must find more time to talk about innovation among themselves and with management, says Hay. "I have always been of the view that board meetings should be about the future. The board should promote conversations about innovation as part of the organisation's growth agenda and be clear on what type of innovation is sought."

Ultimately, boards must regularly test management on whether the organisation can be more innovative. "Boards should resolutely refuse to accept that the status quo is good enough. There are always opportunities to improve a business through innovation if you look hard enough. If the CEO is not aligned with that thinking, the board has the wrong CEO."

CHAPTER 2.

The shifting governance landscape

Responsible stakeholders

Greg Earl

"Responsible stakeholders", *Company Director,* February 2020, AICD.

The remit of corporate social responsibility has now broadened to encompass Australian foreign policy.

As China's share of Australian exports hit a new high of 40 per cent in the middle of 2019, business leaders were presented with an unexpected new corporate social responsibility (CSR) — reducing dependence on the country's biggest export market in the national interest. Directors might be more focused on how to navigate ever-changing Chinese import rules or considering what to do if the country's economy suddenly tanks. But international relations experts have been furiously debating whether those same directors should be playing an active role in implementing a more sceptical foreign policy towards China.

A sharp expression of this new CSR obligation came in a report on the state of the Australia-US alliance by the University of Sydney's US Studies Centre in June, co-authored by John Lee, once a senior adviser to former foreign minister Julie Bishop. Buried in an otherwise straightforward discussion about diversifying trade ties was a major new challenge for business: "Private firms ought to be encouraged to consider themselves 'responsible stakeholders' within a rules-based system in addition to creators of economic wealth and value."

In a blunt response, Lowy Institute international security program director Sam Roggeveen tweeted: "I see Aus (sic) strategists calling for diversification of our economy in order to reduce dependency on, and thus vulnerability to coercion by, China. But has anyone seriously thought about how it could be done? Seems totally implausible to me."

If this new debate about international economic relations was only occurring among academic strategists, directors could perhaps relax. But it has already entered the political arena with Minister for International Development Alex Hawke taking up the same line in order to give some business heft to the government's Pacific Step-up. Emphasising that in 2019 businesses had broader social obligations, he told *The Australian Financial Review*: "We think business has an obligation to this region as well. The Pacific region is our backyard, it's our family, it's neighbourhood." He noted the government had put $3 billion into soft finance facilities focused on the Pacific and wanted business to take advantage of them.

How this will play out in practice is far from clear. During the past few years, intelligence agencies have been briefing businesses on cybersecurity risks to company secrets and inward foreign investment oversight has been tightened to protect strategic assets. The latest calls for some form of more direct action reflect growing frustration that dependence on China has risen despite government efforts to diversify Australian economic connections in Asia.

Lee's report takes the optimistic view: "One virtue of a more open conversation about the comprehensive challenge China poses is that private firms ought to take into consideration the predatory, coercive and punitive actions China occasionally inflicts on other economies for non-commercial reasons as part of a firm's normal risk management calculations... If Australia can identify and tap into a more diverse array of export markets and sources of investment, it would spread risk and enable greater economic and political resilience in the event of political displeasure from Beijing."

But the Australia China Relations Institute's James Laurenceson has produced a very different analysis of this diversification conundrum, which shows no other export markets have been growing as fast as China. Exports to China have increased by $78.5 billion during the past decade while those to old markets such as the US and Japan are up $0.2 billion and to emerging markets such as India and Indonesia, up $5 billion. He says while diversification is sensible, the debate about it has failed to acknowledge key differences between international business and security policy management. "Unlike security ties, the pattern of Australia's external economic engagement is mainly determined exogenously by market forces — economic complementarities and purchasing power — not elected officials or bureaucrats sitting in Canberra," he argues.

While Lee has provocatively told business to think about bigger responsibilities than profits, he is really counting on a more open debate about China's economic practices to make business more wary of being dependent on it. The 2019 Lowy Institute foreign relations poll lends support to this approach with the first sharp downturn in warmth towards China for more than a decade. Only 32 per cent of Australians now think China can be trusted to act responsibly in the world compared with a previous long-running average of around 50 per cent. But this is a measure of general public opinion. The more granular polling of Australian business on the ground in China by AustCham Shanghai shows continuing relatively strong sentiment about the outlook for business in China despite a more authoritarian government.

Company directors face many new demands to take account of stakeholders apart from shareholders these days. But this new foreign policy debate — mainly about China — presents a novel challenge because it is not clear who really defines the national interest when it comes diversifying economic links. However, Perth USAsia Centre founding CEO Gordon Flake says there is too much cynicism about business only being interested in profits to the exclusion of what Lee has termed being "responsible stakeholders". He argues: "Firms are led by people and people make decisions every day based on morality, principle, patriotism, and, yes, national interest. I would not be so quick to dismiss values."

As Hawke's comments suggest, the intense new focus by the government on increasing Australia's presence in the South Pacific to offset China's growing role may become the real cutting edge of business being pressured to play a greater role in foreign policy. The government has provided the old Export Finance Insurance Corporation — newly rebadged Export Finance Australia (EFA) — with an extra $1b in credit to fund commercial ventures in this part of the world. EFA's increasingly important role in this strategic debate has been underlined by the way it has already been given responsibility for financing a rare earths industry in Australia and providing a loan to help fund the Papua New Guinea budget. Hawke has made it clear what is now expected from business: "We've got funds to buy down risk and we want to see Australian and NZ businesses really stepping up themselves to take advantage of the enabling infrastructure and the financing." This comes as the ANZ Bank has just sold down its longstanding business in PNG, following a precedent Westpac set in 2015, by selling operations in five Pacific nations.

CHAPTER 3.

Future-ready economies and the reform required in Australia

Water, energy, infrastructure: top 3 issues for 2020

1 December 2019, "Water, energy, infrastructure: top 3 issues for 2020", *Company Director*, December 2019, AICD.

Results from our biannual Director Sentiment Index show directors want action on climate change, renewable energy and infrastructure.

The AICD Director Sentiment Index shows increased pessimism about the economic outlook with sentiment about the health of Australian, Asian, European and US economies at its lowest point in three years. However, the latest index, based on polling of AICD members in September [2019], shows directors' views on future business growth remain positive, with 43 per cent of those surveyed expecting their business to grow to June 2020.

One third say they expect staffing/labour demand and investment levels to increase in 2020 with the majority (47 per cent and 44 per cent respectively) expecting these to remain stable. On the wage front, 39 per cent of directors say they expect wages to increase a little; 55 per cent expect them to remain stable. The profit outlook is also holding up, with 36 per cent of directors expecting an increase in profits for the second half of this financial year and 31 per cent expecting an increase in profits compared to the budget forecast for January–June 2020.

Expectations about credit availability for acquisitions easing also improved. Nearly two thirds (64 per cent) of directors say an improved economic outlook would encourage their business to increase its level of investment/capital expenditure during the next year — followed by Australian economic policy certainty and enhanced focus on long-term returns.

What's keeping directors awake?

While global economic uncertainty and low productivity are viewed as the main business challenges, sustainability and long-term growth prospects are what directors say keeps them awake at night. Global economic conditions, legal and regulatory compliance, cybercrime and structural change/changing business models are mentioned as concerns by at least one in five directors.

When it comes to short- and long-term government policy priorities, energy policy, climate change and infrastructure are the top three issues directors want action on. Water supply was nominated as the top priority for infrastructure investment, and 17 per cent of directors say drought is the top economic challenge. The percentage of directors who believe infrastructure spending is too low has increased from 65 per cent to 74 per cent.

Red tape

When it comes to governance issues, directors are more concerned about current governance regulations compared to the first half of 2019, with 43 per cent saying they are "somewhat onerous", 38 per cent "about right" and 12 per cent "far too onerous" — up from nine per cent.

D&O insurance has become more of an issue, with 28 per cent of directors saying insurance is readily available for their boards and 38 per cent saying it is slightly difficult to obtain.

Forty-two per cent of directors expect the level of "red tape" to increase in the next 12 months and 77 per cent identify corporate reporting requirements as the aspect of their business most affected by red tape — followed by workplace health and safety, and preparing/paying taxes.

Why so risk averse?

Seventy per cent of directors say there is a risk-averse decision-making culture on Australian boards, saying this is driven by an excessive focus on compliance over performance, followed by pressure from shareholders for short-term returns, and lack of genuine diversity in the boardroom. However, 89 per cent of directors say their board is trying to effect cultural change in their organisation, 58 per cent say their business is actively seeking to improve gender diversity, and 40 per cent are actively trying to increase ethnic diversity.

How your board can innovate for the future

Beverley Head

30 October 2019, "How your board can innovate for the future", *Company Director,* November 2019, AICD.

With the release of AICD and USYD Business School's innovation research, leading directors share ways innovation helped their organisation prepare for the future.

Of the many risks boards and directors must consider, innovation is perhaps the most slippery. Invest in innovation and you risk failure; fail to invest in innovation and you risk annihilation. "The clever board doesn't just increase risk, but takes a calculated look at risk," says ANZ chair David Gonski AC FAICD*Life*.

Competition now comes from every quarter, every country. Internet-charged startups can disrupt decades-old business behemoths. Research from universities swiftly blooms as fully fledged and venture-backed products and services. Global giants open virtual or physical operations and the competitive playing field is upended overnight.

Pioneering research conducted by the AICD in association with the University of Sydney Business School reveals that although three quarters of directors say their organisation has an innovation vision or that innovation features in their strategic plan, far fewer have innovation as a regular board agenda item. There is also a distinct paucity of innovation-focused board committees.

While the report, *Driving Innovation: The Boardroom Gap*, does reveal innovation is an ongoing agenda item in 39 per cent of the nation's boardrooms, it clearly identifies a big blind spot for boards. In short, a significant gap has emerged between innovation strategy formulation and its implementation. Consequently, Australian organisations are falling behind their overseas peers and underestimating the strategic risk of innovation that is too slow, too restrained or just absent.

Australian Bureau of Statistics data reveals almost half of Australian businesses are undertaking innovation — but the nation's R&D intensity is below the OECD average. And when directors were quizzed by the AICD research about their own organisation's investment, 57 per cent did not know how much they spend on R&D.

Kee Wong FAICD, chair of the technology governance and innovation panel of the AICD, notes that as a small nation that for a long time has relied on natural resources, Australia's future as a society is innovation. "We have no other tool for the future apart from literally being a clever country and also one in which innovation is something where we differentiate ourselves on a global scale," he says.

Currently just three per cent of directors say they have science and technology expertise, or international expertise. According to Wong, "Every director has the responsibility to educate themselves and understand the difference between transformative innovation, maintenance innovation — business as usual but faster, at a lower cost — to innovation that is transformative and disruptive."

Directors also acknowledged the need for an innovation lens to be applied across all board agenda items. Rising global competition and the advent of the fourth industrial revolution, which is being turbocharged by technologies such as the internet, cloud computing, robotics and artificial intelligence (AI) will inevitably have an impact on every enterprise — and also its workforce. Directors need to be prepared to grapple with the implications of that for their employees and their balance sheet. Their overseas peers are preparing.

The Spring 2019 MIT Sloan Management Review reveals that in a study of more than 1200 publicly traded companies with revenues above US$1 billion, 24 per cent had "digitally savvy" boards. Driving Innovation notes that: "Those businesses with digitally savvy board members significantly outperformed others on key metrics such as revenue growth, return on assets and market cap growth. Interestingly, a cohort of at least three digitally savvy directors was needed to have an impact on performance."

Reflecting a growing awareness of the need for more diverse boards, in a 2019 SpencerStuart survey of 113 US nominating/ governance committee members, 34 per cent of respondents identified technology experience as a top priority for board recruitment (second highest priority after female directors, 36 per cent). While looking ahead to the next three years, 38 per cent of respondents nominated technology experience (overall second highest priority after female directors, 40 per cent) and 35 per cent digital/ social media experience (fourth highest priority overall).

In Australia, only one in 10 directors say they provide innovation, product development and R&D expertise to their organisation. Access to skills was identified by survey respondents (31 per cent) as a brake on innovation, as was funding (28 per cent) the focus on short-term financial results (19 per cent), as well as lack of urgency (10 per cent). Lack of board or executive support was cited by only four per cent of respondents.

However, directors seem to be focused on mid-term innovation impact instead of the frequently advocated three-horizons framework, which spreads resources 70:20:10 on core, adjacent and transformational innovation efforts. Only four per cent claimed a focus on innovation impacts six to 10 years hence.

Angus Armour FAICD, MD and CEO of the AICD, says although boards do understand innovation is important, they feel they are not following through on implementation with the same frequency as they address other issues such as compliance. "That is a significant concern for individual firms and institutions," he says. "It means their focus is not as strong as it has to be and from the perspective of our economy, we are not as productive as we need to be. Productivity has been in decline, and GDP per capita has been flat or declining. These are all indicators of a less resilient economy. Our innovation performance globally is not at the level we need it to be."

He stresses doing nothing is not an option. "You have to look at productivity performance, at our global rankings, to realise doing nothing means a lower level of prosperity in 10 years' time compared to where we are now."

Armour calls on directors to learn the language of innovation, to have conversations with investors and staff about the need for innovation, and to help foster a culture allowing an organisation to innovate, thrive and compete. Having started the conversation, directors also need to follow through, he stresses, checking in with management to track innovation progress and ensure it is being properly rewarded.

He also advocates for innovation to be formally placed on an organisation's risk register, noting that the implications of innovation will vary from company to company, sector by sector. "It's important the risk register captures two different risks — the risk if we do and the risk if we don't. It's also important not to put innovation in a glass case somewhere and reflect on it from time to time. It must be an integral part of strategy and business every day."

As the report states, "The greatest contribution the board can make to building a more innovative organisational culture is by prioritising the issue and holding the executive to account on delivery."

Case study – Ready to Hatch

Recognising it was lacking the strategy, funding, process and governance to realise its innovation ambitions, Mirvac established its Hatch initiative in 2014. Five years on, the property giant wins accolades as one of Australia's most innovative companies. It now works with French consultancy INCO, which helped set up Mirvac's Impact Accelerator.

According to Christine Gilroy, Mirvac group general manager innovation, the board has played a pivotal role in crafting the strategy, creating a culture of innovation backed by design thinking and setting aside a protected innovation fund.

"We are creating an ambidextrous organisation so we can continue to exploit our current business, with incremental innovation and then big game-changing disruptive innovation," she says.

Mirvac director Christine Bartlett MAICD says the biggest benefit comes from directors and executives sharing innovation experience.

"It's a mistake just to do it with the board. NAB did one [where] the board went but the executive team didn't. The board came back and started asking all these questions and the executive team had no context."

She notes innovation must be a perennial agenda item. "I don't know any company I'm on that doesn't have disruption as one of the risks on the risk register. Disruption is the risk and innovation is the opportunity. No company can afford not to be doing this because the pace of change is just so intense that you need to have your radar up. If you don't do it to yourself, someone else will do it to you."

According to Gilroy, "We have been able to deliver what we took to the board. They were patient because it took a long time in that first year or two to really crank up the engine and upskill the people. Now there is so much momentum that the patience of the board is paying dividends. In the early years, there weren't tangible results. It was a journey of faith, but I always felt the board was with us."

Gilroy presents to the board twice yearly, and individual directors regularly make ad hoc visits to Mirvac's innovation space and get involved with individual projects. "We have an idea at the moment: a new housing typology for young people," she says. "We had one of our board members make introductions to expert people in that area."

Bartlett has a background in IT and finance. She attends tech company summits, has visited Silicon Valley, Seattle, China and Singapore, and in July, led a trade delegation to Israel.

"Directors have a responsibility to keep themselves current, to be inquisitive and curious, and find ways to build their knowledge and skills," she says. "Some of my colleagues have done things like Singularity University to stretch their thoughts and insights, and to challenge them about how they are thinking."

"If you are not trying things that have not worked, then you are not innovating," adds Gilroy.

Case study – Winning feeling

When John Winning launched Appliances Online, his father didn't believe it would work and didn't want the family name associated with the venture. However, he did want to give his son and his innovative idea a go.

It did work, and John Winning is now CEO and director of Winning Group — and is as committed to innovation as he was then.

A family owned and run company, Winning operates under an advisory board structure. "All three directors have, for the last 40 years, only worked for one company. To give us diversity, we have to have an advisory board."

Winning doesn't expect the advisory board to come up with innovative ideas, but he does expect it to be open to them — and augment the innovation insights available to family directors. Besides Appliances Online, Winning Group also now has a logistics company, an installation business, premium lifestyle magazine and a software company called Heelix.

It's the advisory board that grounds Winning. "When I have my head in the clouds, they grab my ankles and drag me back. They make sure the day-to-day stays stable but are not against doing some really interesting things."

Case study – Making waves

Daniel Shaddock is a professor in physics at the Australian National University and CEO and co-founder of Liquid Instruments. The startup is leveraging the science of gravitational wave detection in an attempt to disrupt the multibillion-dollar global test and measurement market. Innovation is the company's lifeblood and directors must understand that, he says.

Instead of focusing on extracting maximum revenue from the first disruptive product Liquid Instruments launched, directors have had to adjust to a company geared for continuous innovation.

New directors joined the company following a US$8.16m investment round led by Washington DC based Anzu Partners, which also saw the Canberra business flip to become a US operating company. The directors — some US, some Australian — make a pretty good mix, says Shaddock. "We have some who understand what we have today will pale in comparison. The silver lining is when directors step down, we don't lose their insight. Former board members are almost as valuable as current board members if the relationship is strong. We're collecting a brains trust as the company grows."

> "Innovation is both an attitude and a process. Innovation is a skill set of openness, of questioning, of willingness to push boundaries and not accept the status quo. You need creativity, but you also need to have metrics and systems working. Innovation, to me, is this constant pursuit of improvement."
> — David Thodey AO FAICD, chair CSIRO.

Five vital steps

1. Lift directors' technology and digital literacy. Innovation requires a clear mindset and focus. It also requires shared experiences among board members rather than allocating responsibility to a "tech" person on the board. It is each director's responsibility to make informed decisions on the proposals put forward by the executive, and, where necessary, to lift their level of digital and technological literacy. Directors do not need to be technical experts, but they must be able to understand how key technological developments will impact their business. Innovation should form part of directors' program of continuing education.
2. Set clear expectations of management regarding calculated risk-taking to drive innovation. This is fundamental to fostering a culture that allows innovative ideas to surface, be tested and implemented promptly. This includes rewarding successes and failures and encouraging continuous learning. True innovation exists by learning from failure. It is the board's role to set clear expectations of the executive regarding what calculated risks they are expected to take. In some organisations, this might require the board re-evaluating the organisation's risk appetite entirely.
3. Develop a shared language with management, and clear narrative for investors/members on innovation. Directors and management should clearly distinguish incremental innovation from disruptive innovation. Growth is generated by innovation, but it requires acceptance of risk-taking. Directors should support management in balancing continuous improvements to current processes and products, while also investing in products and services that will become available in a five to 10-year horizon. Agreed language and a clear narrative will set expectations for the executive team, broader workforce, members/shareholders and other stakeholders.
4. Ensure innovation features regularly on boardroom agendas. Boards should assess how their innovation strategy is being realised and what are the key obstacles to implementation. Having regular conversations on innovation via periodic agenda items can help make innovation a more mainstream boardroom topic. Governance arrangements should be reviewed to determine whether formal board committee or advisory panel structures, drawing on outside experts, would help organisations achieve their innovation goals.
5. Establish a budget and executive incentives for long-term innovation. If innovation is to become a priority, boards need to assign time and a budget for it. This assists the executive team to prioritise initiatives and offer regular visibility of innovation projects. Similarly, performance and remuneration frameworks need to be recalibrated so innovation, including innovation with longer horizons, is encouraged within the organisation.

Case study – Shifting gears

The RAC in Western Australia's 12-year journey to create a board and management culture of innovation saw it dramatically improve its performance.

The RAC in WA's CEO of 21 years, Terry Agnew FAICD, retired in March and is now chair of the Business Council of Co-operatives and Mutuals. He outlines some lessons boards must heed in order to more effectively drive change.

Is there value in creating board sub-committees responsible for innovation?

In my view, no. A key success factor with innovation is collaboration — internally, between board and management, as well as externally. The risk of establishing sub-committees is that it creates further pockets or silos that are the enemy of collaboration. There is much more value in the whole board participating in innovation engagement and dialogue.

One of the challenges for any board is that the regular board meetings are frequently crowded with agenda items. This can limit the time available for dialogue and therefore often results in the innovation agenda item being more around presentations or reports.

Strategy retreats, by nature, are a valuable forum but the real opportunity gap to close is for stronger engagement between board and management. This should extend to the nature of innovation, what an innovative environment looks like and the challenges of innovation, including "failures".

Boards need good processes and frameworks around innovation, but it is also important to spend time discussing the metrics and why they are appropriate. This enhances greater common understanding and engagement in the innovation process and the sort of environment that best facilitates innovation.

The board and executive response when innovation initiatives fail is also important. At both levels it is valuable to spend time discussing and understanding failures and, in particular, what management and board can learn from them.

Another important question: is your board sending a clear message — both verbally and behaviourally — to management about the need to be bold in reimagining the business and moving to a new future?

What would I do differently if I had my time again?

Find a way to establish more dialogue around innovation — between management and board, as well as between senior leaders.

Establish broader links to the external innovation community.

Recruit more external innovation 'coaches' earlier. They should have specific experience in various aspects of innovation.

A wake-up call on innovation

25 September 2019, "A wake-up call on innovation", Membership Update, AICD.

Australia's risk-averse boardrooms are falling short when it comes to innovation, according to an Australian-first study carried out by the AICD, in partnership with the University of Sydney Business School.

A new AICD report, *Driving innovation: the boardroom gap*, has delivered a wake-up call to directors, who are struggling to drive the innovation necessary for Australia to turn around its lacklustre productivity growth.

A risk-averse corporate culture is preventing boards from prioritising innovation, the research found, leaving Australian directors lagging their international counterparts.

"Risk-taking, which is part of innovative thought, is becoming something that's quite dangerous to one's career," David Gonski FAICD*Life* said in an interview for the report. "The board member who's had a glorious career and is now 55 or 60 has an enormous amount to lose in a listed company board, and the listed company senior management has a tolerance for risk which is much less than what it was when I started out 35 years ago, as a director."

Five ways for boards to lead on innovation

The report outlines five key recommendations for boards to improve their performance on innovation:

1. Lift directors' technology and digital literacy.
2. Set clear expectations of management regarding calculated risk-taking to drive innovation.
3. Develop a shared language with management, and clear narrative for investors/members on innovation.
4. Ensure innovation features regularly on boardroom agendas.
5. Establish a budget and executive incentives for long-term innovation.

According to the study, which comprised an AICD member survey, interviews with directors, and global literature review, Australian directors recognise the importance of innovation but too often it is not a regular part of boardroom discussion. While three quarters of the directors surveyed said their organisation had an innovation vision or strategy, more than half of the respondents said that innovation has never been or was only occasionally on their board agenda.

The missing link

"The study tells us that innovation is often missing from Australian boardroom agendas," says AICD CEO and Managing Director, Angus Armour FAICD. "It reveals that traditional risks are the focus rather than the risks – and opportunities - associated with innovation and disruption."

Directors surveyed identified the three greatest barriers to innovation as: human talent shortages (31 per cent); limited financial resources (28 per cent); and the market's focus on short-term financial performance (19 per cent). "In interviews with directors, the problem of "short-termism" was also repeatedly raised as lying at the heart of the innovation challenge," the report says. Members also see Australia's regulatory environment as contributing to a risk-averse corporate culture.

"We need to strike the right balance between regulatory and compliance obligations, and growth and innovation as core goals essential to our national prosperity," Mr Armour said.

The study also reveals that Australian boardrooms have low innovation and digital literacy levels, emphasising the importance of up-skilling directors and refreshing board composition.

Notably, only 3 per cent of directors surveyed say they hold science and technology expertise, only 3 per cent indicate they have international experience, and 10 per cent say they bring innovation-related expertise to the boardroom.

Just over half (57 per cent) of directors are not aware of the percentage of their organisation's total expenditure allocated to R&D and innovation activities. Only 35 per cent said their board had the right skills and experience to assess both the ethical and practical implications of modern technology.

In an interview for the study, experienced company director, Wendy Stops GAICD, highlighted the role of the board in driving innovation, "the board ultimately is responsible for the strategy of the organization. And so, if the board's not encouraging innovation and expecting the executives to keep innovation at the forefront, then the board's not fulfilling its responsibilities".

Mr Armour says the study makes clear that more needs to be done to broaden skills that directors bring to a board. "This can be done through education and upskilling, and by widening the talent pool of incoming directors," he says. "It is encouraging to see that directors are acknowledging the importance of innovation, but directors need to make sure that innovation is more than just an irregular item on board agendas."

8 trends reshaping the global business landscape

1 May 2019, "8 trends reshaping the global business landscape", *Company Director,* May 2019, AICD.

CSIRO's Data61 Senior Scientist Stefan Hajkowicz outlines the major trends reshaping the business landscape, and how directors can manage the associated risks.

In April 2010, the CSIRO inadvertently launched its first megatrends report, *Our Future World*, at the Melbourne Convention and Exhibition Centre when a video link failed during a global consulting company's address. The conference host, journalist Kerry O'Brien, asked us to step in and deliver an impromptu presentation of an internal and incomplete strategic foresight study aimed at shaping CSIRO strategy.

The audience of more than 500 industry, government and community leaders responded well to the science-based narrative for Australia's future. Soon after, we received requests for boardroom briefings and research consultancies. The Australian Institute of Sport and real estate investment trust GPT Group were first to commission megatrends studies of their own.

Today, the CSIRO Data61 Insight Team has completed numerous research consultancies and hundreds of boardroom briefings and executive team seminars and workshops on megatrends. Each project contributes to an expanding dataset on the future comprising geopolitical, economic, environmental, social and technological trends. We're now sitting on a vast trove of data about the future and we're starting to use econometrics, machine learning and predictive analytics to push it further.

The megatrends arising from this research have been covered in *Company Director* over the years, and now the AICD has partnered with CSIRO's Data61 to keep them live.

The concept of megatrends emerged from the field of strategic foresight, a growing space of study and profession centred on exploring plausible futures. The term "megatrends" was first used by Professor John Naisbitt, whose book, *Megatrends: Ten New Directions Transforming Our Lives* (1982) was on *The New York Times* best-seller list for almost two years, selling more than 14 million copies in 57 countries. Naisbitt's work gave us the concept of powerful trajectories of change occurring and the intersection of numerous trends and drivers.

Megatrend analysis is widely used by companies and consulting firms. For example, Hewlett Packard has a public website on relevant megatrends to inform customers, investors and staff about opportunities. In the public sector, the Organisation for Economic Co-operation and Development (OECD), the National Intelligence Council in the US, the Centre for Strategic Futures in Singapore, and the European Commission also use this approach.

Megatrends have become a powerful way of analysing change. There is scope within ASX-listed companies to make much better use of megatrends to proactively harness opportunities and to mitigate risks.

Trend tracking

Megatrends develop gradually over years and decades, but eventually express themselves with explosive force, reshaping the business landscape within months. One example is the impact of ride-sharing apps on the taxi industry. This revolution was part of a broader digital megatrend that combined trends about technological advances — such as smartphone penetration and the accuracy of GPS signals — with trends about cultural change and shifting notions of consumer trust. The change was already underway in 2008, when smartphones were introduced, but it was several years before the marketplace was reinvented.

And when it happened, it happened quickly.

According to Queensland government data, published in the Brisbane Times in February 2018, the price of a taxi plate in Brisbane fell from \$530,000 in 2014 to \$113,000 in late 2017, a decline of 78 per cent in three years. This megatrend developed gradually during the preceding decade but, when it hit, there was no catch-up time for the taxi industry, which needed the same digital tools as its new competitors five to 10 years before the marketplace flipped. Catching up was, and will continue to be, a hard slog.

Megatrends also herald opportunities. In 2012, Michael Cameron, at the time CEO of the GPT Group, commissioned CSIRO to research megatrends affecting the property sector. One megatrend GPT noted was the rising transfer of economic activity from physical retail to background logistics — basically, every time we buy online we transfer a little of the economic activity from the shop floor, which GPT rents, into warehouses, trucking, ports and logistics to get the parcel from the manufacturer to our front door. Because online trade is growing rapidly, GPT increased the size of its logistics business from \$832 million in 2012 to \$1.485 billion in 2015, with plans to invest another \$400 million. Following the success of this logistics shift for GPT, Cameron concluded "one of the best ways to anticipate change in your sector is to spend time outside of it".

Megatrends have high-level implications for corporate strategy. But as a business, you can't choose whether or not the change happens, as you're in a powerful current. However, you're not totally at the mercy of the wind and waves. Adjustments now will make a big difference in a few years.

In 2019, CSIRO will release an update of material found in its 2016 book, *Global Megatrends*. Some of the narrative is similar in that megatrends have multidecadal time frames. However, there's significant new material, including artificial intelligence (AI), the risk of infectious disease, economic restructuring of Asia-Pacific economies, geopolitical shifts, energy storage technologies, the rise of renewables, blockchain, and the continued growth of online platforms. Here are CSIRO's eight megatrends reshaping the future operational landscape for business.

More from less

According to data from the United Nations, by the year 2030, the world will welcome another one billion people. Data from the Australian Bureau of Statistics indicates the Australian population will grow to 30 million by the same year, up from the current 24.6 million. The OECD estimates the size of the world economy (GDP/year) will grow from US$103 trillion in 2020 to US$137 trillion by 2030. More people with more buying power will place greater pressure on scarce global food, water, mineral and energy resources. For example, the International Energy Agency says all forms of energy consumption will grow by 30 per cent by 2030, with renewables the fastest growing category. The Food and Agriculture Organization of the United Nations estimates the global food system will be expected to increase production by as much as 35 per cent by 2030.

The bottom line: Companies that are innovative and develop solutions to more-from-less dilemmas, such as batteries for solar electricity and food for Asian populations, will find a large marketplace ready to buy their products and services.

Planetary pushback

From global to microbial scales, human activity has changed the way the Earth's ecosystems operate. On the global scale, climate change continues along a trajectory roughly consistent with scientific forecasts. In Australia, we can expect a more variable climate with annual average temperatures one degree Celsius warmer by 2030. At the microbial scale, the excessive and sometimes incorrect use of antibiotics has fuelled the rate of resistance. A survey by the World Health Organisation, in early 2018, found that in some countries, up to 82 per cent of people with bacterial bloodstream infections were carrying a "superbug" with known resistance to one or more commonly used antibiotics. Herbicide and pesticide resistance are creating similar challenges in agriculture.

The bottom line: Your company will be vulnerable to new and increasing risks associated with environmental change that need solutions today, not when they happen.

The Silk Highway

In Asia, the focus isn't just on the magnitude and speed of economic growth, it's also on a different type of economic activity. Asian economies are transitioning from an industrialisation phase into advanced-service sector economies with different demand profiles. For example, Reuters reports China spent 1.76 trillion yuan ($382 billion) on research and development last year, 14 per cent more than the year before. Education, health, banking and finance, tourism, administration and other service sectors are growing rapidly in China.

The bottom line: A global strategy can't ignore the Asia-Pacific. This is where the action is in terms of wealth generation and the shifting focus of economic activity.

On the move

Whether it be relocating from a farm to a city, commuting to work, international jet-setting or going on a cruise, people are moving more than ever before. For example, Boeing's most recent 20-year market outlook forecasts rising demand for 42,730 new aeroplanes valued at US$6.3 trillion. The aviation company also predicts the global aeroplane fleet will double in size by 2037.

Freight transport is also on the rise. As e-commerce and online deliveries expand, more parcels and packages need to be moved. Boeing predicts air cargo traffic will grow 4.2 per cent per year for the next 20 years.

Data has also become more mobile. Digital data is migrating into the cloud from people's hard drives and organisational servers. The quantity of data transmitted over the internet continues to rise exponentially.

The bottom line: Now is a good time to think about transport and logistics, both as a business and for your business.

Forever young

The Australian population is ageing. Retirement ages are rising, demand for aged care facilities is growing and costs are soaring. Healthcare expenditure is increasing unsustainably, creating challenges for budget planners in state, territory and federal government treasuries. The Australian Institute of Health and Welfare forecasts total health expenditure to rise from $180.7 billion in 2017 (10 per cent of economic activity) to $320 billion by 2035. Rates of chronic illness associated with diet and lifestyle remain high and sedentary behaviour is increasing as we spend more time on computers.

The bottom line: If you can find health and ageing solutions, you may well have a viable business model.

Digital immersion

As digital technology continues to improve, increasingly it will reshape business models, jobs, learning, communication, governance systems and lifestyles for practically every profession, industry, demographic and geographic region. The transformation of the economy will be significant. A recent report from AlphaBeta Advisors economic consultants and Data61 estimates digital innovation could deliver $315 billion in gross economic value for Australia. The global corporate landscape has been reshaped in line with the digital age, with technology companies becoming dominant. Technological innovation can explain the bulk of growth in market value over the past two decades.

The bottom line: Companies soon won't need a digital strategy because there won't be any other type of strategy. Digital will play a significant role in boosting profits and raising prices.

Intelligent machines

Breakthroughs in general purpose AI technology have elevated the capability of machine learning, robotics, computer vision and natural language processing. We are building machines that have the ability to learn and improve their operations without explicit human guidance. Currently, 20 nations have AI strategies, and in November 2018, Germany became the latest country to announce its plan, committing $4.7 billion to developing AI technology by the year 2025.

The bottom line: What was science fiction has become science fact: AI is a powerful technology and your company needs to adapt to a new world of autonomous systems. If you don't, your competitors will.

Keeping it real

As we become immersed in the virtual world, the marginal value of the real — physical — world will grow. While there's no "unplug" option in the physical world, consumers, citizens and society dealing with information overload are seeking "digital detox".
The best digital technology solutions will be invisible to the customer and simplicity will be key to success. The physical spaces in which we work, play and live will hold greater significance.

The bottom line: The business models best incubated from digital disruption will involve real people, places and physical experiences. Don't lose sight of what the human customer wants in your digital transformation journey.

CHAPTER 4.

Customer-centricity through digital transformation

6 tips for becoming a customer-centric organisation

Deborah Tarrant

1 August 2019, "6 tips for becoming a customer-centric organisation", *Company Director*, August 2019, AICD.

Maximising customer experience through a customer centric culture is more important now than ever following the Banking Royal Commission.

When it comes to customer service, organisations around the world are knocking on the door of Service NSW to find out how to do it right. The outstanding success of the NSW government's central agency for an ever-growing number of services and related transactions is now pivotal in the formation of a Department of Customer Service designed to remove the pain points for citizens across all state government departments.

Operating since 2013, Service NSW delivers driving tests, fishing licences, births, deaths and marriage registrations and a multitude of other services online or via 100-plus service centres, some with extended opening hours and a call centre answered by Service NSW staff. Topline statistics summarise the organisation's transformation:

- One phone number has replaced 8000+
- service.nsw.gov.au website has replaced 900+
- Customer satisfaction is now 97 per cent (up from 69 per cent)
- Average wait time is seven minutes.

Victor Dominello, the recently appointed NSW Minister for Customer Service, reflects on the triumph — rating 97 per cent customer satisfaction as "near perfection" and attributing much to the original decision to build a standalone, agile agency from the outset. "It allowed a service delivery culture to be set up, rather than trying to adapt an existing culture and structure," he says.

While the agency selectively hired many government employees from amalgamating organisations such as Roads and Maritime, it also employed customer service experts from the private sector to drive the change. What it got right was its leadership, says Raj Mendes, founder and MD of the Customer Experience Company, a Sydney-based consultancy that worked on service design with Service NSW before its launch and has since worked on 60 projects for the agency. "They set about creating a cultural DNA, customer principles that formed the guiding light, followed by the design of the experience," says Mendes.

Technology did not come first but was created to support the service environment based on the experience they wanted for customers — for instance, how people are greeted in a centre, "triaged" or queued.

One point from Mendes' colleague Laurence Crew is that "greenfield" environments in customer service are rare. "Typically, for large organisations [pursuing a customer-centric approach] it's a change activity," he says.

It can start small. In fact, having a pilot customer experience program may be the trailblazer a business needs to convince leaders to adopt a more widespread strategy, says Crew.

Putting customers at the heart

Customer-centricity — putting customers at the heart of the organisation — has become a mantra. Customers or consumers now hold the power and they're wielding it, reshaping the future of business in the process. Recognising this, the Australian Banking tin July.

Andrew Stevens MAICD, former MD of IBM Australia and New Zealand and now chair of Innovation and Science Australia (ISA) — the independent board of entrepreneurs, investors, researchers and educators that advises the Australian Government on harnessing innovative practices — defines some big-picture drivers.

"We've moved from an environment of shortage to abundance — consumers now have massive choice," he says. Plus, the nature of the "value" customers are buying today is increasingly intangible — it's confidence, user experience, ease of use or "frictionless", he says. "The market is now global instead of local and it's gone from low-information to high-information, largely through social media. Consumers have more information than they've ever had before."

Essentially, companies must innovate with a customer focus or get disrupted, says Stevens, and they need to move fast in understanding how to be different. Indeed, all the household-name disrupters define a unique customer experience — think Uber, Netflix, Amazon, Zappos, for starters.

Stevens says successful businesses — whether business to business (B2B) or business to consumer (B2C) — understand the value of differentiation and what that means for the choice they're offering the customer.

"Customer-centricity is about choice, value and appealing to the customers at a micro level because 'I get their need'. The frontier of competition today is about insight on the customer — it's the main game," he says.

It's a topic Stevens, a non-executive director at Stockland, CEDA, Thorn Group and GWS Giants, is exploring closely as he zooms in on business models for the future at ISA. Pending a detailed ISA report, to be released later this year, Stevens draws on observations from his executive career spanning professional services at IBM where he ran consulting for global growth markets and saw businesses "leapfrog" their way to competitiveness off the back of customer insights. "Companies that get customer-centricity, typically have a growing global market share, their margins are expanding, and they are highly successful businesses," he says.

Customer needs and preferences are now manoeuvring corporate competitive strategies. It's a headline issue for directors, Stevens argues, and it raises basic glaring questions, which he suggests many boards may have difficulty answering: What do our customers want? How have we chosen to compete? How does our innovation investment stack up with our competitive strategy? "To me, customer-centricity is at the heart of it all," he says.

So, who's doing it well? In B2C, Stevens finds it hard to look past Apple and Samsung. He uses Apple's iPhone X as a case in point, noting that its manufacturing cost has been estimated as low as five per cent of the sales price — meaning 95 per cent is intangible value.

"It's in the design of the product, how it feels in your hand, the service, the warranty, the stores that are all about service to the customer, the brand experience, the way people look at you when you're one of the first people with it, the confidence," says Stevens. "They are brilliant at it and, when you go into a store, they know about you because of your Apple ID." While the product is not unique to every person, the iTunes platform enables the customer to tailor their phone to their own use.

The next data frontier

The talk is getting louder about exponentially growing zettabytes of data powered by AI and machine learning. It's greasing the wheels of business, delivering vital insights into the customer alongside scope for personalisation.

However, Andrew Stevens remains sceptical that many organisations are adequately using the data they have.

"What does our data tell us about our customers and prospects and their buying behaviour? That would be a pretty awkward question for our companies."

Yet a data-related change is coming that will deliver a further call to organisations to move faster on the customer.

Stevens chairs the data standards body for Australia's Consumer Data Right (CDR), which will allow consumers to direct that data held about them by one organisation be made available to another. It starts with open banking in February 2020. Other sectors will follow.

The CDR is a massive opportunity for business, Stevens believes. "We have a regime coming in that says you can top up the data you have about your customer with data that's held by someone else. What does that data tell us about customers' buying behaviour, and what about prospects?"

The most dramatic innovation comes at the convergence of sectors when you create something unprecedented, he notes. "Will organisations be ready to serve underserved customers or provide an aggregation of a whole range of data to benefit the customer?"

With the enterprise currently under challenge over issues of trust and directors considering if they're working only for the shareholder or customer, Stevens says: "There's an expectation that vulnerable customers need to be protected by organisations. This is right in the melting pot of the CDR and it says, if you do that well, you'll be entitled to a return."

Customer excellence

Determining what customers want is challenging for organisations everywhere. It's nuanced, different for every player, but it can be summarised. In its 2018 report, *Tomorrow's Experience, Today: Harnessing a customer first approach in a changing world*, KPMG calls out six pillars of customer excellence:

- Personalisation — using individualised attention to drive emotional connections
- Integrity — being trustworthy and engendering trust
- Expectations — managing, meeting and exceeding customer expectations
- Time and effort — minimising customer effort and creating frictionless processes
- Resolution — turning a poor experience into a great one
- Empathy — achieving an understanding of the customer's circumstances to drive deep rapport.

> "For that [consumer advocate voice] to be part of the business' future it needs to be represented at the highest levels of management. Without that it's going to be difficult to develop and execute a strategy around customer-centricity."
> — Helen Nash GAICD

Before her career as a non-executive director (Metcash, Southern Cross Austereo, Blackmores) Helen Nash GAICD spent almost a decade in senior marketing and as COO at McDonald's Australia. She harks back to the global fast food chain's deep understanding of 10 things customers valued — "an exceptional visit hasn't changed that much over 50 years and it starts with fundamentals such as hot, fresh food to fast service, clean toilets, clean restaurant... An external company was employed in every country globally to deploy the same measurement tool to customer experience [based on these requirements]," recalls Nash. "You set up the business to be on a continuous journey of improvement towards that."

In reality, focusing on the customer can be complicated. Customer experience excellence is not a destination, but a journey, explains KPMG in its report: "It starts with a deep understanding of the customer and the ability to creatively connect technology, people and process to solve an underlying customer need." Orchestration and connectivity across an ecosystem of partners is critical. A vital part of that is alignment of employees to putting customers first. Many claim it's the linchpin.

> "I don't think there's a good understanding of what customer-centricity means. Many are struggling because the concept of good customer service has radically fragmented in the past 10 years."
> — Alan Kirkland, CEO Choice

Grappling with customer concept

"I don't think there's a good understanding of what customer-centricity means," says Alan Kirkland, CEO of consumer advocacy group Choice. "Many are struggling because the concept of good customer service has radically fragmented in the past 10 years." Witness the range of approaches, he says. "Some are doubling down on traditional customer service, the human way, while many increasingly rely on purely digital means of serving customers. Others, such as the big online clothing retailers, are fuelled by logistics and ecommerce, making it easy to find and buy online, getting them to you fast and making it easy to return products."

The challenge begins with gleaning customer insights. "In established businesses they're often still dealing with data sources that don't allow them to see a single customer as one person," says Kirkland. While many increasingly rely on data to drive personalised responses to their customers, personalisation can be inherently impersonal, he says. "By looking at data, you're trying to determine the needs of the customer."

Kirkland sees conflict between being data-driven and a very human reaction from customers who just want to deal with a human being. It's a reality that data and automation can produce really efficient ways of servicing a customer base, he says, pointing to big tech successes such as Airbnb and eBay. "What organisations need to do is work out when that's not the right approach."

> "The executive team in long-term incentives has a customer hurdle performance — and an NPS well above the industry average as one of their hurdles."
> — Jacqueline Hey GAICD

Loyalty: the new customer pain point

There's growing debate in Australia and globally around the importance of loyalty, says Choice CEO Alan Kirkland. "There is a deep feeling among consumers that they have been loyal to a business for many years and should be treated well," he says. "When we talk to Choice members about health insurance, for instance, we see many people who have been paying [premiums] for years, but perhaps not claiming at a high rate. When they need to make a claim, they're angry when it's denied or paid at a low rate."In 2018, the Productivity Commission found that established customers pay a lot more for their mortgages than new ones. In the age of active customer-centricity, Kirkland cautions against extracting value from what's perceived to be a passive established customer base.

Grabbing levers for customer-centricity

A customer-centric journey is only possible for an organisation if there's a consumer advocate voice in the boardroom, insists Helen Nash. "That's the voice I bring to my four boards, but in order for that to be part of the business' future, it also needs to be represented at the very highest levels of management. If not the CEO, it needs to be in their direct reports — chief marketing officer, chief growth officer, chief customer officer. Without that it's going to be difficult to develop and execute a strategy around customer-centricity.

Customer-related KPIs are on the rise. Jacqueline Hey GAICD, a non-executive director at Qantas, Cricket Australia, AGL and Bendigo and Adelaide Bank, where she'll chair the board from October 2019, believes performance and remuneration provide strong levers to promote customer-centricity. "We've included a customer hurdle as a performance measure in our long-term plan," she says.

"The executive team in long-term incentives has a customer hurdle performance — and an NPS (net promoter score) well above the industry average as one of their hurdles."

Hey's appointment comes in the wake of the banking Royal Commission, which highlighted what can happen when profits and shareholder interests in financial services organisations supersede those of customers. Before the Royal Commission, Bendigo and Adelaide Bank had faced pushback from proxy advisors dismissive of such hurdles as soft measures. "We thought it was important for our executive to focus not only on the financial outcomes, but on making sure they meet customer hurdles and performance measures," says Hey. The Bendigo board also pre-empted the recommendations of the Royal Commission by a decade when it introduced deferred base pay for the managing director and, later, for executives. Employee incentives related to the achievement of sales targets were also eliminated "because they obviously weren't in the customers' best interests".

The incoming chair claims Australia's fifth-largest retail bank has a natural advantage over the Big Four due to its long-term, overt focus on customers and community. While Bendigo ranked third in the KPMG Global Customer Experience Excellence report, Hey also points to the bank's consistent Roy Morgan ranking as one of Australia's top 10 most trusted brands. "That's across all brands, not just the banks," she says.

Such rankings come from "not being faceless bankers", adds Hey, noting that the bank's executives are highly visible in its heartlands around Bendigo and Adelaide.

"They're the people at the netball or the football or the cricket, or they're shopping down the street, which means they hear the good and bad from customers all the time," says Hey.

"In this environment of heightened importance of trust, authenticity and doing the right thing, we have a terrific opportunity because customer-centricity is part of who we are, where we're based and how we've always worked."

Case study – Bunnings Warehouse: How employees drive customer-centricity

Customers remember you for the things they weren't expecting," says Clive Duncan, director of corporate affairs and business development at Bunnings Warehouse and a company employee for 40-plus years. He points to customer-first principles from the top down as the backbone of its' organisational growth. The company opened 10 warehouses in Australia and NZ in 2017–2018, for a total 295 stores and 30,000 employees.

Likely on that list of unexpected moments is being served by a senior executive in store or receiving a follow-up phone call from a Bunnings director in the wake of a complaint. And the DIY, garden and hardware retailer dispatches the leaders from its five-state support centres several times a year for Hammertime, a program where they work the shop floor to learn about customer experience first-hand. Senior leaders are also expected to call disgruntled customers if a complaint is made.

"It helps them understand where there's friction or we can do better for the customer," says Duncan. "We're strong on alignment of our strategy and our pillars (lowest prices, widest range, best service) through the organisation."

Further playing to Bunnings customer-centricity is the diversity of those who regularly work the shop floor. It's a workforce spanning generations, from career beginners to retired tradies, reflecting the ages and life stages of customers.

Duncan recounts tales of team members delivering goods in their own cars to customers "who needed them that night".

"They're highly empowered," he says. "That's particularly important for a business our size. Our people are empowered to make decisions on the spot — simple things such as returns or needing something over and above."

The company plays on themes of authenticity and practicality. However, prior to the launch of Bunnings Warehouse 25 years ago, when the decision makers were dispatched to learn about global best service, Disneyland was on the itinerary.

Bunnings' takeaways from the famous theme park continue today with in-store cafes and playgrounds, family activities, workshops, free trailer hire, and weekend sausage sizzles. Curiously, beyond a tradie loyalty scheme, Bunnings is comparatively short on data. Its e-commerce play has only just begun, with plans to complete a rollout of 60,000 products online by this Christmas. Digitally speaking, it's late to the party.

"It's time to start building another channel as the customers change," says Duncan. While it's early days, he says the aim of the omnichannel approach is "about giving customers choice and the same experience whether they're researching or shopping online or in store".

CHAPTER 5.

Digital transformation in the not-for-profit sector

Digital transformation in the not-for-profit sector

Lisa Grinham
CEO, Good2Give

Digital disruption is everywhere, with all sectors being disrupted by technology, including the not-for-profit sector. Just as for-profit businesses must innovate in response to changing customer demands and lifestyles, so must charities when engaging with donors. Charities also need to capitalise on opportunities offered by technology and changing marketplaces, structures and dynamics, to deliver on their mission and purpose.

Charities operate within a complex governance framework. With reporting required to regulatory bodies including the ACNC, ASIC, ATO and State fundraising bodies; changes in financial reporting standards as well as legislative changes from time to time, the responsibilities of Board directors and CEOs of not-for-profits can be significant.

Add into the mix the need for charities to embrace technology, and all the risks (and rewards) that go along with that; undertaking a digital transformation in the not-for-profit space is not for the faint hearted.

The growth in the significance of the 'giving back' movement means that businesses can no longer operate by only considering returns to shareholders. Businesses now need a set of strategies, investments and values that reflect the broader role they play in society. Key stakeholder groups demand it — employees, customers, suppliers and shareholders.

No one knows this more than Lisa Grinham, CEO of Good2Give, whose agenda is to assist businesses deliver a variety of impactful charitable giving programs. By connecting businesses, donors and charities, Good2Give facilitates funding for communities in need, and advocates for wider change to drive greater levels of corporate giving.

"We make it easy for businesses, their employees and their customers to donate", says Grinham, "and the best way to do that is through robust and secure technology. One of our services, a workplace giving platform, is cloud-based and makes it easy for staff to make donations direct from their pay. It also allows companies to match donations, aggregating and streamlining funds distribution to charities, delivering much-needed low cost funding to charities."

Good2Give also runs technology platforms for companies offering corporate grants programs and managing charitable foundations and are always looking for more innovative ways for people to give. In late 2019, they merged with ShareGift Australia, delivering a service that enables shareholders to unlock unused share capital and donate to charities. And they have technology alliances with GoFundraise to enable Fundraising at Work, as well as Quest Payment Systems, delivering Tap2Give so people can tap to donate.

Commencing the technology transformation

On taking the reins of Good2Give in late 2012, Grinham's key challenge was to create, and deliver on, the plan to digitally transform the organisation, so as to remain relevant to its customers, and ensure its ongoing financial sustainability. Delivering donors and donations to charities is why Good2Give exists, and Grinham knew technology was the only way to do this, and to do it at scale.

"I could see the market was changing, our corporate clients and donors were becoming far more tech-savvy and wanted to make donations online. We were swimming in paper, which had to change if we wanted to not only survive as an organisation, but to thrive. I wanted Good2Give to be a disruptor and not be disrupted." Grinham says.

Grinham met a successful tech entrepreneur, who was considering developing a technology platform that did exactly what Good2Give required. Her pitch to him outlined the benefits of them working together, and not in competition. Their complementary knowledge, experience and resources would ultimately result in more than $120 million worth of social return. Not only that, when he brought his team with him, he also donated $1 million to commence Good2Give's digital transformation.

The development of a flexible tech platform, critically important for Good2Give's growth, was now underway. The transformation journey took a lot of hard work, Good2Give had to learn to pivot quickly while at the same time, keep a close eye on cash and continually listen to their customers.

Stakeholder transformation

A technology transformation doesn't just impact back-office systems and processes; it affects all aspects of the organisation. Good2Give Director Michael Graf MAICD notes, "The board is not exempt from the transformation. Boards need to ensure their directors are upskilled and/or bring in directors with new skills to meet the needs of the operation moving forward. We did refresh the board, with three (out of seven) new board directors bringing a wealth of digital capabilities to the table."

Grinham developed the business transformation strategy but for it to be successful, she needed the board to be fully engaged, to understand the opportunity, whilst being cognisant of the risks. It was also vital that the right operational team was in place, which, like the board, was a combination of upskilling existing staff and new hires.

With the right people in place, Grinham delivered on a successful plan to digitally transform Good2Give, bringing all key stakeholders along in the journey.

Investing in technical expertise

The establishment of the volunteer Technology Advisory Group (TAG), as a mechanism to bolster Good2Give's technology and cyber security expertise was quite unique in the not-for-profit, and probably the for-profit sector, when it was created four years ago.

TAG members share their expertise and TAG acts as a sounding board for management and directors, bringing to bear technology and transformation skills honed at firms such as Atlassian, IBM and Macquarie Group as well as startups and digital disruptors. TAG meets every two months, as well as once a year at Good2Give's annual board strategy day.

The Good2Give board find that keeping abreast of current issues and keeping up with the rate of change in the technology space is constant. Management and the board have invested heavily in cyber security — from a technology but also a people perspective. The cyber security protocols are at a level that are acceptable to some of Australian largest companies, including Westpac, NAB, Suncorp, Australia Post, PwC, EY, and many more.

Realising the digital economy benefits

Prior to its digital transformation, Good2Give was facilitating around $5 million annually to charities throughout Australia and New Zealand. That has now risen to more than $20 million, supporting over 2,500 charities and managing donations from 25,000 donors.

Since its inception in 2001, the organisation has raised $230 million. It aims to deliver $300 million to charities by 2022.

As well as providing much needed funding for charities, Good2Give's corporate partners are also realising the benefits of their inspiring charitable programs, delivering greater levels of staff and customer engagement — it's a win-win for everyone.

Innovation a priority for leading consumer advocacy group

Sandra Davey, Chair, CHOICE and Alan Kirkland, CEO, CHOICE

14 November 2019, *Innovation a priority for leading consumer advocacy group*, Governance Leadership Centre, AICD.

The Governance Leadership Centre spoke to the Chair and CEO of CHOICE about the organisation's approach to innovation.

Sandra Davey MAICD, Chair of leading consumer advocacy group CHOICE, and Alan Kirkland, CEO of CHOICE, discuss innovation in organisations and the boardroom.

How has CHOICE adapted to a rapidly changing operating environment?

Alan Kirkland (AK): The biggest change for me has been to bring all of our core digital product development in-house. Go back a decade or so and everyone was looking for opportunities to outsource. But it's hard to make that work in an environment where you need a combination of agility and a deep understanding of your users' needs. You need product people and developers embedded in your organisation, working alongside subject matter experts, in order to be able to respond to rapid changes in your environment.

Sandra Davey (SD): I'd add our approach to innovation and agility. We've invested heavily in our people, platforms and tech over the past few years. As Alan said, insourcing what we now agree is core intellectual and creative property, and, along with that, augmenting and uplifting our existing people capabilities by hiring people with experience in product, UX, developers, and underlying technology and enabling platforms. We have also further augmented our people capabilities by hiring for commercial digital business model and commercial development expertise.

What are some examples of innovative initiatives adopted by CHOICE in recent years?

AK: We invested in a dedicated innovation team, New Things, which had a brief to experiment, free of any need to deliver results for existing products. That approach brought us some great results — the CluckAR free-range egg app, which was one of the early augmented reality apps in Australia, a new online community to engage our users, and the Transformer energy service that demonstrated the potential of an energy switching concierge service.

But the greatest impact of this approach was probably the impact it had on our culture. It gave us the confidence that we could launch new things that users loved. We've now wound down that team, as we're more confident about our ability to drive innovation from within the organisation.

SD: Building on what Alan says, we've also seen an impact upon our systems, processes and structures. As we increasingly work in cross-functional and multi-disciplinary teams, this has started to break down (in a good way) some of our legacy practices. "Agility" typically starts in software development or product teams, and once it takes on, it creates the opportunity to rethink other practices, many of them stale anyway and in need of a shakeup.

How does the CHOICE board foster, drive and monitor innovation?

SD: We've done it in a few ways. Among board members, and being conscious of where we need to get to, our skills matrix has changed considerably. When I joined the Board nine years ago, we had minimal "digital/product/innovation/tech" experience. More than 60 per cent of the board now has significant capability in these areas. The current board has had the privilege of a healthy business and healthy cash reserves, so our risk and investment profile has morphed in line with our needs and strategy.

Another example is the language and behaviours used in our conversations and throughout the organisation: continual learning and improvement, and, importantly, breaking work down and iterating in faster, smaller chunks.

AK: Having clear expectations is important: it is crystal clear to us that the board sees innovation as a priority and is willing to invest in it. The board is also really clear about its need to get out of the way — it is disciplined about not getting into the nitty gritty of ideas we may be testing — it's more interested in knowing why we have decided to play in particular markets and how we will measure success. It's a real shift from outputs to outcomes; that takes discipline but it's very important.

What do you think are the key barriers to innovation in organisations?

SD: Two of the key barriers are board and leadership teams. I'm a believer in the idea that the quality of results is a function of the interior condition from which we operate. If the board and leadership team doesn't have a growth mindset along with an openness to new ways of working, we won't get anywhere. I'm not saying it's easy. In fact, breaking down systems, processes and structures that no longer work is far easier compared to the "unlearning or relearning" that many of us have to do.

AK: For any organisation with established business models, the biggest barrier is competition for resources and attention. There will always be a long backlog of stuff you could do to fix existing products and processes and the items on the backlog often have powerful advocates. However you go about it, you need to carve out some distinct resources that are targeted at innovation.

CHOICE has also been a leader in innovation in the boardroom. What are some examples of innovative board processes adopted by CHOICE?

SD: Using a mashup of agile, lean, and product-led practices and techniques. For example, the OKR framework has dramatically helped to shift our focus from outputs to outcomes. Using simple but effective techniques — such as retrospectives for learning and improvement, and self-selection and no-objection decision making — to free up time for work that really matters.

AK: I'm constantly surprised at how willing the CHOICE board is to just try something new. One thing we are increasingly trying to do is find the right mode of conversation for a subject. Where we need people to be thinking creatively and collaboratively, we try to get them on their feet, scribbling on paper. Maybe that sounds a bit simplistic but the way you have a conversation really matters. Put people in seats around a table and they interact in different ways than if they are on their feet, moving around.

Do you think governance innovation is needed for higher board performance?

AK: Traditional approaches to governance may be fine for some organisations but I don't think they can deliver the best outcomes for organisations that are operating in rapidly changing environments.

SD: Good governance is a given. But, like Alan says, some approaches that have worked well in the past, don't work so well when faced with the kind of volatility, uncertainty and complexity we now operate in.

Can governance innovation help facilitate organisation-wide innovation and improve organisational performance?

SD: The way we structure our organisations, business units, and their practices and processes is changing in order to operate in this new world order, so taking a leadership stance is critical. How we think about power and hierarchies, how we think about our organisations' systems and structures, how we empower and enable autonomous teams to make decisions — these all require different approaches to governance.

AK: I would not say that governance innovation drove organisational innovation or vice versa at CHOICE. For us, it has been more of a dynamic exchange — we adopt agile approaches within the organisation, then start to think about how to apply them at board level. The board starts to think about how best to measure innovation and that infects the way that we think about measuring impact internally. It's ideally a constant exchange of ideas and approaches.

Looking forward, do you expect more organisations to increase the focus on technology and innovation in the C-suite and in the boardroom over the next 5-10 years?

SD: Without a doubt. We can think about technology and innovation both internally and externally. We already know the extent to which we now contend with different user needs, different market needs, a rapid pace of change, and the velocity at which new entrants arrive to contend in the spaces we operate. Technology and innovation have internal impacts as well — so how focusing on our people, their happiness and their capabilities, as well as focusing on refiguring our systems, processes and structures, are all necessary.

AK: I'd say that has been the pattern over the past 5 to 10 years and it will only accelerate. If the sector in which you already operate hasn't already been subject to attempts at disruption, there's a reasonable chance somebody is planning it. More importantly, technology is changing users' needs, so if you want to retain customers, you will need to innovate, most likely through technology. It's hard to imagine a board that would not expect the amount of attention it pays to technology strategy and innovation to grow year-on-year.

CHAPTER 6.

Planning for the future workforce

Culture beyond a cliché

Rhonda Brighton-Hall
Founder and CEO, mwah. Making Work Absolutely Human

As we lurch between glib soundbites, aggressive tweets and gasps of horror at the structural impacts of robotics and AI, we would put forward a simple yet important plea — to consider humanity as we design and build the future of work.

In making that shift, there are few roles more important than that of a board director. Developing a genuine appreciation of organisational culture and its impact on so many inside and outside the organisation, is a critical aspect of the future of work and indeed the future of organisations. It will be, if not already, a core capability of future directors.

Here are some simple ideas about how that can be done.

Understand the system

Organisational culture, or 'how we treat each other around here', is fundamentally a complex human system. As such, it can and should be mapped as a system – the stated rules and policies, mapped against core people processes (recruitment, performance, development, reward/ recognition and change) that are in turn mapped against relationships, expected collaborations and results. Each aspect determines the experience of working within your organisation and whether your culture thrives. Ultimately, this employee experience also maps to customer experience.

Look at the system as a whole, not in short twenty-minute board reports that talk only to one narrow or siloed agenda such as 'recruiting data' or the 'diversity report' but as a map of the whole set of interactions and impacts. What is the 'diversity of recruitment'?

Measure culture as a system, not a single score

Human capital metrics have been available for twenty years. It is always perplexing to see the dismay on an executive or a director's face when their organisation hits the front page of the paper. Often, they've had the numbers that told the story they needed to hear for the longest time but they were distracted by a single (almost always positive) engagement score.

Extraordinary levels of exits and unplanned redundancies are sure signs of leaders who cannot manage contribution or culture. Large numbers of bullying claims, or calls to a hotline, are signs of much worse. Ad hoc or urgent recruitment, instead of workforce planning, are signs that no one is managing the long term — in the age of result short-termism.

These numbers are all symptoms. Keep following them down the rabbit hole until you know what they're telling you. High engagement is linked to productivity but not necessarily to belonging or whether people are thriving. You need a deeper understanding, not just one number.

As an effective director, you need to see the people numbers as a whole set just as you see the financial numbers.

Be thoughtful, not faddish, and prioritise what matters

With a culture map, and knowing your numbers, you can move into being thoughtful on culture. What's working? What's not? Who's leading well and who's not? Who's thriving and who's not? Is the organisation in step with societal change, or not?

Good culture takes years of consistent, planful, diligent attention, and constant reference to what's happening in society. It changes and grows, to maintain relevance. Prioritise what matters to your business, your team and your customers, not just what everyone else is talking about. Think forward.

Currently, we are considering a few linked agendas that have an increasingly societal focus:

Structure of work: What are the impacts on wealth, security and wellbeing? Are there better options than we have currently, or than the portfolio or the much maligned 'gig'?

- Impact of demographics: Rapidly changing demographics of both traditional diversity dimensions (such as CALD or Gender) but also of socio-economic diversity, skillsets and capabilities.
- Ownership of data: This ongoing debate is one to watch. What would be the impact of employees owning their own data beyond your walls, when you cannot control the narrative?
- Impact of changing ways of living: Responses to climate change and changing cities (for example, mega-cities) will fundamentally change the way we work.
- Impact of technology: The potential for technology to change work has largely been overshadowed by its role in changing the consumer experience, but it does have some extraordinary potential to address the design of work and workplaces.

It doesn't take a rocket scientist, or a Doctor of Psychology, to see that these current conversations are all linked. The solution will be linked too. Not 'program by program' or 'slogan by slogan' but thoughtfully, as a whole, with deep appreciation and respect for the society your organisation operates within. Combining these with your business plans and capability needs and appreciating the potential of people as a genuine competitive advantage is your future-facing people strategy.

Ensure you have great *people* people

The people and culture profession is changing rapidly (although some would argue not fast enough). To do culture well, you need really good people in this space. The compliance basics are clear — expertise in remuneration and industrial relations — but you also need design thinkers, organisational psychologists and people looking for the future. You need people who understand and care about humanity. They find or create workable ideas and make them happen at scale.

Ultimately, you are building an effective working system. Not a PR campaign or a singular agenda. They are leading and influencing thinking in this space for you and taking measurable action that can be held to account just like any other executive they sit alongside. Remember the numbers? That is their scorecard.

And finally, have a voice and be the change

It feels strange to end an article on avoiding clichés with a cliché, but you really do have to respect and understand the responsibility and opportunity you have as a director to build better organisations. Work as we know it today, only works well for a very few.

We have both an opportunity and an obligation to imagine and design a better future of work, and better organisations for the future of society. To do so, we need to make that the priority. What is good for individual and societal wellbeing does not have to be counter to financial success. They simply need to be a priority, right alongside financial success, for every good business.

How hiring for EQ could help change your organisational culture

Jane Southward

30 October 2019, "How hiring for EQ could help change your organisational culture", *Company Director*, November 2019, AICD.

Global chief of people at Aurecon, Liam Hayes, says people with high emotional intelligence (EQ), or soft skills, could be more beneficial to your organisation.

The most effective leaders I've worked with have two key things that allow them to inspire their teams — self-awareness about their strengths and weaknesses, and empathy.

Soft skills [human capital] are the hard skills inside the glass walls of today's organisations and my experience is they are difficult to come by and make all the difference when it comes to performance.

Aurecon is a privately owned engineering and infrastructure business with 7500 staff across 25 countries. We're owned by about 700 of our senior staff across the globe and that drives a certain culture because our leaders have skin in the game. We have a global board made up of executive and non-executive directors. The non-executive directors bring independence and governance to the oversight of the organisation.

Communication and listening are critical skills for every leader. Some innately have them, others don't, but I believe you can learn them. The key thing is to recognise when you don't have these skills but be willing to practise learning them. Some people will get better at them than others. Seeking feedback is key to this, as is having a great mentor.

It is also important to recognise no one leader can be great at everything. Leaders need to recruit people around them who play to their weaknesses, therefore creating a strong team.

A learning mindset

The conversation used to always be around IQ, so it is great people are now having a conversation about focusing on EQ. This is a measure of a person's emotional intelligence, but as with IQ, some people will innately have higher EQ than others. With advances in technology such as artificial intelligence (AI), we will see "soft" skills such as a leader's emotional intelligence outrank "hard" skills. We can't yet teach AI to empathise, infer meaning, or manage emotions — which are all critical elements of the corporate world. It will be important for leaders to have a learning mindset. What they are learning may change, but to succeed, the best leaders will still require an innate curiosity and desire for knowledge.

Leaders who are emotionally self-regulated and self-aware know how to pause, think and step into another person's shoes before acting. They know how to sniff out the needs of both colleague and customer. Often people talk about stepping into other people's shoes but fail to take off their own shoes first.

San Francisco-based software company Slack Technologies, for example, has its product managers working in customer support to field complaints first-hand, under the banner of "everyone does support". The idea is not only to build real-time product knowledge, but empathy, as an integral component of digitally resilient cultures.

We must get better at listening. In today's fast-paced society, it's a rare but critical skill in the workplace. If leaders can learn how to get others talking and create safe, engaging environments where the smartest one in the room isn't necessarily the highest-paid, innovation will automatically pop. If empathy is an articulated goal and we make it our aim to see the story from someone else's side, we'll sidestep a lot of time and energy-guzzling conflict. We'll be able to relate better to our clients and teams. And if we can be dead honest with our own strengths and weaknesses, we will then probably have the insight to tolerate others' limitations and oversights.

Continuity

I grew up outside Melbourne and my first job was as a waiter in a small restaurant. This taught me some amazing soft skills.

My first human resources role was a six-month work placement with Connell Wagner [which became Aurecon in 2009] while I was at university. I had no idea what engineers did and had never been that interested in science or maths. This is somewhat ironic as I have since spent 17 years working with STEM professionals and being fascinated by what they do and their impact on society.

I was lucky to be offered a permanent role at the conclusion of the work placement and finished my degree on a part-time basis. When I originally took on this work placement, I was only 20 and I'm still amazed at my journey from HR and payroll assistant to chief people officer at the same company. Staying in the one firm brings the challenge of continuing to develop and reinvent yourself. Having a growth mindset is important because staying in one organisation for a long time, you run the risk of complacency.

In defence of HR

I accept that human resources often gets a bad rap but to do it well is actually quite hard. In the past, it was often tick-the-box processes — which by now we should have already eliminated or automated. That's not where HR can have value. Working with the CEO, executive team and board around the strategic direction of the organisation and what organisational culture and skills the business needs to achieve its aspirations is where HR adds value.

When I think about the evolution of HR practices during my career, what is exciting and innovative is challenging the way things have been done in the past and asking "why". The future of work is now and asking why is so important in shaping this. As leaders, it's what we reward, what we punish and what we walk past that matters. The third, what we choose to walk past, is the most critical when it comes to setting the culture of an organisation.

Remuneration is a hot topic with companies being urged to consider more than financial success when working out how to remunerate people. If you're serious about putting people at the apex of your business, your people practices need to be innovative and leading. How you hire, retain and develop your people must constantly be challenged.

Virtual networks are the new boardrooms to foster dialogue, thought leadership and consensus building. Employees need to know how to use them to generate collective action. Even as the shadow of AI replacement looms over their shoulders, workers need to keep investing in digital. Employees, particularly leaders, need to keep reinventing themselves and redesigning their roles for the future in the face of digital change.

Traditionally, the word "team" has been associated with a sense of place where shoulders rub and office space is shared. The rise of the digital age has re-imagined what it means to work in teams — where you work has very little to do with it anymore.

Making the most of Australia's ageing workforce

Jessica Mudditt

1 October 2019, "Making the most of Australia's ageing workforce", *Company Director*, October 2019, AICD.

As older employees are continuing to work, Julianne Parkinson, CEO of the Global Centre for Modern Ageing, discusses the untapped opportunities in Australia's ageing population.

In 1950, the path from the office to the grave was a short one. For men, at least. The average Australian male retired at 65 and was statistically likely to die just two years later. Retirement wasn't considered a time for trying new things — or even enjoying oneself. In that era, most Australian women did not participate in paid employment, while their domestic duties continued, much unchanged, into their later years.

Today, Australians have among the world's highest life expectancies, with men living to an average age of 80, and women to 84. This change in demographic is set to become more pronounced over time. According to World Economic Forum estimates, a child born in the developed world today has the potential to live past 100.

Dr Kay Patterson AO GAICD, Age Discrimination Commissioner at the Australian Human Rights Commission (AHRC), says bringing about positive change and greater workplace inclusion should be led by company directors.

"Why aren't directors having annual discussions with HR teams about the number of older workers on their teams?" she asks. "They may be having those discussions about gender diversity and other types of diversity, but they never mention ageing workers. Older people might be really well represented in directorships, but we're talking about directors taking an interest in the value of employing older people in the workforce."

Patterson suggests collecting data on your organisation's older workers — existing and new hires — to develop strategies to foster a more diverse workforce. "I don't think [directors] realise the value of having older people who can cross-mentor their younger workers — and vice versa."

She says flexible working arrangements would help retain older workers in the workforce, as many have carer responsibilities. And when workers retire, it is important to capture the knowledge they possess so it isn't lost.

"You don't necessarily have to have older people in full employment, but you don't have to cast them off," agrees Spencer.

"There are real opportunities in having a richer work environment that reflects the complexity and diversity of our society as a whole. Obviously, the benefits to business are in much greater clarity and confidence to design and develop new products and services relevant to older people."

Time and money

Given the trend to living and working longer, Global Centre for Modern Ageing (GCMA) CEO Julianne Parkinson is surprised older people are often forgotten by marketing and product development teams. While people aged over 65 constitute 15.7 per cent of the population — the fastest-growing demographic — they feature in only 4.7 per cent of advertisements. Even then, according to the AHRC, they are only targeted for a limited range of products. "Companies say: it's not that we've intentionally not thought about older people — we just haven't thought about them in either our workforce or customer mix," she says.

The catalyst for GCMA arose in 2014, when the Economic Development Board (South Australia) looked at what could be done to revitalise the state economy, given manufacturing was in decline and SA had a higher percentage, per capita, of people over 65. "We saw that ageing could be seen not as a burden, but as a real opportunity for business," says GCMA chair Raymond Spencer. "Older people were an ill-defined sector who got lumped into one big group — but that's like putting adulthood into one category."

Through advocacy, market development, partnerships, research and learning, GCMA helps organisations and individuals to devise, build and commercialise products and services that allow older people to live and age well. It is a not-for-profit entity with an enterprise ethos — meaning it operates on commercial terms, including a fee-for-service basis.

The centre was established in March 2018 and formally launched in October that year with support from the SA government. The aim was to help companies better understand the needs and preferences of older people and aid them in discovering market opportunities. Parkinson observes the innovative technology industry, specifically home automation, is an area that is ripe for growth, as it promotes independence and lessens social isolation. Other emerging areas include health and wellbeing, nutrition, finance, tourism, hospitality, housing and retail precincts, and learning and education.

In 1992, it became evident Australia would experience a major demographic shift in coming decades as an ageing population, requiring pensions, would place a huge strain on the economy. A scheme was introduced that included compulsory employer contributions into superannuation funds as part of a wider reform package addressing Australia's retirement income dilemma. As a result, today's retirees have more time and funds at their disposal — an increasingly significant market group.

By 2030, the 60-plus age group will account for 60 per cent of total urban consumption growth in Western Europe and north-east Asia, according to a McKinsey report, The Global Consumers to Watch. While the study doesn't have Australia-specific figures, it is reasonable to suggest Australia will have a similar outlook.

According to Parkinson, previous business models are being turned on their heads as consumption patterns among older people change. She cites packaging as one example. "In the past, food packaging for people in their seventies might have been the domain of the traditional aged care provider," she says.

"It was a business-to-business sale from the food packaging company to the aged care provider, whereas now it is a retail sale between the individual and supermarket. Nowadays, people are living at home for longer and supermarkets will be stocking an increasing number of products for this group on their shelves."

Parkinson believes even the midday meal in the kitchen is an outdated concept, as it doesn't consider significant lifestyle changes.

"Many older people aren't at home for the midday meal anymore," she says. "They're on flights, eating off an airline's tray table. Or they're at a music festival, or they've taken a picnic up in the hills on the back of their Harley."

Consumer behavioural information shows older consumers spend more on themselves instead of saving it up for their heirs. According to the Australian Bureau of Statistics, 86 per cent of Australians attended at least one cultural venue in 2013–14; for people over 75, the figure was 66 per cent. Classical music concerts were one area where a greater proportion of older people attended — 14 per cent of people aged 65–74, compared with seven per cent of 18–24-year-olds. And people in their sixties take roughly as many short overseas holidays as people in their twenties.

Parkinson says this is what modern ageing looks like, and it is ripe with business opportunities. "We want companies to understand that, just like other generations, older people are living better and more expensive lives," she says. "This means products and services have to aid them wherever they go in the course of their day or evening."

Readymade market

Older people are a fast-growing population group. In 2017, there were 3.8 million Australians over the age of 65. According to an Australian Institute of Health and Welfare (AIHW) report, this figure will rise to nearly six million by 2031.

"Getting involved in this older market isn't just about a curiosity for your business or a short-term growth strategy," says Parkinson. "This has a return on investment for decades to come if it's done well."

There are also opportunities on Australia's doorstep in Asia, which will have the oldest population in the world in the next few decades. South Korea and Japan are ageing the fastest — Japan's elderly population will make up 37.3 per cent of its total within a decade. By 2057, the AIHW projects there will be 8.8 million older people in Australia comprising 22 per cent of the population. Both governments and entities are actively seeking out products and services to benefit older people.

"The city of Hong Kong has established a HK$1 billion Innovation and Technology Fund to purchase products and services from around the world to allow its older citizens to age well," says Parkinson. "So our message to businesses is this — if you get it right in an Australian setting, the export opportunities are very real."

Ageing is, of course, a global phenomenon and responding to it will require global partnerships, which GCMA hopes to help cultivate. It has significant global expertise with Dr John Beard, former head of the World Health Organization's (WHO) Department of Ageing and Life Course, a member of the board. Beard oversaw the development of WHO's Global Strategy and Action Plan on

Ageing and Health, which sets out ways to prepare for a Decade of Healthy Ageing from 2020–30. Some of the recommendations include developing age-friendly environments, aligning health systems to the needs of older populations and creating sustainable and equitable systems for long-term care.

"The board has a very diverse group of people — some with strong business backgrounds, some with strong academic backgrounds. You want that kind of balance," says Spencer.

Living laboratory

The GCMA runs a test facility called LifeLab, a studio fitted out with cameras and sensors to allow observation of prototypes and products.

A recent pilot project involving Potatoes SA and the University of Adelaide aimed to develop new nutrient-enriched food products using potato puree as the base ingredient. Older people were invited to sample the products inside LifeLab's dining room and give feedback on the look, feel and taste, as well as aspects such as the product's nostalgic appeal and recycling potential.

Other collaborations have included co-designing aged care facilities, designing smart homes, and working with a bank on financial products and services. LifeLab's team is also studying the experiences of the residents of a Port Elliot retirement village — who use a driverless vehicle developed by autonomous vehicle specialist company Aurrigo.

LifeLab's executive director is Finnish cognitive scientist Veera Mustonen, who brings expertise as deputy CEO of innovation company Forum Virium Helsinki. LifeLab is one of just 12 "living labs" around the world specialising in ageing. Three thousand older people have signed up to participate in trials in which they will play the role of co-designer or end-user of a range of products and services. LifeLab is on track to be accredited this year by the European Network of Living Labs (ENoLL).

"Despite having 'European' in its name, ENoLL has become the global standard for living laboratories," says Spencer. "It's really important we operate at that level from a governance perspective, with the requisite ethics advisory practices and oversight. We're really excited because we'll be the only lab in Australia with that kind of accreditation and it will give us a great deal of credibility."

Facing facts

Parkinson says the 'modern' in GCMA signals it is looking at ageing with a fresh lens and urging others to do the same. The greatest challenge to achieving this is ageism.

"Ageism is pervasive," says Parkinson. "It leads to older people being marginalised in our communities and negatively impacts their health and wellbeing."

She believes common misconceptions about older people are that they don't take risks, spend money or enjoy using digital technology. "It's simply not the case," she says.

GCMA's research and insights division disseminates information about older people to correct harmful stereotypes. Parkinson points to the fact that the highest number of entrepreneurs in Australia are over the age of 54; and also to a 2018 Nielsen Report, which found many baby boomers are keeping pace with changing technologies.

New research by Victoria's Swinburne University of Technology and the Queensland University of Technology shows Australians aged 55–64 are the fastest-growing group of entrepreneurs in the country. Tagged 'seniorpreneurs', this group achieved an activity rate of eight per cent, well above the three per cent average of innovation-driven economies. These figures are no surprise when you see that 34 per cent of all Australian business owners are aged 55–64.

"People are not retiring from work and giving back their iPads and smartphones," says Parkinson.

Although there are record numbers of older people in the workforce, discrimination is rife.

A 2013 AHRC report found up to 30 per cent of Australian employers were reluctant to hire workers over a certain age. For more than 65 per cent of this group, that age was anything over 50. The survey also revealed widespread prejudice against older people, stereotyping them as forgetful, short-tempered, rigid and backwards looking.

Support for Australian businesses affected by AI ahead

1 August 2019, "*Support for Australian businesses affected by AI ahead*", Company Director, August 2019, AICD.

The B Team is working to develop principles to help support Australian businesses deal with AI.

In June, the board and management of Energy Australia announced it would establish a $20 million fund to help prepare its employees for the impact of rapid automation. Managing director Catherine Tanna said the company would allocate one per cent of its after-tax profits to the fund once the business hit its hurdle return rate.

This is one example of the range of initiatives announced by a group of businesses as part of the Future of Work program developed by B Team Australasia. The regional leadership group was formed in late 2018, aligned with the ambitions of B Team co-founders Sir Richard Branson and Jochen Zeitz, former CEO of sportswear brand Puma.

The members of B Team Australasia include CEOs and directors of businesses such as Mirvac, MLC and Scentre Group, as well as Sam Mostyn, chair of Citibank Australia and Ann Sherry AO FAICD, chair of Carnival Australia.

B Team co-chair David Gonski AC FAICD*Life* told the forum that the extent of the usage and effect of AI is evolving rapidly. "We believe it is time for business to establish some principles of best practice," he said.

"The working environment is going to change quite dramatically," Tanna told the forum. "We understand some changes quite well where roles disappear, but the more challenging and interesting part is where tasks within roles today are no longer required... People need to be upskilled and the jobs will be more interesting."

She added CEOs shouldn't forget the great perspective employees can offer, learned from working on the frontline. "Getting our business in shape for a radically different world is a two-way partnership with our people. I'm not sure it can be done, or done effectively, without them."

The B Team has identified five Future of Work Principles, which its organisations have agreed to commit to and which it hopes will spark further discussion:

- Strategically plan for technology. Devise a strategic plan for the development and use of technology and the impacts on people within an organisation.
- Create career-growth opportunities. Create individual growth opportunities for team members with specific targets to transition them into their future careers, either internally, between organisations, or externally.

- Focus on the whole person. If there is no longer a position available within the business for a team member because of technological disruption, fully support them in preparing for their next challenge, considering all aspects of their wellbeing, not only from a skill and remuneration perspective.
- Establish support networks. Assist in creating a network of employees experienced in advising others through the process and making the transition easier.
- Be publicly accountable. Report publicly on what has been done in seeking to ensure all stakeholders have been dealt with respectfully and with dignity, encouraging others.

CHAPTER 7.

Does the right boardroom mix now include STEM?

Continuous education will help your board innovate for the future

30 October 2019, "Continuous education will help your board innovate for the future", *Company Director*, November 2019, AICD.

Directors must ensure they continue to upskill and learn if they expect their organisations to successfully innovate for the future, says Kate Harper GAICD.

In April, 30 Australian business leaders headed to San Francisco with the Trans-Tasman Business Circle for its first women's study tour of Silicon Valley. The tour had a serious mission — to learn more about the next wave of breakout technologies, namely Artificial Intelligence (AI) and machine learning, and the implications for Australian organisations, the workforce and the economy. With unique access to applications of these ground-breaking technologies, there was much to reflect on from the tour. The theme that resonated most was the future of the workforce.

How prepared are boards and executives in Australia?

At an executive and board level, the relevant skills are in short supply. Even in the honeypot environment of Silicon Valley, there is an insatiable appetite for computer and data scientists, machine learning engineers, augmented reality designers and others who develop and support the emerging ecosystem.

Organisations across all sectors recognise they need to invest in reskilling up to 50 per cent of their workforce. To keep up with the pace of innovation, this reskilling will be continuous. Lifelong learning is not a new concept, but the pace and scale of technological change is moving it from cliché to economic imperative.

Reskilling to embrace technological change is as relevant for board members as it is for the workforce. One of the many roles a board performs is to provide direction to management. This includes guidance and mentoring as well as a mechanism for healthy challenge across strategy and operations. A key role of any board is to anticipate, identify and monitor risk. The risks associated with the ethics of AI are just beginning to be understood. If the gap in knowledge, experience and understanding of innovation between management and the board is too great, the board's ability to perform its role is diminished. If the board doesn't understand the capability of the technology, it will be challenged to ask the right questions.

How are Australian boards addressing this?

If recruitment of more digital and tech-related skills to ASX companies is any guide, we have much more to do. A notable theme in board recruitment over the past two years has been interest in the appointment of directors with digital and technology skills. However, our analysis of new board appointments to ASX top 100 companies in the past 18 months shows boards are overwhelmingly recruiting for experience from the same sector. Directors with technology backgrounds going into non-tech companies were the next largest cohort, followed by finance sector directors going into non-financial sector companies. The number of directors with technology and digital experience that are actually recruited in the ASX is minimal.

Where will we find the directors companies need?

Companies need directors with the wisdom and battle scars that come from a career in corporate leadership relevant for AI and machine learning. Recruitment processes in Silicon Valley offer some guidance. At an executive level, corporations in Silicon Valley hire not just for creativity, analytical thinking, technology design, programming and complex problem solving, they also hire for potential. Personality attributes such as the ability to learn, collaborate, empathise and facilitate as well as embrace a diverse yet inclusive culture, are highly valued.

As boards seek this next wave of talent, they would do well to focus on the inclusion of directors who bring these valuable skills and who, by modelling the mantra that lifelong learning builds competitive advantage, will drive a culture of continuous learning from the top.

To enable this, the corporate entity will need to invest in education, not just for the workforce, but also at board level. Director development plans must include a dynamic schedule of learning and experiences that will keep them questioning their own skills and capabilities, and those of their companies and leadership.

With boards taking a leadership role, the economy will be better equipped to embrace AI and machine learning, rather than fearing it.

Clever Country Redux

Angus Armour FAICD

30 October 2019, "Clever Country Redux", *Company Director*, November 2019, AICD.

International comparisons continue to suggest we are falling behind globally on innovation, says AICD CEO and MD Angus Armour FAICD.

According to IMF managing director Kristalina Georgieva, we are now in a "synchronised slowdown" with more than 90 per cent of the world expected to experience more sluggish growth in 2019.

Unlike the financial crisis, Australia is not defying this global trend. Australian growth slumped to 1.4 per cent in the year to June, while GDP per capita went backwards over the period. A significant part of this poor economic performance is due to "
a broader global narrative of waning economic dynamism," AICD chief economist Mark Thirlwell writes in this issue of *Company Director.*

Against this backdrop, we cannot afford productivity to languish. Australian directors must now prepare for a sustained period of lower revenue and profit growth, and to work harder to drive productive investment. Mark notes in his column that the rate of growth in labour productivity has been sliding since 2011–12, culminating in a 0.1 per cent decline in 2018–19. Good government policies will no doubt play a role in improving our productivity performance, but boards will also be held accountable for their performance facing a low-growth global environment.

The long-term interests of our organisations, the community and the Australian economy align. Reversing the productivity trend will require organisations to harness technology and embrace innovation. It starts in the boardroom. In this issue of *Company Director*, we ask if directors are prepared for the challenge. Our report, *Driving Innovation: The Boardroom Gap* — the first of its kind in Australia and one of the first worldwide — makes for sobering reading.

While three-quarters of the directors surveyed indicated that their organisation had an innovation vision, for almost half of respondents there was little oversight of how that plan was being realised. More than half of directors were unaware of the percentage of their organisation's total expenditure allocated to R&D. There was also a skills gap, with only three per cent of directors saying they had science and technology expertise and 10 per cent saying they had innovation-related expertise.

International comparisons continue to suggest we are falling behind globally on innovation. Recent analysis by Harvard's Kennedy School of Government shows that on a measure of the productive knowledge held in our economy, Australia is on par with developing economies. We also slipped two spots to 16th in the latest World Economic Forum global competitiveness rankings released in October. On innovation and ICT adoption we fare even worse, ranking 18th and 29th, respectively.

The director community must show leadership. We must lift our own technological and digital literacy, encourage and reward entrepreneurial thinking, and ensure innovation is a regular item on the board agenda.

The results of the innovation study show the AICD needs to do more to support members in this area. Across the range of AICD activities — from education to communications to advocacy — we will look to provide directors with the knowledge and resources needed to thrive in an increasingly fluid, tech-driven economy.

As an initial step, we will take a more structured approach to communicating with members on new technologies and disruptive trends. We will particularly look to draw on the expertise in our community, and in Australian business more broadly, to highlight case studies of organisations that have successfully implemented an innovation strategy. We will also review our director resources and curriculum to examine how innovation is covered and if changes should be made to highlight performance aspects of board responsibilities more prominently.

On the advocacy front, the challenge will be sustaining public debate on the importance of innovation to our shared national prosperity. The AICD will also be exploring where further research can help build our knowledge base, such as on investor expectations of boards.

Bob Hawke AC GCL famously said, "No longer content to be just the lucky country, Australia must become the clever country." Innovation and commercialisation is a persistent weakness in our economy. The director community cannot be content with our rankings on the league tables. We must take up the challenge and spur the next era of Australian growth.

Is your board prepared for the risks in the Internet of Things?

Beverley Head

1 December 2019, "Is your board prepared for the risks in the Internet of Things?", *Company Director*, December 2019, AICD.

While the internet of things (IoT) offers many opportunities for businesses, there are risks involved in connecting real world objects to smart devices. Is your organisation ready?

Digital transformation is alluring. It's an opportunity to use computers to streamline operations, connect physical infrastructure to the internet, collect data in real time, optimise operations and improve productivity and performance. For example, sensors from Australian agtech company The Yield now give oyster farmers early warning of changing water temperatures and salinity, barometric pressure and tidal information — all via their mobile device. This technology assists 300 oyster growers to better work around environmental conditions.

Meanwhile, Rio Tinto's autonomous heavy haul train in Western Australia's Pilbara region uses data from connected sensors and artificial intelligence (AI) to guide the way the train is driven, delivering product to the port nearly 20 per cent faster than a manned train.

According to management consultants McKinsey & Co, "If policymakers and businesses get it right, linking the physical and digital worlds could generate up to US$11.1 trillion a year in economic value by 2025."

What if they get it wrong?

There is mounting evidence that in the race to transform, some organisations are downplaying, not appreciating, or are even unaware of the cyber risks that can arise from connecting physical equipment to the internet — which links operational technology with information technology.

Councils, manufacturers and utilities around the world are already counting the cost of cyber attacks on physical infrastructure. ZDNet, the business technology news site, reporting from the Gartner Security and Risk Management Summit held in Sydney in August, reveals Ramsay Health Care audited the equipment in its 74 hospitals after seeing a demonstration of an ultrasound device being compromised by hackers in 30 seconds.

The Australian Energy Market Operator had also aired concerns about an attack on our power grid as more household solar panels are plugged in. And Western Australia's Horizon Power is vetting personnel with access to its networks.

According to the Internet of Things Alliance of Australia (IoTAA), at the end of 2018 there were 10 billion IoT devices in operation globally. That is tipped to reach 20 billion by 2022 and more than 60 billion by 2025. In May, technology analyst Telsyte calculated more than five million Australian households have at least one IoT device. It predicts the average household will have 37 such devices by 2023. Without proper security and governance, each of those connections is a potential backdoor for attack.

Retired Major General Patricia Frost is the Washington DC-based director of cyber at Partners in Performance, a global management consulting firm. She has 32 years' experience in the military and was, until 2016, director of cyber, electronic warfare and information operations for the US Army.

Frost notes that many of the industrial systems used to manage utilities, water purification, gas and steam turbines are legacy systems. They are built standalone, often using supervisory control and data acquisition (SCADA), which although not immune to cyber attack have been somewhat protected by the air gap between them and the internet. There is now a race to connect these legacy systems to modern information technology networks over the internet.

"That is creating a new attack surface and vulnerability," says Frost. "Systems in the past were literally separated and isolated in air gap networks. My concern is we are rushing to digital transformation without truly understanding the operational risk based on threats the business is now exposed to." This stretches from criminal "hacktivists" to nation-state attacks.

Frost warns boards need to understand what equipment is being connected to which networks — and for what purpose — and also to assure themselves the organisation is properly prepared to deal with a cyber attack. She says boards should make serious assessments. "Ask where does the value of the business sit, what are our most critical assets and then overlay the digital domain and connections between the IoT and business information network," she suggests. "Why are we making certain connections, is that truly of value to the business? Or is it just ease of access? In some cases, technology has made us a little lazy. We want the data now, even though it's not bringing much value to us."

Certainly, there is enthusiasm to connect the physical and the digital. Extrapolating McKinsey & Co research through to 2025, IoTAA CEO Frank Zeichner estimates that IoT can deliver an economic kicker to the local economy worth up to $116b and a two per cent hike in national productivity. This is not to be sneezed at.

Belinda Cooney GAICD is chief financial officer of Interactive, an Australian IT services provider, and a non-executive director of the 86 400 neobank. She believes that while directors have not been blindsided by the integration of information technology and operational technology, the pace at which it has proceeded has caught some unawares.

"When I think about security and risk as a director, it is very hard to decouple IT risk from operational technology because you have people using the systems," says Cooney. "You can't think of them as isolated things. When asking questions at board level, a lot of people think cyber risk is mitigated by doing a penetration test to figure out if anything has happened. In my experience, it is a lot more than that. You need to extend your line of questioning. Who is using the system and what is the access to our physical environment?"

Cooney notes directors have tended to focus on cybersecurity as it relates to data, rather than physical equipment. "Many don't realise how much IoT is used in their business," she says.

Besides good oversight of the cyber risks associated with information and operational technologies, Cooney says directors must ensure that organisational culture provides "enough psychological safety for people to speak up if they see something funny, to report it if it's not quite right".

Frost says directors must be curious. "If you look at the output from a wind farm or a solar array — could that be used as a vector to cause instability to the complexity of power grid and other generators of power because that fluctuation of power is so fragile?"

Directors need to consider how decisions are being made about connecting the digital and the physical. "Who is responsible and accountable?" asks Frost. "The governance may need to change in companies when connections are made in the digital domain that could bring a detrimental operational risk to the company."

She also recommends more granular monitoring of physical assets. "Most of the security controls we're seeing in cybersecurity are at the upper layer of operational technology, not down at the asset," she says.

Frost also believes implementing security to monitor the asset output could help protect an organisation. "When you see that baseline disrupted or changed, that will be your first warning something malicious is happening to your assets."

Jeff Hudson, CEO of global security firm Venafi, agrees with the need for greater cybersecurity at the machine level. "Gartner says we spend US$10 billion a year protecting human identity — but we are just getting started in protecting machine identity," he says. Hudson also believes this is increasingly important because everything from lifts to cranes to autonomous vehicles link to the internet.

"This is very poorly understood," he says. "There is a blind spot. Everyone assumes it has been taken care of, but it hasn't. Machines are making real-time life-and-death decisions about humans. We spend a lot of time making sure humans have the credentials to do a job, whether it's in the operating room or stock trading. Now algorithms and robots are taking over and we have to do the same thing."

CHAPTER 8.

Diversity

Significant milestone

Louise Petschler GAICD

"Significant milestone", Company Director, February 2020, AICD.

The gender diversity of Australian boards is improving, however there is still much more to do.

In December, the AICD announced that for the first time, women held 30 per cent of all ASX 200 company board positions. This represents a substantial milestone for Australia's largest listed companies — one that reflects the commitment of their chairs, directors, investors and stakeholders to more diverse boards. And it marks a decade of significant change. In 2010, when the AICD began collecting statistics on gender diversity on boards, women held just eight per cent of the seats in ASX 200 boardrooms.

In 2015, the AICD backed the launch of the Australian chapter of the 30% Club and called for ASX 200 boards to achieve a minimum of 30 per cent female representation within three years. While it's taken a year longer than that ambitious time frame there is a lot to celebrate in this progress, most significantly the efforts of ASX 200 chairs and boards directly, and also those of many stakeholders.

The AICD has consistently argued that board diversity is a positive contributor to good governance. A diverse mix of views and perspectives around the table increases board performance and reduces the risk of groupthink. Our support for change has included maintaining quarterly reporting on progress, the launch of the AICD Chairs Mentoring Program in 2017, working with the 30% Club, research on practice and policy, governance scholarships and ongoing engagement with the ASX director community.

Where to from here?

The challenge is to maintain momentum to make sure the minimum target 'sticks' and encourage other organisations to achieve the target. The AICD considers a 40 male/40 female/20 other gender diversity model to be good practice for all boards, with 30 per cent as the minimum target for female representation.

The 30% Club has extended its focus to the ASX 300, advocating for 30 per cent female directors by the end of 2021. Of course, diversity is a much broader issue than gender diversity alone, and a focus on board diversity must have as its starting point the board having the requisite skills, experience and expertise to fulfil its governance obligations.

Board diversity will continue to be an important focus for the AICD in our advocacy program. More about board gender diversity at: aicd.com.au/advocacy/board-diversity.

Unions put the case for employee-elected directors

19 September 2019, *Unions put the case for employee-elected directors*, Governance Leadership Centre, AICD.

Changing the adversarial management-workers relationship needs to start in the boardroom, they argue.

Australian Workers' Union (AWU) National Secretary, Daniel Walton, believes employee representatives on boards could do more than identify labour-related risks. They would help transform company/employee collaboration and innovation.

Walton says a debate on employee-elected directors on boards is overdue. He wants industry, unions, governance associations, academics and other stakeholders to discuss different models of employee representation on boards — and local research on the topic.

"Australia has a massive problem with collaboration," says Walton. "We still have an adversarial system from the 1960s of companies versus employees. We need a culture where companies and employees work together to innovate and create value. That has to start at the top in organisations through boards that have employee representatives as directors."

Australia ranked 66th in cooperation in labour-employer relations, far behind most developed countries, in the latest World Economic Forum Global Competitiveness Report. Walton believes employee-elected directors on boards is a crucial first step to improve Australia's international position on labour-employee relations and workplace collaboration generally.

Financial Sector Union (FSU) National Secretary, Julia Angrisano, believes employee-elected directors would address failings in the shareholder model of governance. "The 'old boy' network of sitting on each other's boards is still far too prevalent," she says. "ASX 200 companies need and will benefit from a diversity of views. The single board model (favoured in Australia and the United States) privileges the interests and rights of shareholders at the expense of other parties such as employees, suppliers and super funds."

Momentum building

The push for employee-elected representatives on boards is building in Australia and overseas, amid renewed debate about "stakeholder capitalism" and the need for boards to serve the long-term interests of employees and other stakeholders, not only shareholders.

The UK Labour Party last year proposed all companies with more than 250 employees be required to have one third of their board comprised of employee representatives. If elected, the Labour Party will also change employee ownership of companies.

The revised UK Corporate Governance Code (effective January 1, 2019) already has a stronger focus on boards understanding the interests of employees. UK companies can choose one of three options (in the comply-or-explain code) on how they give employees more "voice" in the boardroom. This could include an employee-elected board member, workforce advisory board or the designation of a non-executive director to engage with employees.

Earlier this decade, France legislated that companies with 5,000 employees worldwide, or 1,000 in France, by law must have one employee representative on the board where there are up to 12 board members, and two on the board where there are 12 or more directors.

US Democratic Party Presidential hopeful Elizabeth Warren last year controversially proposed that large American corporations should let employees elect 40 per cent of their directors.

Prior to the 2019 Federal election, the Australian Labor Party said it would "… examine measures that increase collaboration between employers and workers, including worker representation on boards, giving consideration to global models currently in operation". Had Labor won the election, a bigger push for employee-elected directors, possibly mirroring the international experience, would be underway.

European experience with co-determination models

German and Scandinavian countries have long had some employee directors on their boards. The two-tier board model in Germany includes a management board (which runs the company) and a supervisory board (which appoints the management board).

Depending on the organisation's size, the supervisory board can have a third or half of its directors elected by employees. Shareholders elect the rest of the board. Supervisory boards range from three to 21 members, meaning up to 10 directors could be employee elected.

"The Europeans have been miles ahead of us on good corporate governance for decades," says Angrisano. "In many European countries, the presence of employees, long-term shareholders and other stakeholders on company boards has acted as a powerful voice in guiding companies to long-term success. It has checked the power of opportunistic shareholders to force through hostile takeover bids and divestment. It has democratised corporations and delivered higher long-term investment, productivity, growth, research and development, wages and returns to stakeholders, all of which are necessary for building a fair and sustainable economy."

Having employee-elected directors on Australian boards seems plausible but is rife with complications. Germany has a long history with the concept of co-determination, which involves the rights of workers to participate in management of companies they work for.

Proponents of the German model of employee-elected representatives on boards say it has encouraged collaboration between workers and companies. "Having employee-elected directors helped European companies manage through some difficult situations and implement change," says Walton. "That's the benefit of employees having a greater say in the boardroom."

Critics say the supervisory model has led to too much groupthink, too little diversity and cumbersome boards. Also, academic evidence on the German board is mixed. Comparisons of the two-tier German structure and one-tier model favoured in the United States, Australia and many other Western countries often find neither model is superior. Both have their pros and cons, and country-specific factors may influence the performance of both models.

A likelier outcome is convergence rather than divergence. That is, the two-tier model adopting aspects of the traditional western governance model, as has been the case in Germany this decade, and the one-tier model adopting aspects of European models, as political parties in the UK, US, Australia and elsewhere push for employee-elected directors. Were this model to evolve in Australia, boards of large listed companies might be expected to have one or two employee-elected directors. They would most likely be union representatives, as unions are best placed to mobilise employee votes on director elections, affecting board composition and adding a new boardroom dynamic.

The fear is executives and directors would be reluctant to discuss transformative strategies, such as a restructure that will spark job losses, with a union representative on the board. Also, that employee-elected directors may lack general business and board skills to govern across a range of areas, be change resistant or affect boardroom chemistry. Some boards might argue they can understand the needs of workers through employee advisory councils or other mechanisms to source and act on employee views. Formal appointment of employees to the board could be unnecessary or counterproductive.

Longer-term view

Walton believes these and other issues can be overcome with appropriate education and governance experience for employee-elected directors. "Other countries have made this model work. It's demeaning to say employees cannot add value to a board because they haven't been executives or had long governance experience. There are workers across the spectrum who have huge capability to add to governance and boardroom diversity."

He says governance stakeholders can help manage the transition of employees onto boards through education initiatives and board pathways. "If we want employees to add value on boards, we need to ask: What governance training will they require? How can we get that training to them earlier in their career? How can we create opportunities for them to serve on smaller boards, committees or advisory councils so they have governance experience?"

Walton urges companies to be open-minded about the short- and long-term benefits of employee-elected directors. "I guarantee we wouldn't have had a problem of wage underpayment in the franchising sector if an employee-elected director was on the board of those companies. Even a junior union official would have known to ask management if all staff were being paid fairly and informed the rest of the board on this risk."

Angrisano says the Financial Services Royal Commission exposed corporate-governance shortcomings in the banking sector, resulting from a management failure to stop misconduct. "One outcome from the Royal Commission was the big-four banks having to go through a self-assessment process and they all have identified rigid and obsolete management and decision-making structures as contributing to poor governance and poor culture." She believes having employee-elected representatives on bank boards would help address these issues.

Walton argues the main benefit of employee-elected directors is transformation. "In this era of industry disruption, companies will need to change faster than ever. The German coal industry, for example, had extensive support for retraining of employees who were made redundant, thanks to company/worker collaboration that began in the boardroom through employee-elected directors. This model will help Australian companies respond to disruption."

Walton has canvassed the concept of employee-elected directors with stakeholders and says there is early support. "CEOs say to me, 'show me how having employee-elected directors will create value'. Most realise that creating mechanisms for employees to have greater input and collaboration in company decision is valuable in the long term."

He says the push for employee-elected directors must be well-researched and consultative. "We can't rush towards such a big change for boards. We need rigorous research to determine what is the best model of employee-elected directors on boards, for an Australian context. Most of all, we need an extensive debate on this issue and stakeholders working together to find the best way for a stronger employee voice in the boardroom. The move towards employee-elected directors in Australia is inevitable, in my view. It needs to be managed."

Will fewer ex-CEOs consider future directorships?

Tony Featherstone

19 July 2019, *Will fewer ex-CEOs consider future directorships?*, Governance Leadership Centre, AICD.

... *And the implications for board succession-planning strategies.*

Australia's governance community has persistently warned that boards will find it harder to recruit experienced directors if directorship risks keep rising. Those fears look prescient, amid warnings that former CEOs are becoming less interested in listed-company boards.

A heightened regulatory environment after the Banking Royal Commission and greater legal, financial and reputational risks for directors top the concerns. Increased governance workloads, stagnant board fees and competition from private-equity boards are other issues.

"Some retiring CEOs in that 55-plus age bracket are becoming gun-shy of listed-company directorships," says Korn Ferry head of board services, Robert Webster. "They look at the work, risk and scrutiny involved — and what boards pay — and think it is no longer worth it."

Webster adds: "Increasingly, retiring CEOs are finding appeal in private-equity boards that potentially offer greater rewards through equity incentives, allow directors to focus more on strategy than compliance, and don't operate under the glare of governing a listed company."

The veteran search-firm expert, known for advising boards of some of Australia's largest companies, say declining CEO interest in directorship is worrisome. "Retiring CEOs are a natural source of future directors and chairpersons. But that trend is changing, and it has implications for board succession planning. A large experience gap on boards could emerge."

Australian boardrooms are among the world's oldest by average age and a generation of leading company directors in their late 60s or early 70s are expected retire in five to 10 years.

The average age of ASX 200 directors in 2015 was almost 62, down from a peak of 62.9 in 2012, according to the Australian Council of Superannuation Investors. An increase in female directors, who on average tend to be younger than their male peers, has slightly lowered the average.

Governance expert Dr Ulysses Chioatto says: "A demographic cliff is approaching for Australian boardrooms in the next three to six years. You can't fudge the statistics; there are a lot of directors in that 65 to 75 age bracket who will retire in that timeframe, based on board term cycles."

Former CEOs who join boards do more than replace ageing directors. There have been calls from investors for boards to have a higher proportion of industry experts who live and breathe operational detail. Typically, retiring CEOs are a key source of industry expertise: for example, an ex-bank CEO joining the board of a financial services group.

Webster says the confluence of these trends will lead to a shortage of experienced company directors in the next decade. "A lot of directors who have been around a long time will start to retire or cut back on board duties and there will be fewer ex-CEOs to replace them. We need more discussion about broadening the supply of future directors."

Age diversity debate

Debates on board succession planning are typically based on anecdotal rather than empirical evidence. There is a long list of directors wanting to serve on ASX 200 boards because of the professional challenge, prestige and higher fees. The debate about whether enough of these directors are sufficiently experienced and skilled for an ASX 200 board is subjective.

Also, gauging the views of retiring CEOs on listed-company directors is problematic. The pool of retiring CEOs is, by its nature, small. Many ex-CEOs take some personal time off before resuming their career and are unlikely to rule out a governance career in listed companies.

However, data shows higher regulation is affecting the appeal of boards. About 43 per cent of respondents to the AICD Director Sentiment Index (first-half 2019) said the impact of legislation on director liability affected their willingness to continue to serve on boards. And 52 per cent said it affected their willingness to accept a new board appointment.

Those results may not fully include the effect of new white-collar crime laws in the Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Bill 2018, which Parliament passed in March 2019. The reforms enable the Australian Securities and Investments Commission (ASIC) to pursue heavier civil and criminal sanctions against banks and other companies, and executives who breach corporate and financial services laws.

Prison terms for the most serious offences in the *Corporations Act 2001* increase from five to 15 years and there are sharply higher financial penalties in the reforms. The maximum financial penalty for contraventions of a relevant civil penalty provision, currently $200,000 for an individual, increases to the greater of $1.05 million or three times the benefit gained or loss avoided.

Dr Chioatto says the penalty reforms elevate directorship risks and reduce the appeal of listed-company governance for retiring CEOs. "The legal risks of serving on a board are arguably the highest they have ever been and Australia's new civil and criminal penalty regime is among the toughest in the world. I suspect ex-CEOs will increasingly ask if the financial and career rewards of serving on a board are still worth it relative to the risk and pay."

Stagnant growth in director fees is another consideration. As the Governance Leadership Centre reported last month, increases in listed-company board fees in the past three years have barely matched inflation, according to remuneration consultant Egan Associates.

Dr Chioatto believes static fee growth hinders listed-company boards in the recruitment of former CEOs. "The average total pay is about $6 million for an ASX 100 CEO and $2 million across the ASX 200," he says. "A non-executive director, even if they have three or four directorships and a full-time governance portfolio, earns nothing like an executive salary. If board fee growth remains flat, directorship will have less appeal, at least in terms of financial reward, to retiring CEOs."

Compounding the fee challenge is the push from proxy advisers to reduce "overboarding", where directors serve on too many boards and have limited time should a company emergency arise. Simply, directors are expected to serve on fewer listed-company boards, reducing their earnings capacity and potentially making boards financially less appealing for full-time directors who rely on that income.

Low growth in board fees also affects the competitiveness of listed-company directorships with those in the private sector. "We are seeing retiring CEOs joining the boards of private-equity companies rather than listed companies," says Dr Chioatto. "It's not a huge trend yet, but there's greater potential financial upside for directors on private-equity boards, less focus on compliance and more on strategy. That appeals to ex-CEOs who like building companies."

New thinking on future supply of directors required

Dr Chioatto believes listed-company boards will need to think differently about the supply of directors. Broadening the pool to include senior consultants is the starting place. "Boards traditionally have been reluctant to appoint management consultants because they are not seen as having sufficient operational experience," says Dr Chioatto, who is a former strategy consultant.

"But an ex-partner of a top global consulting firm can add huge value to a board in terms of cross-industry knowledge, skills in strategy development and ability to make complex decisions in fast-changing markets without all the facts."

Korn Ferry's Webster says boards will need to source more offshore-based directors. Australian boards mostly source Australian-based directors who they know and who are less affected by time zones and travel to board meetings. More ASX 200 companies, especially those expanding offshore, are appointing foreign directors but change is slow. The globalisation of Australian business has not spread widely to boardrooms.

The pool of offshore-based directors, including retired CEOs, is exponentially larger than that available in Australia and far more diverse. However, sourcing foreign directors can be problematic because Australian boards typically pay lower fees than US boards and expect more work from directors, making international directors a small part of the succession answer.

Recruiting younger directors is another succession strategy and increasingly favoured by boards needing skills in technology and the digital economy. Webster says it is harder to recruit younger directors than boards realise. "It sounds good on paper, but there are not a lot of young executives out there who have the general experience needed to serve on an ASX 200 board. A young director needs to be able to govern across a wide range of issues, not only technology, and have well-developed business judgement and broad experience."

Another option is expanding the appointment of alternate directors who act for a company director for a set period, or the use of "shadow" advisory boards. In theory, this would help boards establish a pool of potential directors who could serve on the main board and assess their performance. It would also help potential directors learn about the organisation before serving on its board and hit the ground faster in their first term on the board.

But greater use of alternate directors and shadow boards, although mooted over the years by some chairpersons, involves extra governance costs and has never taken off in Australia. Both practices might need to be revisited if director supply is constrained.

Boards could also consider ways to keep older directors serving for longer. The view that directors should serve no more than three three-year terms — lest they become "institutionalised" in their company — might need revisiting in circumstances where longstanding directors continue to add governance value.

Moreover, the perception that a director in their early 70s is due for retirement or will contribute less to the board, is as demeaning as it is short-sighted. Every director is different and it is likely that the average age of boardrooms will rise as the population ages and people work longer and are healthier.

Equally, it would be wrong to avoid board succession-planning debates for fear of "ageism". As more is expected of directors, it is legitimate for stakeholders to ask if boards have sufficient age diversity and a considered succession plan to replace those directors who are likely to retire or cut back directorships in the next three to six years.

CHAPTER 9.

Boardroom moral and ethical decision making

ABC chair Ita Buttrose on governing the national broadcaster

Narelle Hooper MAICD

1 December 2019, "ABC chair Ita Buttrose on governing the national broadcaster", *Company Director*, December 2019.

ABC chair Ita Buttrose AC OBE reflects on her trailblazing career so far, and shares her plans to restore lost trust in the organisation.

It's nearly one year since Ita Buttrose AC OBE MAICD was appointed as chair of the ABC and she admits that ethics are playing a huge part in the battle to restore trust in the wake of previous board upheaval.

In February 2019, Scott Morrison announced her five-year appointment to chair Australia's most trusted organisation, describing Buttrose as a person of integrity and strength trusted by Australians.

Buttrose is critical of the loss of trust in business, politics, sport and other institutions — and of how rules get broken when money is involved. She says the only way to restore trust is by your behaviour. "It starts at the top. You have to understand what ethics are all about — we have to become ethical leaders. The culture or the ethics of the place, the chair, directors, the managing director, all through management structure— it goes all the way down to the bottom. If the top of the structure is an ethical one, then those values permeate the organisation.

"The people who work here know that I have their back and if I say I'll do something, I do it. I try to be very honest in all my dealings."

Now facing the prospect of hundreds job cuts and budget pressures at the ABC, Buttrose met in December with the board and management to decide on a five-year strategy.

Last May, she and the board appointed a new managing director, David Anderson, who had been acting MD during the period of upheaval. One immediate thing to put right at the ABC was to signal trust in the relationship between the chair and managing director. Buttrose says it is crucial to have absolute trust in one another.

"The managing director has to know whatever we talk about will remain between us — and he has to do the same thing, whatever I'm saying to him."

Buttrose and Anderson meet regularly. "We talk very frankly about issues," she says. "I sometimes make suggestions for him to consider. He tells me what's on his mind and listens while I give him my thoughts. We know where we want the ABC to go. He's working on a five-year plan he'll be announcing in March 2020. So we've been talking about that and what we're hoping to achieve. We bounce ideas around. It's a very frank discussion — and we have it behind closed doors."

In the 11 months since moving into the role, Buttrose has been a visible and vigorous advocate for the ABC's role in Australia's social and cultural fabric, as a fearless public broadcaster and champion of the public's right to know. She has promoted the ABC as a vehicle to strengthen regional and global soft power and has challenged growing political correctness, bemoaning the loss of larrikinism and lack of diversity in programming and on the board.

On her approach to governance, Buttrose says she is not a paper shuffler. "Make a decision and get on with it," she says. "I like to make decisions, to work out where we're going, to think how we're going to get there — then work out the plan and set off. I'm a believer in running things on time, but within that, making sure we allow time for the things that need a long discussion — prioritising the tasks of the board so we spend time on the things that matter."

In dealing with Canberra, Buttrose says she found the public hearings in the Senate inquiry unnecessarily aggressive. "It's not customary for directors of boards to be subjected to that," she says. "I found some of the questioning very aggressive. I don't think the directors needed to be treated with such aggression. They are men and women trying to do their best. I understand the reason why they were having a Senate inquiry, but you don't need to be that aggressive in your questioning."

A busy life

In retrospect, Ita Buttrose AC OBE MAICD was an obvious fit for the role of ABC chair. It helps she's spent more than 60 years in the media — starting as a copy girl at 15, running messages and making tea. Following in the footsteps of her journalist and former ABC executive father, Charles, she has worked in print, radio and TV; as an editor, a publisher, CEO and director. And with publishing industry giants such as Sir Frank Packer and Kerry Packer AC, Rupert Murdoch and Sir Peter Abeles.

So when the job of heading Australia's national broadcaster was going in the wake of the shock sacking of CEO Michelle Guthrie and resignation of chair Justin Milne FAICD in 2018, how was it such an ably qualified person didn't get a look in during the original selection process? Buttrose says she knew the role was going but didn't apply. "I was busy doing other things," she reflects.

Buttrose is a former chair and now national ambassador for Dementia Australia, a member of the Sydney Symphony Council and a trustee of the Centennial and Moore Park Trust.

"I do have a very busy life and lots of other commitments, some of which I've put aside for this job," she says. "So when the Prime Minister approached me, you sort of think, well, why not?"

The 2013 Australian of the Year, Buttrose is the 18th chair in the ABC's 87-year history. She's the second female chair (after the late Dame Leonie Kramer AC DBE in the early 1980s) and the first with actual media experience. A media icon, Buttrose was also popularised in the 1980 Cold Chisel song *Ita* and has 64,000 Twitter followers.

Buttrose is frequently asked in business circles about political bias in ABC coverage by journalists who've been described as a "nest of left-wing vipers" and "inner-city, latte-sipping socialists out of touch with ordinary people".

"Sometimes unconscious bias does play a part," she says. "People form views, but for the most part, if you look at our news programs, ABC 24 and so on, Australians rely on that news and they are happy with it. And they are our shareholders. We've had umpteen reviews into the ABC. There's always a review going on. We seem to get through them quite well and nobody finds anything untoward. When governments change office, we often get the same claim from the new government. Doesn't matter which one is in office, there's always some problem with the ABC. If there's a fault, blame the media — and the ABC is a popular punching bag."

Leadership turmoil

Buttrose is circumspect when asked about the events that led to the breakdown in the relationship between the CEO of two years, Guthrie, and chair of just over a year, Milne, followed by their spectacular exits in September 2018. There were allegations of political interference, and ABC executives and directors were grilled at a subsequent Senate inquiry. In her trademark direct fashion, Buttrose is emphatic: "That's all past."

The 2018–19 ABC annual report deals with the fallout from the drama in two paragraphs of her letter from the chair. "The ABC," Buttrose writes, "is an essential part of Australia's social fabric… more than two-thirds of the population connect with [it]. How many other Australian institutions can boast that level of constant engagement? Or the solid levels of trust and support?

"In my short time as chair of the ABC, I have sought to maintain those benchmarks. It has not been easy. The period covered by the annual report included some disruptive leadership issues culminating with the departure of both the former managing director and chair in September 2018. As a result, the board and management spent too much time in the latter half of 2018 being the news rather than producing it. That is now behind us."

In the annual report, Buttrose thanks ABC deputy chair Dr Kirstin Ferguson FAICD for a job well done when she became acting chair following Milne's exit, navigating the organisation through a Senate inquiry and departmental investigations. Ferguson was also acting chair when the legal settlement with Guthrie was made over an adverse action for being terminated halfway through her five-year contract. The ABC annual report lists a total payment of $1.56 million, including $1.34 million in termination benefits for the year to June 2019. "It's wonderful now, having the stability of Ita as chair," says Ferguson. "I'm relishing my role as deputy chair, which is to support the board and the chair."

The last half of 2018 was "a challenging time for everyone on the board" Buttrose writes in the annual report. "It is important to acknowledge the key finding of the Senate inquiry that the board's decision to terminate Michelle Guthrie was made without reference to real or perceived political interference. Staff morale was badly shaken, and my priority has been to reinvigorate it by restoring order and enhancing good governance with the help of managing director David Anderson and his management team. Our employees, in content areas and vital support functions, need a strong sense of direction and a feeling that management has their backs. I feel we are providing it now."

Buttrose and Anderson are now grappling with a diminishing budget, including a $84 million cut from the 2018 budget in real terms. As she told a Friends of the ABC forum in September, the "attention economy" is ever growing with the FAANGs (Facebook, Apple, Amazon, Netflix and Google) and torrents of available content, while commercial media is "pulling up the drawbridge".

She says these challenges are "daunting and perhaps good reason to think about marching backwards or retreating completely". However, Buttrose has a counterintuitive instinct. "This is our opportunity to be bold, to be enterprising, to be Australian."

She says being chair is a good role in which to ask: "What if it doesn't quite go like that? What if something changes?"

Ageism

Buttrose was a captain's pick by Scott Morrison, selected outside the normal ABC process. When asked about headlines questioning whether 77 was too old to be a CEO or chair — which Buttrose found offensive — she points to the likes of the 79-year-old Speaker of the US House of Representatives, Democrat Senator Nancy Pelosi.

"We can be quite ageist as a nation," says Buttrose. "People have got skills to bring to bear — could we all just be a bit more adult about it and try to broaden our horizons? Could we just change our attitudes to ageing? Younger people who insinuate I might be a bit older have never got to where I am in life, so they have no idea what it's like. They should wait until they walk in my shoes before they pass judgement. It's quite obvious I still have the ability and skills. I haven't lost my curiosity. We don't think about age anywhere in very positive ways. You know you can only lead by example, and I hope I'm an example and that people will observe I am a woman of a certain age, but it doesn't reduce my capacity to do a good job."

Buttrose says there are benefits in being an older director and supports Minister for Aged Care Ken Wyatt's notion of a senior's gap year at 65 because it is now apparent that many people will end up working until they are 80.

"You do learn as you go along," says Buttrose. "As you get older and get more experience, you do read people a lot better and understand people a lot better. That is a really good skill and you become more discerning. I can pick when people are telling me porkies, as well. I could do that years ago, but I think I do it a lot better now."

One immediate thing to put right at the ABC was to signal trust in the relationship between the chair and managing director Anderson. Buttrose says it is crucial to have absolute trust in one another.

"The managing director has to know whatever we talk about will remain between us — and he has to do the same thing, whatever I'm saying to him."

Buttrose and Anderson meet regularly. "We talk very frankly about issues," she says. "I sometimes make suggestions for him to consider. He tells me what's on his mind and listens while I give him my thoughts. We know where we want the ABC to go. He's working on a five-year plan he'll be announcing in March 2020. So we've been talking about that and what we're hoping to achieve. We bounce ideas around. It's a very frank discussion — and we have it behind closed doors."

Buttrose is also hopeful that the case for more secure funding for the broadcaster is being understood, as the Australian Competition and Consumer Commission (ACCC) put it recently "in recognition of their role in addressing the risk of under-provision of public interest journalism that generates broad benefits to society".

Recovery mode

In the annual report, Buttrose described the period the ABC has been through as one of "disruptive leadership". And the problem with disruptive leadership is that it permeates all the way down through an organisation. So how does the chair of an organisation recovering after a disruptive phase respond?

"You take your time," explains Buttrose. "You listen, you observe and you read, trying to get a real handle on what's been going on. Then you look at how things are done and you start to make suggestions about doing some things differently, but not too drastically."

She adds it's important to respect your colleagues and lead by example. "You're aware they've been through a disruptive time," she says.

Buttrose says that as an editor, she made sure she got out to meet people in the community, adding that the way to understand people is to mix and talk with them.

She has continued on that path, insisting the ABC board and management get out more. The board has met in Townsville and next year will convene in Darwin.

"You've got to get out to the countryside, to the suburbs. You've got to look at what the letters to the editor are saying, they're always a good barometer of what people are thinking."

That's one rationale for the ABC's Australia Talks survey, which asked more than 54,000 people to share their thoughts and feelings on almost 500 questions; plus interviews with 60 community leaders, in collaboration with Canada's Vox Pop Labs. The aim is to promote a national conversation about the key issues affecting modern life — people's concerns, health and happiness, and perceptions of their nation. It has proved revealing.

"I feel like the federal election showed that media and politics has become really weighed down in broad and overarching philosophies, which are something to aspire to, but we're forgetting to talk about the everyday fears and concerns of people," was how one Australia Talks interviewee put it.

Buttrose emphasises it's important to not lose sight of one thing. "The ABC is really funded by the Australian people," she says. "We belong to the Australian people, that's who we are responsible to. That's why it's very important everybody at the ABC understands our job is to serve the people of Australia. It doesn't matter what we think about all of these things, we have to think about what they think."

Four expert views on the future of governance and ethics

18 October 2019, *Four expert views on the future of governance and ethics*, Governance Leadership Centre, AICD.

Applied ethics skills will become a key board tool as business complexity grows.

Predicting the future of business is rife with complications. Few foresaw Donald Trump becoming US President, Brexit, or earlier the global financial crisis and tech crash. If key events that shape business and governance are hard to predict, how can boards prepare?

A better approach is extrapolating current governance trends into the future and understanding how boards might have to adjust to rising community expectations on business behaviour and ethics. Powerful forces that are influencing boardroom ethics will only grow.

The Governance Leadership Centre asked four ethics experts about the direction of governance and ethics over the next 10 years. There were common themes in their responses: the need for greater boardroom training on ethics, boards even more focused on corporate culture and behaviour, and applied ethics skills as a competitive advantage.

There was also a view on different board models that might evolve in the coming decade if there are recurring ethical failures in governance. That could include regulators having a greater say in director appointments or even industry associations providing salaried directors to boards.

Here are the responses of the four ethics researchers/practitioners.

Dr Petrina Coventry FAICD

Professor at the University of Adelaide, non-executive director with a number of listed and not for profit organisations, business ethicist and private-equity partner.

Between now and 2029 there will be greater focus placed on character and background when making director appointments. Choosing a director based on skills and experience — or who is known to other directors on the board — will not be enough. Boards will have to consider a director's character as well as their ability to govern through complex ethical issues, before their appointment.

Activist stakeholders will make more aggressive "calls" on a director's individual and a board's collective virtues during their tenure. It's a bit like the Wizard of Oz syndrome: stakeholders will want to know much more about the people behind the screen (directors); not just their skills and CV but their view on the world, evidence of moral character and ability to make complex ethical decisions. Stakeholders will test that the director's ethical position aligns with the organisation's purpose.

Directors will increasingly need education in the area of applied ethics. It will not be enough to assume directors are equipped to make ethical decisions, given rising complexity in business. Boards will need new tools, frameworks and at times external advice to help them understand how to interpret and respond to decisions that involve a multitude of stakeholders with different needs. They will need to view applied ethics as a core skill.

More board decisions will be made on an ethical basis — companies acting in the right way — rather than just following the law. Too often, when companies face complex ethical decisions, their response is to wheel in the lawyers and adopt a compliance approach. They do what the law requires, even though the law often lags community expectations and ethics, the law can often be out of date or wrong.

Boards will recognise that if they continue to follow the low road (compliance) rather than the high road (having the character to do the right thing) their organisation will not be maximising value for stakeholders.

Also, due to the rapid and mercurial nature of changing technology and societal implications, there will be more focus on "existential ethics" in the boardroom in the next 10 years. Boards will be challenged to face up to their organisation's responsibility to society and the planet, and directors will increasingly be viewed as keepers of their company's moral code and character.

That trend is underway now as boards spend extra time on climate-change governance and other ESG issues, and will surely grow as boards govern for a more diverse group of stakeholders and view value as a long-term concept that goes beyond the organisation's short-term profitability.

There will be tougher career consequences for poor ethical behaviour. I suspect some industry associations and professional bodies will take a harder line; ethics will play a greater role in who they admit and whether they retain their membership. We will see people "struck off" from industries for poor ethical behaviour, as happens in medicine and law.

The big unknown is what will happen over the next decade if organisations continue to have serious ethical failures and what that means for boards. If boards cannot govern their company's ethics to the standard required, regulators might do it for them. It might be that an organisation, led by regulators or an industry association, appoints full-time directors to boards, monitors their governance performance and professional development, and rotates directors across boards.

There are obvious complications and challenges with this model, but the only way to get true "independence" on boards that aids ethical thinking, and better diversity, might be for someone else to appoint and monitor directors — and for those directors to move between organisations after a few years. We are already seeing regulators here and overseas taking extra interest in board performance and that will continue if ethical failures are recurring.

We might find that having part-time directors on boards as organisations grow and ethical decisions become more complex, is no longer sufficient to address governance challenges. At a minimum, we'll see directors holding fewer board positions in their portfolio in the coming decade.

Dr Tracy Wilcox

Academic Director, Postgraduate Program at UNSW Business School, expert in business ethics and sustainability.

The issues that boards will grapple with over the next 10 years will be very different from today. The world is changing quickly, business complexity is intensifying and shareholder activism is expanding. In years past, people signed a petition against a company; today, activists can mobilise millions of people worldwide via social media, as with the climate-change strike.

Boards will govern much more for the needs of a diverse group of stakeholders, beyond shareholders. That is happening now but when making decisions in the future, boards will think deeper about how that decision affects employees, customers, society and the planet. The multi-stakeholder component of decisions will create greater ethical challenges for boards, which will have to balance outcomes for potential winners and losers in decisions.

Boards will respond to stakeholder needs in several ways.

First, through true diversity. Not only around gender or race, which are important, but ensuring different stakeholder groups are represented on boards - employees for example, as is the case in Germany. If boards are serious about governing for a diverse group of stakeholders, they will need to ensure key stakeholders are represented and that could change board composition as we know it. Boards that keep appointing directors from the same small pool are not "future proofing" their organisation.

Second, ethics training will become a much bigger part of a director's professional development. Boards will need specialist skills on ethics and sustainability to confront the governance challenges ahead. We cannot assume that a director who had a long executive career can always understand the needs of diverse stakeholders, and balance tensions between short-term and long-term organisation performance. I am not suggesting directors will need a Master of Philosophy; rather, applied ethics skills learned through executive education.

Third, boards will focus much more on ethics and organisation culture — a trend that is clear today. Technology will be a key driver. Boards will want to know that the organisation's data scientists, for example, are considering the ethical implications of their work, and following codes of ethics. And that the firm has an ethical approach to artificial intelligence, machine learning and other emerging technologies that have significant implications for governance.

Boards will also respond to ethical challenges by adopting the "precautionary principle". That is, being more proactive in mitigating risks, even when the magnitude of that risk is not clear and there is no legal imperative to act on it. Essentially, it is about boards saying, "we can't be certain how this risk for the organisation will play out, but let's act early to mitigate it", rather than reacting when it is a problem or a regulator demands remediation. Good boards will ensure their organisation gets in front of the law through a strong focus on ethics from the boardroom to front-line staff.

Financial markets will also have a greater say on organisation ethics in the coming decade. That has been underway since the 1990s with the focus on environmental, social and governance (ESG) and will grow. Firms, and by default boards, with demonstrably poor ethics will get marked down by investors, and vice versa. The cost of boards not thinking sufficiently about the ethics of complex decisions, or not having the skills to do so, will rise significantly in the next decade.

Dr Andrew John

Associate Professor of Economics at Melbourne Business School, lecturer in ethics and corporate social responsibility.

Two trends will drive the evolution of governance and ethics over the next 10 years. The first is increasing public expectation of good business behaviour. The second is rising business complexity.

As for the first, trust in institutions worldwide has declined this decade but that may be partly because the community has higher expectations of how a company should behave.

"Being a good corporate citizen should be business as usual, not a marketing campaign."

These expectations strengthen the business case for organisations behaving ethically and for boards to ensure that happens. The notion of boards interpreting their fiduciary duty narrowly in terms of the organisation's short-term profitability is in the dustbin. High-performing organisations will have high ethical standards that attract, engage, and retain talent. Ensuring organisations behave ethically will be fundamental to long-term business success and sustainability.

Boards will also focus more on the link between ethics and risk management. We know from the academic literature on corporate social responsibility (CSR) that organisations which hold themselves up as a paragon of virtue risk greater scrutiny and community backlash. Being a good corporate citizen should be business as usual, not a marketing campaign.

The CSR literature shows organisations that are perceived to have good corporate social responsibility develop a form of insurance in the community. When a crisis emerges, the organisation is likelier to get the benefit of the doubt from the public if it has shown consistently strong ethics and behaviour over a sustained period. Boards should give some thought to how their approach to ethics throughout the organisation could minimise damage if something goes wrong.

As for the second trend of rising business complexity, it is hard to predict where artificial intelligence and other technologies will go, but the increasing business complexity over the next 10 years is a near certainty. Boards will need to consider the ethical implications of technology—including, but not limited to, data management and privacy—and anticipate that technologies may be a source of crises and scandals. The challenge is that boards and even executive teams will find it harder and harder to keep up with their organisation's own technologies. One possible board response to complexity is to add more technical expertise, either among directors or through external advice. Consider recent problems: Boeing's board was criticised for lacking technical expertise in the 737 Max crisis; Volkswagen's board missed the "cheat device" scandal over emissions performance. In both cases there was a clear lack of technical expertise at board level. If boards lack technical skills, how can they understand the intersection of technology and ethics and make complex decisions in this area?

I believe the board response in the next 10 years will be to "normalise" ethical thinking and ethics discussions. Too often we avoid talking about ethics, because it is an uncomfortable part of business conversations. We need to avoid thinking that debating questions of ethics or values is tantamount to an accusation of unethical behaviour.

If boards want to encourage deeper discussion about the ethical impact of governance decisions on diverse stakeholders, they need to create space for it. Boards of the future could do this in different ways: by ensuring there is more focus on ethics in board agendas, by the formation of ethics subcommittees, or even by conducting ethics off-sites in the way there are strategy off-sites.

At an individual level, directors should also develop better skills in self-awareness and decision-making bias. With appropriate training, directors will be better able to identify and understand both their own biases and those of their peers. There will be greater focus on board interactions and dynamics, and how those feed into ethical decision-making.

Given rising community expectations and growing complexity in business, stakeholders may legitimately question whether the model of part-time directors holding a portfolio of roles is still the best way for boards to operate. A better approach might be for directors to hold fewer roles and focus more on each, opening up positions for others. Board diversity will benefit.

Most of all, boards will need the capacity to respond to unexpected challenges imaginatively. Boards will need to experiment with new governance approaches and models — a one-size-fits-all approach to governance and ethics will not work.

Cris Parker

Head of The Ethics Alliance, a program at The Ethics Centre, and director of the Banking and Finance Oath, a pledge of integrity and commitment in the financial services industry.

In my opinion, a much stronger 'language of ethics' will develop in boardrooms over the next 10 years. Directors will be well versed in ethics, had ongoing training in this area, and see ethics as a core governance skill. The boardroom approach to ethics will be much more applied. There will be less anxiety about discussing ethical issues or a director's ethical viewpoint on an issue, which might be very different to your own, because boards have skills in this area.

Bias training will become a staple of director training. As an example: experienced directors are generally good at what they do, but there is a risk of a "halo effect" which could create an unwillingness or a perceived need to challenge a successful chair. Such biases can cloud ethical decisions.

Directors will spend greater time ensuring a high level of ethics is embedded throughout the organisation, particularly in technology. Top data scientists, for example, will tell you that the ethics of data needs constant monitoring and boards will need to be satisfied that this is happening. More boards will consider forming an ethics committee or another structure to focus more director/executive resources on the topic and have time to do deep dives into ethical issues.

Directors will need extra time to address a changing value equation for organisations. The true value of organisations is in their people, their culture, their contribution to society and how they balance difficult decisions that affect stakeholders differently. Boards will get better at debating and deliberating the ethics behind complex decisions, and being more transparent about how they arrived at decisions that might disappoint some stakeholders.

I believe boards will be more open to activists and others with a different point of view in the coming decade. Rather than see activists as a force to oppose, boards will try to understand their views through engagement and if they have merit, act on them. Climate change is an example. Good boards will engage with activist groups to understand their view and it not unreasonable to think boards and activist groups could work together on some issues, or even appoint an activist as a director.

Setting a company's ethical compass

18 October 2019, Setting a company's ethical compass, Governance Leadership Centre, AICD.

Crucial to get the balance right in an increasingly complex corporate environment.

In a packed room at the RACV Club in Melbourne in September, directors listened to an insightful discussion on one of the most important, complex governance issues today: ethics.

Although ethics has long been a staple of good governance, the fallout from the Financial Services Royal Commission and, last year, the Australian Prudential Regulation Authority's (APRA) review of the Commonwealth Bank has intensified focus on the board's role in ethics.

Ethics is rarely straightforward for boards. It sometimes is simplistically pitched as a choice between good or bad, but many board decisions involve trade-offs. For example, the balance between short-term and long-term performance; the competing needs of diverse stakeholders; and the tension between what is required by law and what is the right thing to do.

An ability to balance these and other trade-offs is central to ethical governance and was a recurring theme among the events panellists during the discussions at the Australian Institute of Company Directors luncheon.

Panellists included: Dr Simon Longstaff AO, executive director of The Ethics Centre; Kathryn Fagg AO, Chair of Boral and a non-executive director of Incitec Pivot, Djerriwarrh Investments and CSIRO; Jacqueline Hay, Chair-elect of Bendigo and Adelaide Bank; and Sean Hughes, an Australian Securities & Investments Commissioner.

Here are 12 key take outs from the panel discussion about how boards can ensure their organisations have an ethical culture and navigate growing complexity around this issue.

1. Values, purpose and principles

Having a clear organisation 'compass' around ethics was critical, said panellists. Good boards and executive teams established the organisation's core values, purpose and principles, and 'set the tone from the top'. They applied those values consistently through ethical decision-making. Although it sounded obvious, too many organisations lacked strongly defined and communicated values — and made board decisions without reference to them.

2. Short-term versus long-term performance

Panellists argued that short- and long-term organisation performance was not mutually exclusive. Listed companies had to deliver short-term performance to meet market expectations, but short-term outcomes must be in the context of the firm's long-term strategy and values. Effective boards resisted being dictated to too much by a short-term time frame that was not in an organisation's long-term interest, because it could lead to poor ethical choices.

3. Shareholder versus stakeholder primacy

There was a strong view among panellists that corporations had to act in the best interests of a diverse group of stakeholders. Boards were not only there to service the needs of shareholders. Doing the right thing by customers, employees, the community, regulators and other stakeholders was, by default, good for value creation and shareholders in the long run.

4. Balancing competing needs

Panellists said a key challenge was to understand who a board was governing for and the competing needs of different stakeholders. Then, to weigh up those needs in board decisions and deliver an outcome that directors were prepared to stand behind, even though some decisions inevitably created stakeholder winners and losers. Panellists acknowledged that juggling different stakeholder needs, across different time frames, and involving financial and non-financial returns, was complex. But it was central to ethical governance decision making.

5. 'Should do, not have to do'

An interesting observation in the discussion was the prevalence of boards and executive teams to fall back on "what does the law require the organisation to do?" rather than "what should we do?". Panellists noted that ethical decision-making went far beyond compliance; it began with what was right, and was proactive, rather than reactive or forced by regulatory demands. Only doing what the regulator or law expected — or waiting for a regulator to insist on industry change before doing what was right — was a recipe for poor ethical decisions.

6. Simplification

Some panellists noted the link between increasing organisation simplification and ethics. Following the Financial Services Royal Commission, more financial institutions were simplifying their products and services, distribution channels, fees and processes. In doing so, they were reducing layers of complexity that created scope for unethical practices and improving the quality, transparency and timeliness of information provided to boards.

7. A new customer conversation

An important observation in the discussion was the push by business to reset the customer conversation. There was a view that too much trust had been lost between Corporate Australia and customers, creating the perception that too many large organisations engaged in unethical practices designed to boost earnings and reward shareholders. The key for boards was to better understand the needs and views of customers and ensure they were sufficiently represented in governance decisions — a practice more boards are focused on these days.

8. Employees and ethics

Panellists noted the growing desire among employees, particularly young people, to work for organisations that made consistently ethical decisions, had a long-term focus, gave back to the community and balanced the needs of diverse stakeholders. Panellists said organisations that had an ethical culture were better placed to attract, retain and develop top talent. Those that displayed questionable ethics risked losing good staff to rivals.

9. Multiple layers of ethics protection

The best defence against poor ethics was a strong organisation culture and multiple layers of ethics protection, noted panellists. The board, executive team or senior management could not hope to stop all ethical breaches in an increasingly complex environment. It began and ended with all staff understanding the organisation's values, purpose and principles and being supported by management and the board to apply them consistently. An ethical culture at all levels of the organisations provided multiple check points to identify, communicate and mitigate bad behaviour.

10. Social media

Panellists noted the power of social media in exposing ethical breaches in organisations and how it had made life more challenging for directors. Boards needed to be much more alert about social media and what stakeholders were saying — and ensure there were strategies to understand how social-media audiences were commenting on the organisation's ethics and respond to them. Boards and executives had to be willing to defend the organisation's ethics.

11. Virtue signalling

Some panellists were concerned about recent government comments about big business 'virtue signalling' over non-financial issues such as climate change or their social licence to operate. Panellists argued that boards and executive teams were often responding publicly to what the organisation and its stakeholders believed — and that communicating those views could be beneficial. More employees expected their organisation to advocate on important social or environmental issues, show leadership and demonstrate ethics publicly.

12. Boards pushing back

Balancing the needs of different stakeholders over different time frames did not mean boards should be beholden to a particular stakeholder group, or always put long-term performance ahead of short-term results, said some panellists. Boards had to have the courage to push back on stakeholders who tried to dominate organisation trade-offs. Having clear values and ethics, and making decisions that consistently related to them, was the best form of defence against stakeholders who pushed a narrow agenda that might not be in the corporation's best long-term interests. Ultimately, boards had to weigh up what was best for all stakeholders, on balance.

CHAPTER 10.

Lifting the bar: learnings from recent royal commissions

Picking up the pieces

Christian Gergis GAICD and Sally Linwood

"Picking up the pieces", *Company Director*, February 2020, AICD.

The culture, governance, risk and remuneration fallout from the Banking Royal Commission should be a board priority in 2020.

February this year marks 12 months since the release of the final report of the Banking Royal Commission. The central conclusion by Commissioner Kenneth Hayne AC QC — that "failings of organisational culture, governance arrangements and remuneration systems lie at the heart of much of the misconduct examined in the commission" — set the tone for a year in which scrutiny of board practice and governance reached new heights.

Last year also saw the start of both the aged care and disability royal commissions, and an Australian Law Reform Commission (ALRC) inquiry into corporate criminal responsibility; the CEOs and chairs of two of Australia's major banks stepped down; and for the first time, a second strike was recorded against the remuneration report of one of Australia's largest companies, Westpac.

So what can boards learn from an environment where expectations of boards are rising, and community and stakeholder tolerance for misconduct has reached a new low?

Expectations

Front and centre for boards should be trying to understand, respond to, and ultimately shape, stakeholder and community expectations. As Hayne commented, the evidence before the Royal Commission showed entities too often put the pursuit of profit above all else, including the interests of customers and compliance with the law.

The task now for boards and the organisations they govern is to credibly and publicly demonstrate how they are considering other stakeholder interests in their decisions. Boards should be asking themselves how they intend to bring the stakeholder voice to the board table, and what steps they can take to better understand community expectations.

In an environment where debate rages on the purpose of the corporation and calls to reshape directors' duties – particularly to act in the best interests of the corporation — remain, it will be incumbent on organisations to show how they produce shared value for stakeholders and the broader community.

Personal accountability

Perhaps the most significant shift of the year has been an increasing expectation that the senior leaders of organisations take personal responsibility for corporate misconduct and loss of trust. Former NAB chair Dr Ken Henry and CEO Andrew Thorburn stepped down after Hayne cast doubts in his final report on their ability to lead their organisations. In November, Westpac CEO Brian Hartzer left his position in the wake of the AUSTRAC civil proceedings, and both chair Lindsay Maxsted FAICD and risk and compliance committee chair Ewen Crouch AM FAICD announced they would be leaving the board sooner than planned.

The question for directors is: when should they be held responsible for misconduct that occurs on their watch? While directors can stress the importance of the line between board and management, ultimately organisations must be able to demonstrate personal accountability when things go wrong. The fallout from the Royal Commission has shown that the size and complexity of an organisation, and relative distance of NEDs from the day-to-day running of the company, will not quash calls for board-level accountability.

At the same time, the question of accountability has raised the related issue of liability. Should directors and officers who are held publicly accountable for breaches of the law, also be personally liable? That question will be the subject of ongoing debate in 2020, with the ALRC to hand down its report on corporate criminal responsibility by the end of April.

Board oversight of culture

Boards are increasingly focused on how they can provide effective oversight of organisational culture. Setting the tone from the top is crucial, however modelling the right behaviour is just one aspect. The challenge for boards is how to provide ongoing cultural stewardship while retaining the distinction between the board and management, and recognising that NEDs are necessarily distant from day-to-day operations. This challenge is particularly acute for large, complex organisations. Boards are struggling with two related challenges: devising tailored metrics, and consistently but constructively testing the trust they must place in the CEO and other senior executives.

Multiple royal commissions have also demonstrated the need to consider the myriad ethical considerations that impact on board decision-making – and why boards must ask not only "can we" but "should we"?

In 2019, the AICD released two new resources for boards on governance of organisational culture and ethical decision making, which provide some guidance for directors: *Governing Organisational Culture and Ethics in the Boardroom: A Decision-Making Guide for Directors*

Governance of remuneration

The Royal Commission and its aftermath have forced a rethink on remuneration and whether current structures remain fit for purpose. Commissioner Hayne observed that in almost every case, the conduct at issue was driven in part by individuals' pursuit of gain, whether in the form of remuneration for the individual or profit for the business. The link between misconduct and remuneration has broad implications and is relevant well beyond financial services.

Boards are taking steps to strengthen their approaches to remuneration governance and must test that remuneration structures are operating as intended, and aligned to the desired strategy and culture. Questions of what the organisation values — and whether staff are properly rewarded for "doing the right thing" — accountability and the appropriateness of metrics used to measure performance are being debated. Boards are also increasingly considering whether they require a greater oversight of remuneration practices — and the behaviours they drive — throughout their organisation, that is, beyond the traditional domain of senior executive pay.

Executive bonuses continue to make the headlines and it is clear that shareholders, regulators and the community expect bonuses will be reduced — to zero where appropriate — to demonstrate accountability for conduct failings. For listed companies, investors want to see that incentives are genuinely at risk, rather than essentially fixed pay in another guise.

Oversight of non-financial risk

More specifically, boards across all sectors are attempting to grapple with the question of non-financial risk — a fluid concept, but generally understood as meaning operational risk, compliance risk and conduct risk.

The Australian Securities and Investments Commission Corporate Governance Taskforce report on director and officer oversight of the area within seven financial services entities was the first time the regulator had explicitly set out views on better governance practice. While the report, coming on the back of the Australian Prudential Regulation Authority CBA report and entities' self-assessments, contained few surprises, it nonetheless highlighted that practice in this area needs to improve.

The taskforce will also release its report on variable remuneration this year.

At the heart of the problem for boards is agreeing with management the kinds of indicators, particularly leading, that point to areas of weakness. Unlike financial risk, which has been well understood for decades, maturity in this area remains relatively low. Gaining a better handle of non-financial risk should be a core priority for all boards in 2020, and will take a clear and sustained focus. Failure to do so may well see 2019 repeated.

Groundhog Day?

Narelle Hooper MAICD

"Groundhog Day?", *Company Director*, February 2020, AICD.

In February 2019, the final report of the Banking Royal Commission marked the start of a process of reflection and change on finance sector governance, culture and accountability. At the time, it was recognised that boards, management and regulators would require discipline, focus and substantive investment to apply the lessons. A year on, Australia's financial services sector has been hit with more revelations. So what have we learned — really?

On February 4, a year ago, the three-volume *Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* landed with a thud in the Australian business community. Commissioner Kenneth Hayne AC QC's findings exposed to the public the entrenched nature of misconduct, lack of customer focus and accountability, and governance failures at Australia's largest financial institutions.

After months of testimony and 75 case studies, it resulted in 76 recommendations and 24 referrals for further action, drily reminding all of the basic principles that should be embedded in decision making — starting with "obey the law".

Following the global financial crisis, financial services entities and regulators in Australia and elsewhere gave close attention to financial risk. However, Hayne flagged that in Australia, too little heed had been paid to regulatory, compliance and conduct risks, often grouped under the umbrella of non-financial risk.

"Too little attention has been given to the evident connections between compensation, incentive and remuneration practices and regulatory, compliance and conduct risks," wrote Hayne. "The very large reputational consequences that are now seen in the Australian financial services industry, especially in the banking industry, stand as the clearest demonstration of the pressing urgency for dealing with these issues."

Hayne quoted the G30 in his final report: "As the Group of 30 said in November 2018, 'getting culture and conduct right is not a supervisory requirement. It is necessary for banks' and banking's economic and social sustainability'."

Pledging immediate action, the boards and CEOs of our financial institutions stepped up investment in systems and personnel to work through a mounting list of issues and began publicly reporting on their remediation of failures. With NAB singled out for special comment, CEO Andrew Thorburn and chair Ken Henry AC headed out the door, joining a growing list of exits.

Regulation

A chastened and beefed-up Australian Securities and Investments Commission (ASIC) got busy with a tougher enforcement mission and long list of expected prosecutions. Meanwhile, the AICD began its extensive member consultations and developed its Forward Governance Agenda — a program of work responding to the debates on governance practice through the streams of standards and professionalism, culture, director duties and stakeholders, demonstrating accountability, and remuneration.

By May 2019, the Australian Prudential Regulation Authority (APRA) diplomatically revealed the enormous scale of the quest and the weaknesses in its paper summarising the results of the self-assessments by 36 regulated institutions on their governance, accountability and culture. APRA demanded additional capital requirements of $500m each from ANZ, Westpac and NAB to reflect higher operational risk — following the $700m penalty imposed on CBA in 2018, after APRA's prudential inquiry into the bank.

APRA chair Wayne Byres GAICD said Australia's major banks were well-capitalised and financially sound, but improvements in the management of non-financial risks were needed. "This will require a real focus on the root causes of the issues that have been identified, including complexity, unclear accountabilities, weak incentives and cultures that have been too accepting of long-standing gaps," he said. "Their self-assessments reveal they have fallen short in a number of areas and APRA is therefore raising their regulatory capital requirements until weaknesses have been fully remediated."

However, by November, AUSTRAC's federal court allegations of anti-money laundering breaches at Westpac left seasoned directors dismayed. Had anything really changed?

Fiona Shand FAICD, a non-executive director and long-time AICD course facilitator says many she's spoken to in the director and investor communities are deeply frustrated at how little has changed in the past year. "Every day when you open the newspaper, it may be a different person or organisation, but they are the same fundamental issues. It's Groundhog Day. We can all accept the baggage of legacy problems and systems in large organisations, but where is the sense of urgency to effect real change? With a few exceptions, we haven't seen boards and companies transparently accepting responsibility and making the behavioural changes communities expect."

Shand says there is still a deep disconnect between boardrooms, directors and communities they operate in. "Companies and directors cannot continue to say 'trust us to fix the mess we made' and expect to be believed."

Certainly, that was the lesson for Ken Henry. Reflecting on what went wrong during his time as NAB chair, he told the ABC it was not responding fast enough. "We should have pressed harder. There's no doubt."

The issue, he said, was "not dealing quickly enough with emerging problems, being prepared to interpret emerging problems as being of an administrative or technical nature rather than something that goes to the way that the bank impacts on its customers".

However, Rahoul Chowdry, partner and head of the financial services industry group at MinterEllison, who joined the AMP board in December 2019, says there must be an appreciation of the deep-rooted issues and scale of change required. "Many of the issues that have surfaced during and post the Royal Commission are deep-seated, so it's simplistic to claim that financial institutions have learned nothing. The issues will take time to resolve."

Every bank is under pressure, he says, and organisations must make up an investment deficit in data and non-financial reporting information, regulatory reporting, compliance and risk management reporting — and invest in technology.

"There's no question, many organisations are finding it a big challenge to keep up with the speed technology is changing and the sophistication that is required while also dealing with many legacy systems and controls that are no longer fit for purpose," says Chowdry. "This is a particular issue for organisations that are product- rather than customer-centric. Boards are a lot more probing and questioning. That's reflected in their response to their roles as directors. One of the great things [the Royal Commission] has done is to force a general uplift in governance standards in this country."

Chowdry says sound products, efficient operations, good culture and an appropriate customer focus are a recipe for sustainable shareholder value. "Those that fall short will experience pressure on profits and the ability to maintain dividends. We're already seeing this play out. And the cost is being borne by shareholders."

Shand says that 12 months on, "we've learned a hell of a lot, but we haven't put it into play. With a few exceptions, we haven't made the behavioural change we're going to need. In order to make that change, we're going to need for directors and management of organisations to go."

She describes the lack of connection between board and community as the "hubris of the legacy mirror" — a belief by senior directors that they have a right in that space. "There is a behavioural shift we have to make. We have to say: the emperor has no clothes. We need fresh eyes to see fresh issues and solutions — and a maximum board tenure of 12 years."

John Connolly FAICD, who runs issues management consulting company John Connolly & Partners, says directors must be acutely aware of the changed social context. This is also being fed by revelations of broader business shortcomings.

"A lot of good has come out of the Royal Commission, but the environment has become more toxic," he says. "What's happened for everyone is the accountability has narrowed. Go back a couple of years, it was about companies and then about executives; and now it's about directors. People want to see the directors go. That's the seriously big difference and if you are a director of a large public company now, you have to be thinking about the fact that you're much more accountable than you were before."

Connolly says directors must focus more deeply on what's going on in the organisation, even though they may still have concerns about blurring the line over their duties with management. "Everyone's been talking about reputation and communication. You have to work out if this is a communications problem or an operating problem. In many cases, 60 per cent of problems are operating problems, not communications problems. People being underpaid is not a communications problem, people not being cared for properly in nursing homes is not a communications problem. There is wilful blindness... as to what's been going on."

Connolly says boards and management should do scenario planning and focus groups to get a grip on the real issues and concerns. "The reality is the experience of employees and customers is completely different to that of a board executive."

CHAPTER 11.

Governing in slow economic times

How low can we go?

Mark Thirlwell MAICD

"How low can we go?", *Company Director,* February 2020, AICD.

With the first RBA meeting of 2020 early this month, market pricing indicates a good chance of a rate cut to 0.5 per cent.

Three cuts in June, July and October 2019 took the cash rate to a record low of 0.75 per cent. Even as the Reserve Bank board decided on October's cut, it conceded that at very low rates, monetary policy might have become less effective, and it was worried about the negative impact on the income and confidence of savers. Undaunted, financial markets continue to price in a good chance of at least one more rate cut in the first half of 2020, possibly as early as February. Some economists expect the cash rate to hit 0.25 per cent before year's end. With RBA Governor Philip Lowe confirming in a speech on 26 November that 0.25 per cent is the cash rate's effective lower bound (ELB), we look destined to come very close to the trigger point for unconventional monetary policy in 2020.

Conventional monetary policy involves the RBA adjusting the cash rate to influence other interest rates in the economy and thereby impact output, employment and inflation. But once the policy rate reaches the ELB, a central bank must turn to unconventional monetary policy tools (UMPTs) if it wants to deliver additional stimulus. International experience has seen a range of UMPTs deployed, including: negative policy rates with the central bank charging, rather than paying, interest on commercial bank reserves; forward guidance via the provision of detailed information about the likely future path of the policy rate, conditional on specific calendar- or data-based conditions; central bank lending operations to provide ample liquidity to financial institutions at favourable rates; Quantitative Easting (QE) via large-scale purchases of government securities funded by an increase in central bank reserves, aimed at lowering risk-free interest rates; the expansion of QE to include private sector assets such as mortgage-backed securities or corporate bonds; and foreign exchange market intervention to drive down the exchange rate.

In his speech, Lowe assessed several of these options, drawing on a study conducted by the Bank for International Settlements. His view was that while the available evidence offered strong support for some UMPTs as a means of supporting financially stressed and crisis-hit economies, the evidence for other positive effects was less compelling. Lowe also cautioned that they came with a range of potentially problematic side effects, including risking undermining the incentives of other actors in the economy to act in appropriate ways, distorting lending decisions and blurring the lines between fiscal and monetary policy. He argued that a package of UMPTs dominated any single policy, with a premium on the clear communication of central bank actions.

Lowe also effectively ruled out several of the UMPTs described above. He noted that Australia's financial markets were operating normally, obviating the need for unconventional lending operations; stressed that "negative interest rates in Australia are extraordinarily unlikely" — not least because he found the international evidence on their efficacy unconvincing; and stated that the RBA had "no appetite to undertake outright purchases of private sector assets". He conceded QE (in the form of the purchase of Commonwealth and state government bonds) would become an option once the cash rate hit the ELB. Even that would be a necessary but not sufficient condition, with the RBA only likely to activate QE if the economy was also moving away from its goals for full employment and inflation.

Lowe emphasised repeatedly that in his view, QE was a highly unlikely contingency for the RBA, noting: "QE is not on our agenda at this point in time" and adding that although the time could come when QE would be useful, "we are not at that point and I don't expect us to get there".

All of which seems quite clear in setting the likely path of policy this year.

However, the RBA's own forecasts suggest both unemployment and inflation will still not be where the central bank would like by the end of 2021. If that turns out to be the case, the pressure for additional monetary stimulus will remain. Moreover, that pressure would increase markedly in the event of any adverse shock hitting the economy. Granted, Canberra could yet choose to deploy its own fiscal policy tools more aggressively — but if it doesn't, the odds of Australia experiencing its first bout of unconventional monetary policy this year or next are on the rise, despite the RBA's misgivings.

CHAPTER 12.

An update on the regulatory environment

Fundamental attribution error?

Pamela Hanrahan

"Fundamental attribution error?", *Company Director*, February 2020, AICD.

An Australian Law Reform Commission inquiry into corporate criminal responsibility is wrangling with the issue of when and how a company should be made criminally liable for the conduct of those acting on its behalf.

Despite what we see in the media, most businesses do not set out to deliberately break the law. Exceptions usually fall into two categories — self-styled 'disrupters' (think Uber and the taxi laws) and gamers who shave expensive compliance costs from the front end and gamble either that no harm will result or that the short-term gains will outweigh the costs of detection and punishment down the track.

But legitimate businesses — including large and well-established businesses with vast compliance systems and budgets — do break the law dispiritingly often. Explanations range from poor regulatory design and lax enforcement, through individual or corporate greed and hubris, to what the 2003 Canadian documentary, *The Corporation*, characterised as the inherent psychopathy of the business corporation. Wherever we sit along that spectrum, solutions to the problem of corporate lawlessness can seem elusive.

The latest assault on the problem is the Australian Law Reform Commission (ALRC) inquiry into corporate criminal responsibility. The inquiry was called by Attorney-General Christian Porter in April 2019; its Discussion Paper 87 was released in November 2019; and the final report to government is due on 30 April 2020. The ALRC review is the latest of numerous reviews on aspects of corporate behaviour and regulation conducted in the past three decades, including the ASIC Enforcement Review Taskforce in 2017 and the Royal Commission into misconduct in the Banking, Superannuation and Financial Services Industry in 2019.

The ALRC's specific focus is on how Commonwealth criminal laws deal with corporate misconduct and the ways in which they might be altered to create more effective deterrence and appropriate accountability.

As part of its preliminary work, the ARLC reviewed 25 Commonwealth statutes directed squarely at business conduct, ranging from the *Agricultural and Veterinary Chemicals (Administration) Act 1992* (Cth) to the *Work Health and Safety Act 2011* (Cth). These include the banking, corporations, consumer and competition, environmental, and tax laws. Across those statutes, it identified 2898 criminal offences as potentially applicable to corporations, of which almost 80 per cent attract substantial penalties.

The ALRC inquiry addresses a range of conceptual challenges that arise when we subject an artificial, rather than natural, legal person to the criminal law. Traditionally concerned with both conduct and motive, criminal law imposes liability only where both are present in the same person. It exerts its coercive pressure on the body (deprivation of life or liberty) and soul (ostracism and shame) of the defendant, not just their hip pocket. These challenges inform the ARLC terms of reference, which include examining the optimal relationship between civil and criminal forms of corporate regulation, sentencing principles, and individual liability for corporate conduct.

The terms of reference also require the ALRC to revisit the thorny problem of "attribution". This answers the legal question of when and how the wrongful acts or omissions of individuals or teams acting within or for the corporation should be treated as criminal acts or omissions of the corporation itself. As the ALRC observes: "There are currently multiple methods of attributing criminal and civil liability to a corporation. Part 2.5 of the [Commonwealth] Criminal Code attempted to provide a single innovative and comprehensive method, however, the evidence... demonstrates a preference for alternative statutory methods." In fact, across the 25 statutes reviewed by the ALRC, 16 expressly exclude the corporate criminal responsibility regime adopted in 1995 in Part 2.5 of the *Criminal Code* and instead adopt a different methodology.

For more than 85 per cent of offences likely to be committed by a corporation, attribution of liability is based on a methodology described by the ALRC as the TPA — *Trade Practices Act 1974* (Cth) — model. The model is a form of direct — rather than vicarious — liability that deems the conduct and state of mind of certain individuals to be the conduct and state of mind of the corporation. These individuals may include directors, officers and agents and those acting at their direction.

The TPA model predominates in Commonwealth law, but there is not one statutory approach. Within the model, the ALRC found: "Attribution varies slightly from statute to statute and there is inconsistency as to whether a due diligence defence applies." It operates in addition to, rather than instead of, the common law method of attribution, which is different again.

Alternative methods of attribution lead to uncertainty as to the circumstances in which a corporation is liable. Where conduct is caught by multiple legislative regimes, there is a risk of different liability for the same conduct. The ALRC points to the example of extended warranties, which may be subject to the financial services, corporations and consumer statutes. The ALRC says that: "Though each of these statutes contain similar attribution methods, the provisions are not identical and circumstances are conceivable whereby the attribution method might result in corporate liability under one Act, but not another."

To address the problem, the ARLC proposes there "should be a single method for attributing criminal (and civil) liability to a corporation for the contravention of Commonwealth laws, pursuant to which the conduct and state of mind of persons (individual or corporate) acting on behalf of the corporation is attributable to the corporation, and a due diligence defence is available to the corporation".

The ALRC proposal parts company with the United Kingdom, Canada and New Zealand, which have recently favoured a model of corporate liability known as "failure to prevent". This model creates a separate offence under which a corporation is liable if certain specified offences (including bribery and tax evasion) are committed by a natural person who is relevantly connected to the corporation, and the corporation failed to exercise due diligence or to take reasonable measures to prevent the offence. Failure to prevent is not an attribution method – it is a standalone offence.

The ALRC rejected this approach, arguing: "Being convicted of a failure to prevent offence imposes a lower level of culpability than being directly responsible for the offence, because attribution means the corporation itself is criminally responsible for the offence, not just for failing to prevent someone else committing it." Another significant difference between the two approaches is that the ARLC model would apply to all Commonwealth criminal offences, not just those to which it is selectively applied.

It is tempting to view the ALRC inquiry as a lawyers' picnic, but it is important for business. Attribution is at the foundation of corporate criminal liability; the fact that something so fundamental is not addressed coherently points to broader problems with the state of Australian business law. The ALRC's thoughtful examination of the issue is welcome. However, extending attribution, and therefore the potential for corporate criminal liability with all that entails for shareholders, beyond that of our peer economies needs careful consideration.

Your regulatory radar for 2020

14 January, "Your regulatory radar for 2020", *The Boardroom Report*, Volume 18, Issue 1, AICD.

As we start a new decade, we look ahead to major issues and regulatory changes that directors need to be across in 2020. Here's a summary for the year ahead.

From 1 January 2020, public companies, large proprietary companies and corporate trustees of APRA-regulated superannuation entities needed to have a whistleblower policy in place. ASIC has granted relief from the requirement to have a policy to public companies that are NFPs or charities and have yearly consolidated revenue of less than $1 million.

ASIC has also released new guidance for companies on whistleblower policies — see Regulatory Guide 270 Whistleblower policies.

More generally, companies will be looking to the substance of their internal policies and procedures to ensure compliance with the substantive whistleblowing protections under the *Corporations Act 2001* (Cth), which still apply to organisations exempted from the requirement to have a formal policy in place.

Royal commission reports

The Royal Commission into Aged Care Quality and Safety will issue its final report on 12 November 2020. Governance is expected to be a focus of the final report, which will set a framework for a complete overhaul of the aged care system — from system philosophy and design to interactions with health and disability services, to workforce, funding and regulation.

In mid-November last year, the Aged Care Royal Commission sat in Hobart. For the first time, the focus was governance in aged care, the links between governance and outcomes and how the commission may look to improve governance.

The Interim Report released last year in 2019, entitled *Neglect*, sets out the extent of the failure of Australia's aged care services and called for an overhaul of the design, objectives, regulation and funding of aged care in Australia. Directors should note that the governance discussion is still at an early stage and that directors and boards may be the focus of future hearings. Read more on the Interim Report and the AICD view of the effect on NFP governance.

Meanwhile, the Disability Royal Commission is to issue an interim report no later than 30 October 2020 and a final report no later than 29 April 2022. Hearings began in Townsville in November last year and the inquiry sat in Melbourne in December, where the issue of neglect and abuse in group homes was examined.

A total of 177 submissions have been received by the Royal Commission into Violence, Abuse, Neglect and Exploitation of People with Disability.

APRA targets boards on cyber security

APRA-regulated entities have until 1 July 2020 to ensure their arrangements with third party service providers comply with stricter cyber-security requirements issued last year under Prudential Standard CPS234. The standard requires regulated firms to develop adequate cyber-security systems, clearly identify who in the firm is responsible for cyber security, and to notify APRA of all "material information security incidents".

Overall, APRA is revising its approach to supervision of governance, culture, remuneration and accountability. It has indicated that this will involve strengthening the prudential framework; sharpening its supervisory focus and sharing its insights.

Some key activities APRA has flagged include updates to Prudential Standard CPS 510 (Governance) (with areas for review to include the effectiveness of board obligations in relation to risk culture, the relative emphasis on financial and non-financial risks, and the need to strengthen requirements in relation to compliance and audit functions) and conducting deep dive and thematic reviews in areas such as risk culture and drivers of effective governance practices.

The AICD also expects APRA's new Prudential Standard on remuneration CPS 511 (Remuneration) to be released in the first half of this year. APRA is working with ASIC and Treasury to design, implement and jointly administer an expanded accountability regime (modelled on the Banking Executive Accountability Regime) for regulated entities.

Government inquiry into audit to report by March

The Parliamentary Joint Committee (PJC) on Corporations and Financial Services is to report on the findings of the inquiry into Regulation of Auditing in Australia by 1 March 2020. The big four accounting firms are expected to come under scrutiny over alleged conflicts of interest between their consulting and auditing work, particularly for major banks. The committee said in a 2019 report that it had "ongoing concerns" about company audit quality and wanted a "serious review" of audit. The inquiry findings are likely to impact board audit committees, with ASIC also flagging that it will focus on audit quality as part of its Corporate Governance Taskforce.

ASIC report on variable remuneration

ASIC is expected to release the second report of its Corporate Governance Taskforce this year, to focus on board oversight of variable remuneration — a vexed issue, especially in financial services. ASIC's report is set to comment on practices at listed entities both within and outside financial services.

This follows the Taskforce's report on director and officer oversight of non-financial risk last year. This year, ASIC will continue its supervision activities for the remainder of FY20 and continue to engage in more intensive supervision to improve corporate culture and conduct (including through its Close and Continuing Monitoring program aimed at large financial firms, and the Corporate Governance Taskforce).

We will also continue to see an increase in court-based enforcement underpinned by ASIC's new "why not litigate" approach. Enforcement will target cases of high deterrence value and those involving egregious harm or misconduct (especially towards vulnerable consumers), and will likely seek to utilise new powers and penalties focused on corporate and individual accountability. ASIC has also flagged expanded oversight of financial markets, including on-site reviews of culture and conduct risk programs, corporate governance and compliance arrangements.

Work Health Safety

Work health and safety will continue to be a focus for governments and boards alike. The findings of the Boland review into the model work health safety laws are currently the subject to a regulation impact statement process undertaken by Safe Work Australia. The recommendations flowing out of the review include that:

- access to insurance for payment of WHS fines (but not legal costs) be prohibited; and
- a new offence of industrial manslaughter be introduced where the outcome of gross negligence by duty holders is the death of a person.

Notwithstanding the recommendations, and the fact that COAG has yet to consider them, in recent months, WHS reforms, including new industrial manslaughter offences, have been proposed or legislated in NSW, Victoria, WA and the Northern Territory.

The Australian Council of Superannuation Investors has also recently called for mandatory market reporting of workplace fatalities by listed companies, following a recent report showing limited disclosures by the ASX 200. Of particular concern is the safety of contractors, with that category of worker being over-represented in workplace fatalities.

Modern Slavery reporting

Organisations which are covered by the Commonwealth legislation should begin to prepare for modern slavery reporting deadlines. *Australia's Modern Slavery Act 2018* (Cth), which took effect on 1 January 2019, requires organisations to provide a statement on modern slavery risks in their operations and supply chains, and to take steps to address these risks.

The Commonwealth Modern Slavery laws apply to Australian entities with annual consolidated revenue of $100 million or more. Statements must be submitted annually, with first statements due this year. If your organisation is required to comply, please refer to the AICD's practical tool [*Modern slavery risk oversight*] designed to assist directors with their oversight role of modern slavery risk in their operations and supply chains. It also sets out timelines for reporting.

By way of update, the NSW Modern Slavery Act 2018 remains on hold pending the outcome of a parliamentary inquiry.

Foreign bribery shake-up

In December 2019, the Crimes Legislation Amendment (Combatting Corporate Crime) Bill 2019 (Cth) (2019 Bill) was introduced into the Senate by the federal government, which would see the introduction of a new failure to prevent offence for corporations, as well as the creation of a deferred prosecution agreement scheme.

The current bill has been referred to the Senate Legal and Constitutional Affairs Legislation Committee, with the committee set to report by 19 February 2020.

The government has also released draft guidance on steps that a corporation can take to prevent an associate from bribing foreign public officials, and is seeking submissions on this guidance by 28 February 2020.

The government previously went through a detailed consultation process on an earlier iteration of the bill, which resulted in it being debated, but never passed due to the 2019 federal election.

Director ID numbers back on the table

Company directors could soon be issued unique identification numbers to track them throughout their careers. In a bid to prevent illegal phoenixing activity, the new director identification numbers (DIN) will require all directors to confirm their identity to a unique identifier that will be kept permanently, even if they cease to be a director.

The Treasury Laws Amendment (Registries Modernisation and Other Measures - MBR) Bill 2019 was introduced into Federal Parliament late last year, after the previous version of the bill lapsed with the calling of the May federal election.

Assistant Treasurer Michael Sukkar says the DIN will be kept by a director forever and provide traceability of a director's profile and relationships across companies and over time. "This will provide greater insights to regulators, businesses and individuals on the identity and affiliations of directors and prevent the use of fictitious identities," he told Parliament.

"DINs are being appropriately progressed as part of the MBR program to ensure that they are integrated with other important registry information. This enables critical data to be linked on the platform, which is key to the success of the DIN."

It is expected that the related issue of public accessibility to director personal information will be dealt with in phase two of the reforms where more detailed data and disclosure frameworks will be developed.

Getting the priorities right

John Price

"Getting the priorities right", *Company Director*, February 2020, AICD.

One year on from the Banking Royal Commission, the corporate watchdog is already in high-deterrent regulatory mode.

In welcoming the final report of the Banking Royal Commission in February 2019, ASIC chair James Shipton was speaking from the perspective of an organisation that had closely supported and cooperated with the inquiry from the beginning. "The Royal Commission report identified ASIC's enforcement culture as the focus of change needed at ASIC," he said. "This focus accords with ASIC's change agenda, which included adopting the 'why not litigate?' enforcement stance, initiating our Internal Enforcement Review and enhancing our governance structures."

It has been a year of change. ASIC established its Office of Enforcement to oversee and direct a renewed focus on a more effective, quicker, more transparent and higher-deterrence regulatory approach. We instituted more intensive supervisory programs and targeted thematic and sectoral risks such as poor governance structures and non-financial risk. Similarly, we initiated the close and continuous monitoring program to examine major financial institutions' operation of areas that may signify further issues. Breach reporting and complaints handling were identified as litmus tests for an entity's compliance and customer-focused culture.

Indicative of the sense of urgency has been ASIC's preparedness to take on new responsibilities where we could, without waiting for legislative reforms. As the nominated principal regulator of conduct in the superannuation industry, ASIC identified persistent underperformance relative to peers as posing significant harm. We introduced closer monitoring of the industry's implementation of the Protecting Your Superannuation Package reforms.

Of the case studies examined by the Royal Commission, ASIC launched 29 investigations, and four moved quickly into litigation (one, involving the Dover financial group, resulting in a guilty verdict in December 2019). Two matters involving NAB or related entities progressed rapidly to the penalties stage. In the second half of 2019, more than 300 investigations were active, covering a range of misconduct across the extent of ASIC's broad jurisdiction — breaches of D&O duties, insider trading and market manipulation, auditor and liquidator breaches, and breaches of licensing obligations, including Australian financial services.

In all, the past year has seen a 24 per cent increase in the number of ASIC enforcement investigations, and a 134 per cent increase in enforcement investigations involving the largest financial services firms in Australia (or their officers or subsidiary companies). ASIC has also undertaken a number of initiatives that align with the Royal Commission's general findings and recommendations.

ASIC took action in two cases where it believed significant consumer detriment was imminent, warranting the use of its recently legislated product intervention power. These two matters – certain short-term lending models, and the issue and marketing of short-term high-leverage products – are currently playing out through consultation or the appeals process, and others are in prospect.

Other proactive and/or preventative measures have included moving to restrict unsolicited telephone sales of certain insurance products, a range of measures designed to limit and control the sale of add-on insurance products – such as a deferred sales model, providing the consumer with some degree of consideration before commitment – and spelling out our expectations for providers of consumer credit insurance.

At the time of writing, a number of bills before parliament propose increased licensing and banning powers for ASIC, and extending the unfair contract terms provisions in the *Australian Securities and Investments Commission Act 2001* to insurance, among other things.

Perhaps one direct recommendation that might otherwise go overlooked best encapsulates the outcome of the past year. ASIC and its co-regulator, the Australian Prudential Regulation Authority, have settled a new agreement for cooperation and information sharing that captures the prioritisation and urgency of the Royal Commission's approach. Without that support and strategic partnership, one-off reforms count for little. From the ASIC perspective, elevating the interests of investors and consumers should not be the sole priority of the corporate regulator, but without that there won't be the restoration of trust and mutual respect our financial services industries require to operate for the benefit of all Australians.

CHAPTER 13.

Shifting culture in an established organisation

6 questions to ask your chief human resources officer

Murray Priestman MAICD

20 June 2019, *Six questions to ask your Chief Human Resources Officer*, Governance Leadership Centre, AICD.

Boards can better understand culture in their organisations.

It hardly needs saying that organisational culture is critically important. The recent Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry highlighted its importance, and major fund managers such as State Street are making it a key investment criterion. There are few boards that will not have it on their agenda.

The Royal Commission was clear about the importance of culture, recommending that banks should "assess [their] culture and its governance, identify any problems with that culture and governance [and] deal with those problems" (Recommendation 5.6, p 392). And lest there be any doubt as to who specifically is accountable, Commissioner Hayne confirmed that primary responsibility sits with "those who manage and control them: their boards and management" (p 47).

But just as culture is crucial, so is it widely misunderstood. "Culture" is an amorphous concept. There is no universally agreed definition, for example. The primacy of culture over other factors such as vision, direction or structure in shaping the success of an organisation is such that culture is famously said to eat strategy for breakfast, but that doesn't make it easy to understand or, critically, measure. To add to the confusion there is a substantial industry dedicated to defining, building and changing culture.

What is clear is that organisational culture is a core responsibility of the board. From a board perspective, culture is often understood through a presentation by the Chief Human Resources Officer (CHRO) on the latest staff survey results. Financial services boards will hear regularly about their risk culture, and many industrial firms will focus heavily on safety culture.

Despite the ubiquity of the word, the board's role in overseeing culture can be challenging. Given the intangible nature of the concept, there are few obviously right or wrong answers. However, arguably, it is not the job of the board to provide answers, but instead to ask the right questions of management.

There are six questions that boards can raise with their CHRO that will help them to better understand culture in their organisations.

What are we talking about when we talk about culture?

The word "culture" means different things to different people. Every consultant worth their fee will have a definition, and most papers and reports on the subject start by setting out theirs.

"Culture" is often used interchangeably with related concepts such as "values", "behaviours", "principles", "traits", "ways of working" and "purpose". From a board perspective, how culture is defined is probably less critical than ensuring your organisation is clear and consistent when talking about it.

The CHRO and other key executives should be able to clearly define what they mean by "culture". This is vital if they are going to explain it to employees, let alone effectively build and measure it. This in turn will ensure that everyone in the boardroom is on the same page when discussing culture.

A simple starting point can be to ask your CHRO how they tackle culture; they are often the default functional owner. Indeed, many HR functions have renamed themselves "People and Culture", and their answer can hint at the depth of thinking within your organisation; are they responsible for all the elements that shape your culture, for example? Better still, talk to employees across the organisation and ask them how they feel about it.

How many cultures do we have?

Organisations invariably describe their culture in terms that suggest it is homogenous or firm-wide, but the reality is very different. Organisations will inevitably have different sub-cultures across teams, functions and geographies, and this is perfectly normal. Moving fast and breaking things is probably useful in the product development or innovation-centric teams for example, but it's not what you want from your risk function.

Sensible companies (and CHROs) consciously recognise this and shape their activity accordingly. This might mean explicitly defining different cultures for different business units, even structuring them to create more autonomy and empowering them to reinforce their unique values as they see fit.

Or it could involve defining an overarching culture that is flexible enough to accommodate the breadth of activity and people across the company.

What is important is that there is careful activity to translate the stated culture into activities, policies and behaviours that are tangible for every person in the organisation; if you aspire to a culture of openness for example, then your leaders should be accessible and visible to more junior employees.

Bringing the culture to life in a meaningful way is definitely the responsibility of the board and executive, but it shouldn't exclusively be a top-down activity. Staff should be encouraged – compelled – to think about what the firm's culture means for them personally to bring it to life.

This is a critical activity, and your CHRO should be able to describe how it takes place.

Are we taking a holistic approach to building culture?

There are two things many firms get wrong when they put in place a plan to build culture; they focus too much on the outputs, and they tackle the drivers of culture in isolation.

Firstly, the outputs. It is critical that boards (and CHROs) realise that culture is an output, not an input. Understanding this helps shape how you change it.

To put it in simple terms, consider this: if you target job candidates with low integrity and incentivise them with a bonus scheme that only rewards the best performers while the lowest performers are terminated, then you will almost certainly create a culture of toxic rivalry. Measuring employee views on this is useful, but if you want to actually stop employees stabbing each other in the back then you need to change your recruitment and incentive structure: tackle the input, don't just measure the output.

Not only should there be a focus on the inputs, but there should also be a recognition that this needs to be holistic; hiring for collaborative skills and enshrining this in the culture is laudable, but if you then promote and reward based on individual performance, you are sending conflicting messages about what you value.

There needs to be consistent reinforcement of the same culture and values from the start to the end of your employee's career with you, and your CHRO should be able to demonstrate how they are driving this.

Does our culture differentiate us?

Your culture is unique — or at least it should be. How you define and build your organisational culture should be a differentiator and a source of competitive advantage. All too often however, it isn't.

Definitions of culture are often mapped back to just four elements: integrity, collegiate behaviour, customer focus and speaking up. Does that sound familiar? Few directors could argue the importance of these traits, but their universal relevance also makes them very generic — and that's not what you want your culture to be.

For example, our organisation recently helped a client define "direct honesty" as a cultural trait; close enough to "speaking up" but also capturing the candour, if not bluntness, that was evident in all our interactions with them. Directors should challenge their organisations to express their culture in a way that is authentic and recognisable, but also distinctive.

How do we involve our customers in building culture?

Many organisations enshrine customer-centricity in their core values, and even those that don't would argue it is imperative. But what steps does your firm take to bring this value to life?

There are different levels of involvement that you can give your customers. And "customer" in this context also includes members, shareholders, regulators, community groups and other key stakeholders that have a strong interest in the outputs of your organisation.

At its most basic, employees should be regularly reminded of who their customers are and what they want. This means incorporating customer content into key touchpoints such as new hire onboarding and performance measures.

More committed organisations might actually bring their customers into the building. Listening to clients talk about their experience with you (and your competitors) can be powerful, and baking this into leadership development activity or town hall events sends a clear message about your culture.

For a genuinely customer-centric culture though, why not actually engage your customers in helping define what your culture should be? Talk to clients, investors, regulators and ask them what they want from you. That removes the guesswork, and it makes it very clear to employees exactly what a customer-focused culture looks like.

It also sends a clear message to those stakeholders you engage with just how committed you are to putting customers at the heart of your culture.

So ask your CHRO how they bring the customer into the room, physically or metaphorically, with your employees.

How are we measuring culture?

One of the easiest ways to start a fight between two organisational psychologists is to ask them if culture can be measured.

When you are dealing with a concept so hard to define, it follows that measuring it is equally problematic, and many will argue that it is not possible. Whether they're right or wrong, that's not a realistic option for boards.

Almost all organisations will use an employee survey, and that is what many regulators and shareholders look for first. Increasingly, technology offers more innovative ways of measuring attitudes, such as social media or discourse analysis that can gauge employee sentiment by analysing the tone and content of emails. Boards should check how far their CHRO is aware of these tools and their potential for their organisation.

More importantly, boards should also examine the inputs; if you want to track changes in culture then you need to measure the things that shape it. What candidates do you target and what is your employee proposition? What skills do you recruit for and how do you onboard new hires? How do you measure and reward performance? How is "talent" defined?

These are the key drivers of your culture. If your CHRO is serious about measuring culture, then they should be talking to you about all the inputs.

Culture can be a complicated topic for boards to wrestle with, but it's never been higher on the agenda. It is a topic that directors need to understand if they are to be genuinely effective. These questions provide a starting point for conversations about culture with the CHRO. This, in turn, should help boards tackle the issue in an informed and meaningful way.

CHAPTER 14.

Setting culture in a growing business

Buckle up for a bumpy board ride on innovation

14 November 2019, *Buckle up for a bumpy board ride on innovation*, Governance Leadership Centre, AICD.

Directors of start-ups need governance nerve as well as skills.

Innovation governance expert John Martin MAICD refers to the Steve Martin movie *Parenthood* when asked about the challenges of chairing emerging tech ventures.

In a memorable scene, the grandmother character talks about her love of rollercoasters and how some people prefer merry-go-rounds that do not have the same ups and downs — an analogy Martin uses to explain board composition in emerging ventures.

"The top issue by far in innovation governance for emerging tech companies is who you choose as directors," says Martin. "Some directors do not have the stomach — or the skills and network — for companies that, by their nature, have higher risk and can be a wild ride at times. Such directors are better off governing established companies that have more stable growth paths and easier to understand products and services."

Martin has been a director of emerging tech companies for more than two decades. He recently retired as CEO of Regeneus, an ASX-listed regenerative-medicine company after also serving as Executive Chairman, and serves on the boards of listed investment company Concentrated Leaders Fund, Sparke Helmore Lawyers, Ai Media and private tech ventures here and in California.

The former corporate lawyer says he has seen experienced company directors regret their decision to govern small tech firms. "I recall a chairman who mostly had large ASX listed company experience tell me he was uncomfortable leading a board of a small newly ASX-listed R&D biotech firm that ran at a loss and was already thinking about its next capital raising. He found it stressful and worried about perceived reputational risks involved. He did not stay long after the IPO."

Martin cautions directors against joining boards of emerging tech firms because they see them as a path to larger boards or a way to gain innovation experience. "When things don't go to plan or market expectations are not met, the firm's directors can come under intense pressure. Know what you are getting into because this type of governance can quickly take directors out of their comfort zone."

Martin's advice is timely. Listings of information technology (IT) and financial technology (fintech) companies have leapt in the past five years as ASX attracts local and international tech firms. There were more than 200 tech listings in August 2019, from 130 in June 2015, according to ASX.

Capital is pouring into private tech companies as investors seek higher returns. The IT sector contributed almost a fifth of all private-equity-backed buyout deals here in 2018, according to the latest Australian Investment Council Yearbook.

Strong innovation momentum is also evident in the research sector as more universities form innovation precincts and lift collaboration with industry. Co-operative Research Centres (CRCs) and other collaborative structures also require directors with innovation experience.

The upshot is more boards being formed for emerging ventures in IT, fintech, biotech or clean technology — and rising demand for directors who can govern innovative ventures that have higher potential rewards and risks and require different board skills.

Martin says directors must understand the speed of emerging tech companies. "In biotech, the Australian market typically lets small companies raise enough capital to last 24 months. You are racing against the clock from day one. If the company does not hit its targeted milestones, the market can mark the company down savagely. Some biotechs live from one capital raising to the next, putting their board under significant pressure and making directors nervous."

Boards of emerging ventures must be able to validate the innovation's potential, says Martin. "You don't have to be a scientific expert to serve on the board of a biotech company. But you need to know how to look for 'status elevations' with innovations – are there prominent and respected scientists involved in the technology and do they have any experience in commercialisation? What data, published research and IP underpins the technology? What is the quality, experience and skills of management and the other directors on the board? What is the calibre of rival companies in the space and is this area of interest for larger potential licensees or partners? Who is staking their reputation in this innovation and who has skin in the game? What journals are publishing the research?"

Directors must have a clear understanding of the market opportunity and the costs, timing of the technology's development path, the "pivot points" for value creation, and the opportunities for commercial exits, says Martin. "It takes an average of 12 years for an experimental drug to make it to market and only five in 5,000 such drugs that enter preclinical testing progress to human testing. Only 20 per cent of those drugs get approval."

Martin adds: "Directors must be prepared for high failure rates in the biotech sector and the rollercoaster ride that inevitably comes with that. Typically, boards of emerging companies are smaller, so when the big pressure moments arrive, directors need to be clear on the value proposition of the technology and how to secure that value for shareholders, rather than just rely on the group view."

Working with entrepreneurial founders

Katherine Woodthorpe AO FAICD says prospective directors of emerging tech ventures need to understand the relationship between the board and founder – and how that influences innovation governance.

Dr Woodthorpe is one of Australia's leading directors in the innovation and technology space, having governed many listed and unlisted emerging ventures, across sectors. She chairs the Bushfire and Natural Hazards Co-Operative Research Centre (CRC), HEARing CRC, National Climate Science Advisory Committee, co-working space Fishburners, and is a member of the National Health and Medical Research Council (NHMRC).

"Founders of innovative ventures often have a big personality, enormous self-belief and an overwhelming sense of ownership of the idea and the organisation," says Woodthorpe. "Those traits helped them get their idea off the ground and can be a great strength. But they can also cause a constant struggle with the board. Some founders only form a board because they have to, take as little notice of it as possible, or see directors as a handbrake."

Woodthorpe says prospective directors should meet founders and understand if they can work with them. "You never know how a founder operates until you see the nitty gritty in the boardroom, but the more due diligence you can do beforehand the better. You want to work with founders who understand, value and respect the board's role. You need to know the founder can transition from working in the lab to running a public company."

Reining in entrepreneurial founders can be another challenge, says Woodthorpe. "The founder has all these ideas, global ambitions and is moving very quickly. However, the opportunity may not be as big as he or she thinks it is. The board has to find a way to push back, even if the founder is a majority shareholder, without denting his or her enthusiasm or creating conflict. It comes back to being clear on the strategy and milestones."

Woodthorpe says boards of emerging tech ventures need clear metrics to assess the innovation's commercialisation potential. "To some extent, directors rely on the founder's assertions about the technology's commercial potential. The board then does its homework to test those assumptions and verify the founder's views. I always focus on sales; it's no good creating a technology for a global market if the company cannot get that product to market, convince customers to buy it in the right timeframe and make sufficient margin on it."

Boards of fast-growth ventures need to shape the organisation's risk appetite," says Woodthorpe. "The board cannot be overwhelmed by the scary bits of governing a tech venture. It needs to understand the risks involved and directors need to understand personally if they can — and want to — govern within that risk appetite. Directors who have only governed large listed companies might find the organisation's risk appetite does not match their own. The key is knowing that upfront before joining the board."

Hands-on governance

John Barrington AM FAICD says directors of emerging tech ventures must be prepared for a more hands-on governance role. Barrington is Executive Chairman of Artrya, a promising artificial-intelligence start-up involved in diagnosis of coronary heart disease. He is also a director of the Harry Perkins Medical Research Institute, Creative Partnerships Australia, and Chairs Curtin University's School of Management Advisory Board.

Before his interview for this feature, Barrington was assisting on Artrya's data collection. "You have to be prepared to roll up your sleeves when serving on the board of a tech start-up," he says. "That doesn't mean non-executive directors should do day-to-day tasks in the organisation, but you are not there just to read board papers and attend meetings. The role is much more about strategy than just conformance matters. Tech start-ups need directors who can be more 'hands-on' where needed, open doors for management, sell the vision and help bring in investors."

Barrington, a strategy consultant, says a form of "agile governance" is needed in innovative start-ups. "Board and management develop the long-term strategy, but within that are lots of sprints as the team pushes towards its targeted milestones. The organisation needs to get good at prioritising, often in fortnightly windows, and the board must be able to respond to sudden changes."

Barrington says the concept of "unknown unknowns" — a phrase popularised by former US Secretary of Defense, Donald Rumsfeld — is prevalent in tech start-ups. "When you're creating a solution that has never been done, the board does not know what it doesn't know. The board must be prepared for rapid experimentation and failure within the organisation, and have contingency plans. The board must foster a culture that is agile and adaptive."

Directors of tech start-ups should be prepared for low or no board fees and most likely taking equity. "Often, directors must be prepared to buy in and work for little or nothing at the start, knowing the business could fail, and that they might potentially never get anything out of it. That's the trade-off for larger financial rewards if the venture succeeds."

An ability to assemble the right investors — "smart money", as Barrington calls it — in tech start-ups is needed. In Artrya's first capital raising, the board targeted a small group of prominent Perth businesspeople who understand the nature of tech start-ups. "You want investors who bring more than money," he says. "They need to be excited and realistic about the innovation's potential, understand its risks and be there for the long haul. You need investors who believe in the organisation and its people, who can offer assistance when asked and who may participate in future capital raisings as milestones are met."

Start-up directors should prepare for shorter board tenures, says Barrington. "Most directors are unlikely to serve three terms on the board. As the organisation grows, so too will the board. You must be ready to retire from the board if different skills are needed and to hand the baton over to another director with different skills, for the company's next evolution. And, equally, to know when to leave the board when things don't go as expected."

CHAPTER 15.

Is it possible to get remuneration right?

The rise of executive kings

Allan Feinberg

17 December 2019, "The rise of Executive Kings", *Membership Update*, AICD.

BDO's Allan Feinberg examines six principles for finding a competitive and fair balance in executive pay.

Structuring executive pay is no new topic — in fact, some would say it's been in play since the Viking Era when raids began on England in the late eighth century. Likened to a 'corporate takeover', monks were slaughtered and countless treasures or 'cash incentives' were carried away. Taking advantage of political instability after the 'acquisition', the Viking Leaders became wealthy kings or 'executives' and their armies, 'the shareholders' reaped the value they had helped to create.

Although we live in civilised times, this system isn't too different from what we see today — many complain that 'executive kings' are being paid even when they get conquered in battle and lose valuable company assets, and shareholders expect a return on their invested funds.

So how do we avoid a situation where enrichment is not one sided? Where one party does not succeed at the expense of another?

Creating fair enrichment

When looking at executive remuneration this simple equation can establish what is fair and reasonable. Fair is when both parties — the executive and the company — make money with each other and not from each other. This means one party does not succeed at the expense of the other.

Executive packages must be competitive, but they can't be competitive at the expense that they can't be commercial. This is the cornerstone of any executive remuneration policy.

Getting enough 'executive skin' in the game

The challenge today is offering a competitive package that creates long-term value. What we see too frequently is Boards reverting to general market practice, implementing a large short-term incentive (STI) plan that vests annually, and a long-term incentive (LTI) plan which is too large and hard to grasp. This scenario is to the detriment of the company and its shareholders, placing the executive in a position of comfort that allows them the opportunity to cash out before the impact of their decisions are felt.

When you think about it, executives are there to manage for the long-term and their performance should therefore be based on long-term performance. This in turn creates an accountability trail, which means that the executive will bear the pains or gains of the decisions they have made.

Getting enough skin in the game is not an LTI scheme that promises riches based on some future date, but rather a mechanism which forces executives to hold equity in the companies they lead. Skin in the game ultimately means giving your executives a piece of the business and the opportunity to participate in long-term celebrations with the company and its shareholders.

Striking the balance – when is it time to reassess?

Protecting the interests of both the executive and the company should be your priority – if you are not experiencing the successes and pains together, then it's time to reassess your incentive design.

In summary:

1. Executives are there to manage for long term performance. Therefore, limit the size of your short-term incentives and limit the amount they can cash out at the end of the year. Large STI's create a short-term view.
2. Increase or introduce a deferral component that translates into equity. It's called 'skin in the game'. The only way you can make someone really accountable is when they bear the financial brunt of their own decisions.
3. Limit the size of the LTI component and introduce non-market measures. This ensures relevance of metrics. Reconsider the use of relative Total Shareholder Return (TSR) especially for companies below a billion-market cap, this measure is too volatile and is not representative of company performance. Alternatively, if you decide to utilise relative TSR include one or two other non-market measures as well.
4. Business are in the business of making profit. If you are going to use non-financial measures make sure that the measures can be linked to financial targets and do not represent an additional payment for executives doing their job.
5. Make sure your schemes pay out only if financial objectives are reached. If you wish to pay out for milestones then ensure those milestone payments are subject to a service condition or the final value creation event. Executives should not be allowed to realise their investment in the business before their performance can be evaluated.
6. Lastly understand market practice and don't blindly follow it. No company is the same, they have their own nuances, people and plans and this needs to be reflected in the company's incentive arrangements.

Growing divide over boardroom fees

Tony Featherstone

20 June 2019, *Growing divide over boardroom fees*, Governance Leadership Centre, AICD.

Directors working harder to assess organisation culture, but pay growth is stagnant.

Nobody doubts that board workloads are rising as directors dig deeper into organisation culture after the Financial Services Royal Commission. Less considered is whether board fees should increase, after years of small gains, to compensate directors for extra work.

Proponents of higher pay say directors are underpaid relative to executives, partners of large professional-service firms and consultants. Fees should rise faster because stakeholders and regulators want more of boards, and for directors to hold fewer roles.

Also, board committees' workloads have increased significantly in the past five years and it is common for directors to attend meetings of committees they are not members of, to better understand issues that affect other committees and the organisation. Chairing an ASX 100 Audit and Risk Committee has become a significant role in its own right.

Critics say listed-company directors are well paid for what is a part-time role; that comparisons with executive or consultant pay are irrelevant; and that many directors chose the role as much for the intellectual stimulation, networking and work/life balance, as pay.

"Investors would be open to a debate about higher board pay, provided boards can demonstrate extra pay leads to better governance outcomes," says Martin Lawrence of proxy advisory Ownership Matters. "Some of the worst governance failures in recent times involved directors who were among the highest paid in Australia. Insufficient board pay wasn't the issue."

Lawrence believes board fees are about right. "Looked at from the outside, ASX 100 companies seem to have little problem finding suitably qualified directors. Where else can someone earn $200,000 a year for working a day a week and have as much flexibility? Comparisons with executive or consultant 'day rates' are meaningless because most directors don't want to work 16-hour days anymore."

Lawrence rejects claims that directors should be paid for higher workloads after the Royal Commission and the Australian Prudential Regulation Authority's (ARPA) report last year on the Commonwealth Bank. "Frankly I'm surprised that bank boards weren't doing that type of work on organisation culture before the Royal Commission. This so-called extra work is what directors should have been doing in the first place to understand culture and risk. It's hard to argue that boards should now be paid more for that work."

Lawrence says lack of transparency is the underlying problem with board pay. "It's not clear how many hours directors are expected to work in their role, or how that workload breaks down between different board tasks. I'm not saying boards should report every hour a director works, but there's scope for better reporting on what is expected of directors and how much time they put in across different tasks. That would help investors better assess fees."

Debates on director pay are complex and rife with generalisations. The perception that directors earn a six-figure annual fee for attending a dozen or so meetings each year (including committees) is misguided. Many directors receive modest income from board fees.

Pay varies widely across sectors: most listed-company directors are paid; about 80 per cent of private-enterprise directors are paid; and just over a third of government and not-for-profit directors are paid, according to the AICD Remuneration Survey 2016.

The average board fee for the listed sector was $87,604; in private enterprise it was $53,777; for NFPs, $25,930, found AICD. Listed-company fees varied greatly by organisation size: a director of a company with more than $2.5 billion in assets earned $161,271 on average.

Board fees fall sharply beyond the ASX 100. A NED in an ASX 101-200 company earns a little over half of his or her peers on a top-100 board. Clearly, debates about high board fees are mostly centred on a small group of directors in the largest listed companies.

Case for higher fee growth

Also, increases in listed-company board fees in the past three years have barely matched inflation, according to remuneration and governance consultant Egan Associates. Some boards of financial-services organisations have taken pay cuts to demonstrate their accountability for governance problems and acknowledge that directors are not immune to consequences for poor performance.

The upshot is that board fees have remained largely static at a time of rising workloads, greater stakeholder expectations of boards, and higher legal, financial and reputational risks for directors — a trend that Egan founder and CEO John Egan believes potentially warrants a board pay rise in some settings of up to 30 per cent. Egan is one of Australia's most experienced remuneration and board consultants.

He says the increase should be applied to ASX 200 boards on a case-by-case basis, be spread over three years, and issued through share rights that vest when a director leaves the board.

"It doesn't feel right if the Chairman of an ASX 50 company earns $500,000 for working at least two days in the role each week and the CEO earns $4 million," says Egan. "Nor is it appropriate if an NED earns $200,000 a year and a senior executive is earning well over $1 million. If we expect directors to spend more time in the role, we need to ask if their fees are still appropriate after years of modest increases."

Egan believes directors of government enterprises should receive higher fees and that more not-for-profit organisations should pay board fees. "The work that boards of government organisations do is incredibly important, yet their directors typically earn a fraction of what a listed-company director makes. Many NFPs rely on volunteer directors who want to give something back to the community, but these roles require time and skill, and have risk."

Egan has noticed three core changes in boards after the Royal Commission and APRA's CBA report. The first was a recognition among some directors that extra work was needed on organisation accountability. "Frankly, some boards are doing more work now because they weren't doing enough in the first place," says Egan. "The Royal Commission was a wake-up call that boards are ultimately responsible for the organisation, its culture and behaviours."

Greater focus on organisation sustainability was the second change, says Egan. "Too many boards relied too heavily on financial information and did not spend enough time understanding non-financial issues, such as culture, which go to the heart of sustainability. I see directors now elevating their oversight of risk and spending much more time on it."

The third change was verifying management information. "Boards for years have relied on information management provides, to make decisions. In some cases, boards have received inaccurate or incomplete information, or management has filtered the data. There's a growing recognition among boards that they need to spend some time verifying information and sourcing external views as a second opinion."

Egan says these combined changes have greatly increased workloads for ASX 100 boards. "The director of an ASX 50 company who spent 50 days each year on the role might now spend up to 75 days as the board's responsibilities expand. In that context, $250,000 for a very experienced director is not that high on a daily rate compared to other fields that require senior businesspeople, particularly given the legal and reputational risks involved with the role."

Moreover, as board workloads increase, directors are expected to hold fewer roles, to avoid the practice of "overboarding". Proxy advisers and institutional investors have focused on director workloads and some have blanket limits on how many roles directors can hold. They believe directors who hold too many roles are less effective and have insufficient flexibility should a crisis strike and the board role becomes almost full-time.

"If career directors have to hold one or two fewer board positions to keep investors happy, and they are relying on the fees to maintain their lifestyle, it's a big hit to their income," says Egan. "If the market wants directors to serve on fewer boards, and spend more time in each role, then we need to ask if each role should come with higher fees.

Egan adds: "In the above context, investors will focus increasingly on board and individual director capability (to govern culture) and expect that the disclosure of capability matrices extends well beyond a series of one or two-word descriptors, with increasing disclosure in individual director profiles highlighting the relevance of their background to the tasks of the board in their governance oversight."

Competitive fee pool needed

Michael Robinson, a director of Guerdon Associates, a leading remuneration and board adviser, says ASX 100 boards will need higher fee pools to recruit high-quality directors. "There is a push from investors for boards to have more directors who are industry specialists and/or more women. That means recruiting former executives who can still command high salaries."

Competition for former CEOs who can transition to boards is rising, says Robinson. "In years past, an ex-CEO joined the board because he or she wanted to stay active in business and was happy with less income. It's much harder for boards to attract top former CEOs these days; they can see that director workloads are rising, director pay is not great relative to what they can earn elsewhere, and there is a lot of potential risk involved in governing large organisations."

Private equity is another consideration. "The available pool of former CEOs shrinks as many join private-equity boards," says Robinson. "An ex-CEO can earn a lot more on a private-company board through leveraged equity incentives; can apply a laser like focus to maximising shareholder return in a specific five-year time frame without the distractions of six-monthly results announcements; and does not have all the compliance and regulation that comes with governance of ASX-listed companies. ASX 300 boards will increasingly struggle to compete with private-equity for former CEOs if director fees stagnate and regulatory burdens increase."

Competing for international directors will also become harder. As Australian companies globalise, they may need to source offshore-based directors with international experience. "US boards generally pay significantly higher fees than Australian boards do, for less work," says Robinson. "Again, it becomes hard for our boards to compete for top director talent if our fees are not internationally competitive."

Although there are clear arguments for higher board pay, Robinson says it is a difficult environment to argue for higher fee increases. "It would be hard to get support from external stakeholders given the governance issues in financial services and other sectors. This is somewhat surprising because as company valuations increase, and organisations become larger and more complex, it stands to reason that the amount spent on governance should rise. Paying a bit extra for the board is a small cost for better governance of a multi-billion-dollar company."

Robinson says it is ironic that risk officers and governance specialists are among the most in-demand fields in corporate Australia, but board pay is flat. Chief risk officers at Australian banks are now among their organisation's most powerful and highest-paid executives, and compliance officers generally are in higher demand as the regulatory landscape changes."Companies are paying a lot more for governance and risk experts at the executive level, but nobody wants to pay extra for that skill at board level," says Robinson. "We're asking a lot more of boards for essentially the same pay. At some point, listed-company boards will become less attractive to the best directors if growth in board fees does not improve."

Case study: One board's approach to the remuneration of front-line employees

20 June 2019, *Case study: One board's approach to the remuneration of front-line employees*, Governance Leadership Centre, AICD.

Q&A with Deputy Chairman of QBE, John M. Green FAICD.

The remuneration of frontline employee has become an increasingly important issue following the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. The approach and involvement of boards in relation to front-line employee remuneration varies considerably. The Governance Leadership Centre recently spoke to the Deputy Chairman of QBE, John M. Green FAICD, about the approach of QBE's board.

GLC: In your view, how important is front line remuneration as a contributor to your company's culture, and why?

JMG: At QBE, we consider remuneration, and in particular incentives, as a key enabler to achieve the culture we aspire to. The way we reward and remunerate our people tells them what we consider to be important and what we truly value as an organisation. This is equally true for all employees, not just those with customer-facing roles. Every employee either directly supports a customer or supports an employee who supports a customer.

GLC: Is front line remuneration explicitly within the remit of your Remuneration/People Committee, and, if yes, what is the role of the Committee in this regard?

JMG: Yes, the ultimate responsibility for the governance of all remuneration and people matters sits with the people and remuneration committee (PARC) of the group board, though we do receive valuable input and support from our geographically based divisional boards. The vast majority of our front-line employees are remunerated within the same global framework that applies to all employees across the group. This means that apart from a very small agency business in the US, with fewer than 100 employees, we have no sales incentives plans at QBE. This has been a deliberate decision of management and the board, pre-dating the Hayne recommendations.

GLC: Has this changed following the Hayne recommendation, or are you considering a change?

JMG: No, as I mentioned above, the QBE group PARC had already taken a view that commission or volume-based incentive plans create a risk of conflict that could result in behaviours contrary to our values and adverse customer outcomes. At QBE, we previously had only a very small number of sales plans which applied to a small number of junior level employees and while these plans were well-managed, we felt there was no need for stand-alone sales plans and we took the decision to phase them out a few years ago.

GLC: How often does your board review the design and operation of the remuneration framework for front-line employees?

JMG: The group PARC reviews the group-wide remuneration policy and its effectiveness every year. This includes front line employees and has resulted in a number of deeper reviews over the past 5 or so years. It is an area where we are always seeking to improve; how we measure effectiveness and what are the right data points. We haven't always got this right and we have learnt a lot from our own experiences as well as from APRA case studies and the Hayne Royal Commission.

GLC: Hayne's recommendation draws out the importance of measuring not only what front line staff do, but how they do it. In your company what do you consider when assessing the "how" and what is the impact on front line remuneration?

JMG: Our approach at QBE applies to all employees and not just front-line employees. We believe the "how" is just as important as the "what" and we have introduced a new performance framework for 2019 (called ME@ QBE) which formally assesses both aspects of performance. Throughout the year, employees receive multi-rater feedback on how their behaviours align to the QBE DNA, a set of cultural attributes which describe who we are, what we stand for and how we need to operate to be successful. This includes how we manage risk and our customers. The final performance rating, incorporating both the "what" and "how" has a direct impact on the incentive outcome — and importantly can be both positive and negative.

Board oversight of front-line remuneration

Sally Linwood

20 June 2019, *Board oversight of front-line remuneration*, Governance Leadership Centre, AICD.

How we incentivise and reward customer-facing staff pivotal to company culture and customer outcomes.

Executive remuneration has been at the forefront of investor and media attention for some decades, and remains a critical item on the agenda of boards across corporate Australia and globally.

But an issue that has traditionally received limited attention is now gaining prominence. Front line remuneration — how we incentivise and reward customer-facing staff — is pivotal to company culture and customer outcomes.

The Hayne perspective and APRA

In the final report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Commissioner Hayne observed that, in almost every case, the conduct at issue was not driven only by the relevant entity's pursuit of profit. It was also driven by individuals' pursuit of gain, whether in the form of remuneration for the individual or profit for the individual's business.

In many cases, variable remuneration arrangements incentivised behaviour that was adverse to customer interests.

As Commissioner Hayne identified, there needs to be a focus on how performance is delivered.

In commenting on the practice to pay front line employees in banks fixed and variable remuneration (typically rewarded, at least in part, on the basis of financial metrics linked to product sales), Commissioner Hayne acknowledged that, on its face, this is unsurprising:

"…Banks are commercial enterprises. Why not encourage and reward sales? And focusing on sales or profits provides concrete, quantifiable measures of performance. What could be simpler or better?

There is a short and obvious answer. Focusing only on what is to be sold is not enough. How the employee does the job is at least as important as what the employee does…"

Ultimately, Commissioner Hayne recommended that all financial services entities should review, at least once each year, the design and implementation of their remuneration systems for front line staff. This is to ensure that the design and implementation of those systems focuses not only on what staff do, but also how they do it.

The Commissioner also made several recommendations relevant to APRA's supervisory work, including:

- In conducting prudential supervision of the design and implementation of remuneration systems, and revising its prudential standards and guidance about remuneration, APRA should have, as one of its aims, the sound management by APRA-regulated institutions of not only financial risk but also misconduct, compliance and other non-financial risks.
- In revising its prudential standards and guidance about the design and implementation of remuneration systems, APRA should, amongst other things, require APRA-regulated institutions to design their remuneration systems to encourage sound management of non-financial risks. This is to reduce the risk of misconduct and require the board of APRA-regulated institutions (whether through its remuneration committee or otherwise) to make regular assessments of the effectiveness of the remuneration system in encouraging sound management of non-financial risks, and reducing the risk of misconduct.

APRA's draft guidance on remuneration is expected to be released imminently — within a matter of weeks — for consultation. In addition to the significant implications it will have for executive remuneration, it will likely deal with the approach to remuneration systems more broadly. (Currently, the remuneration requirements in APRA Prudential Standard CPS 510 are largely focused on executives, although they do capture other employees whose activities — individually or collectively — may affect the financial soundness of the institution.)

It seems inevitable that the new APRA guidance will have ramifications for other sectors of the economy.

Financial services practices and the Sedgwick Review

For banks, board involvement in front line remuneration is not a novel concept.

Notably, in 2017, Mr Stephen Sedgwick AO released the final report of his Independent Review of product sales commissions and product-based payments in retail banking in Australia.

Mr Sedgwick made recommendations about remuneration structures for retail bank staff, including that:

- banks remove variable reward payments and campaign related incentives that are directly linked to sales;
- eligibility to receive any variable reward payment should be based on an overall assessment against a range of factors that reflect the breadth of the responsibilities of each role; and
- variable reward payments should ultimately amount to a relatively small proportion of fixed pay.

Significantly, he also recommended that boards and CEOs should visibly and effectively oversee the implementation of these recommendations for at least the next five years, and report publicly on how retail staff are remunerated and how their performance is assessed. He also recommended that boards and CEOs ensure that effective, safe channels are in place to obtain feedback from frontline staff about their perceptions of the effectiveness of the reform effort, including in respect of whistleblower arrangements.

Mr Sedgwick recently completed an interim review into implementation of the recommendations. He noted that progress has occurred and that the clear trend is towards policies that will be fully consistent with the Recommendations in respect of in-scope bank staff well in advance of 2020. Notably, all banks provided evidence that their board and CEO have actively considered the implications of the 2017 Review for their business.

In his final report, Commissioner Hayne recommended that banks should implement fully the recommendations of the Sedgwick Review. In the Commissioner's view, however, implementation of the Sedgwick recommendations "is only the first step", with banks needing to "continue to give frequent and considered thought to how their variable remuneration systems are structured: to whether they are geared not only to what employees do but how they do it."

It's also worth mentioning that the Productivity Commission's report titled Competition in the Australian Financial System recommended that all banks appoint a Principal Integrity Officer (PIO) — with a direct line to the board — to protect against incentive payments which conflict with customer interests. Then Treasurer, Scott Morrison, called the idea an "interesting one that we will give very serious consideration".

So what does all this mean for non-financial services boards?

The misconduct highlighted at the Financial Services Royal Commission hearings, including the link between misconduct and remuneration, has broad implications. Boards outside financial services may also wish to reconsider whether they require a greater level of oversight over remuneration practices — and the behaviours they drive — throughout their organisation.

Of course, it must be acknowledged that remuneration is not the only lever available to influence culture. Remuneration policy and practices sit within a broader cultural ecosystem that includes other people-focused processes, general governance policies and risk controls. A holistic governance review is necessary to ensure alignment and consistency across the cultural ecosystem.

Some non-financial services boards have implemented measures to ensure a greater level of oversight of front-line and other employee remuneration, including tasking the board's People or Remuneration Committee with oversight of organisation-wide remuneration practices. However, practice is varied.

The responsibilities of a People or Remuneration Committee (as outlined in governance charters) may range from periodic oversight and reporting, through to specific approval requirements for the company's remuneration framework and approach.

How do we consider how we incentivise and reward customer facing staff?

Unfortunately, there is no easy answer.

As a start, it is important to decide, document and communicate upfront the matters that will be taken into account – such as alignment of behaviours to codes of conduct and company values and taking initiatives and owning outcomes – and who is accountable for decisions.

It is also important to consider how any metrics used to determine variable remuneration outcomes are chosen. A common customer-focused metric is linked to a company's Net Promoter Score (NPS) — a customer satisfaction metric that measures a customers' willingness to return for another service as well as to make a recommendation to their family, friends or colleagues.

A more nuanced metric, which looks at outcomes rather than just satisfaction, may be appropriate for some companies. For example, in the context of retail banking, one of the Sedgwick recommendations was that "all customer measures should be genuinely customer-centric and tailored to the role being assessed, and progressively reflect a focus on customer outcomes not just customer loyalty/satisfaction".

Many entities are also implementing remuneration accountability frameworks to ensure that leaders and employees are appropriately rewarded for positive behaviours, and held to account for negative outcomes and behaviours. These frameworks set out the types of events and behaviours to be considered, and provide increased rigour, consistency and fairness as to how they are assessed and any consequences determined.

Questions for boards to ask about frontline remuneration

- Why do our frontline roles need to have incentives in place at all? What outcomes are we seeking to achieve?
- How do the incentives in place balance the company's profitability with ensuring positive customer outcomes?
- How are the metrics aligned with delivering positive customer outcomes?
- Is the design of incentives aligned with the company's purpose, strategy and values?
- Is the quantum of the opportunity appropriate (that is, enough to motivate, but not too much to drive a myopic focus)?
- Have the incentives been stress tested for different potential outcomes for the company and for the customers, and have we considered unintended consequences?

If a board has not previously had a role with regards to front line remuneration, but is considering broadening its remit, it should also consider:

- What lens it wants to apply (for example, will it consider group-wide remuneration through a culture and behaviour lens rather than a traditional remuneration lens)?
- Will the board approve policy and/or design, or simply be provided with oversight?
- Will the board have a role in approving remuneration outcomes?
- How often will a board-level review of the company's remuneration framework take place?
- Does the company's remuneration framework vary by business unit or country and, if so, what does this mean for board oversight?

CHAPTER 16.

Not-for-profit governance priorities in the spotlight

Not-for-profits matter

Fiona Payne
Non-Executive Director and Chair

The not-for-profit (NFP) sector of the Australian community, or the for-purpose sector as it is increasingly known, is large and diverse and significant — economically and socially.

In January 2020, Philanthropy Australia reported there are over 600 000 NFPs nationwide, including over 5000 trusts and foundations, making significant contributions in almost every field of endeavour, including health, education, research, social services, arts, sport, environment, religion and crisis management.

Of these, the ACNC *2018-19 Annual Report* indicates that 57 000 are registered charities. Registered charities with revenue greater than $50 000 are reported to contribute over $79 billion to the Australian economy each year and employ more than one million people. They are supported by almost four million volunteers who contribute 521 million hours per annum, or the equivalent of approximately 265 000 FTE (2019, S. Cole, *For the love and/or for the money*).

The contribution of NFPs to the social well-being of the Australian community is less easily quantified but is described by the Our Community group, as giving people a voice, improving quality of life, encouraging community participation and engagement, promoting social inclusion and providing services that are responsive, relevant and accountable to their communities.

Why the spotlight?

There are many reasons for the increased focus on NFP governance, including:

- reduction in the level of trust in government as an institution, while charities generally retain their previously high levels;
- increased reliance on the NFP sector to provide essential services on behalf of, or in partnership with government, as a result of the economic imperative to reduce costs associated with the growing public service, and by necessity, increased scrutiny;
- recognition that the NFP sector's access to philanthropy and volunteers adds economic value and their independent status provides scope for creativity and innovation, and flexible, local responses to problems;
- growing concern about the sustainability of many NFPs, and the emerging need to ensure generation of some margin to deliver mission;

- establishment of new NFPs in response to perceived government inactivity on important issues such as climate change;
- impact of social media in sharing issues and causes widely and rapidly; and
- systemic governance failings in various NFPs.

These issues have contributed to the growth in the size and scope of the sector and the increasing complexity of NFP governance.

In addition, current issues impacting Australian corporations such as effective performance monitoring, increasingly complex compliance obligations, stakeholder engagement, incentivisation, remuneration and culture are equally relevant for the NFP sector. Although they may need to be viewed through a different lens, these governance issues transcend sectors.

It's a tough gig

The NFP sector, especially the human services sector, which is the one I am most familiar with, is undergoing significant reform. Consumer Directed Care in aged care and the National Disability Insurance Scheme in disability are two examples. From my experience, there has been inadequate support to enable the transition of people and organisations to this new way of accessing and delivering vital community services in the free market. Monitoring performance is often a challenge due to lack of information and /or inadequate systems, as is the focus on relationships instead of transactions.

The compliance obligations are increasingly onerous, especially for the many small organisations who do not have adequate technology to support complex reporting requirements. One large, national organisation I know of is required to report to at least 19 entities for various legislative, accreditation and compliance matters, some on a daily basis. Despite its size, much of the reporting must be compiled manually.

There are increasing requirements to engage meaningfully with stakeholders, in a range of ways for a myriad of different reasons. In disability, people are now customers, co-designing services. In health, patients are partners in their health care journey. Staff in human services are increasingly acknowledged as the organisations greatest asset and engaged more than ever. Feedback, especially negative commentary, is increasingly valued for the opportunities it affords to improve service quality.

Many human service NFPs experience significant workforce issues including attracting and retaining staff, competition between industries for a limited pool of workers, ageing workforce, adequate remuneration and values alignment in an increasingly mobile workforce.

The various royal commissions have also placed increased demands on NFPs, not only in responding to specific requests for information, but in considering the learnings from their findings. There are also lessons from other inquiries such as the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, the ASIC report of CBA's compliance and the APRA Enforcement Review Final Report.

The spotlight is a friend

Great opportunity exists for those who recognise the value of the current, intense interest in governance and are able to invest in service improvement and innovation. Each of the NFP boards I am involved with is making changes as a result of considering the recommendations from the various investigations and applying the learnings to their organisations. This requires diligent and thoughtful analysis, dedicated resources and 'bandwidth'. The immediate priority for many smaller organisations however, given current industry pressures, is finding money to keep the lights on, so their ability to leverage the opportunity is not so easy.

Be the spotlight

The recent focus on governance has provided an explosion of material and resources to consider and as a director, there is a need to prioritise how your time is invested – preparing for board meetings, reading articles and social media feeds, attending forums, workshops, webinars and meetings, joining networks, being part of discussion groups and catching up with colleagues. Much of the generic governance material does consider implications for the NFP sector, and there are many NFP specific resources. I applaud the AICD for their focus on this large section of their membership base.

One of the greatest challenges for the contemporary director is getting to know their business...finding different ways to engage with the people we serve, those who provide these vital services, our funders, our partners and /or competitors in the marketplace, the people making policies that may affect these organisations and those who want to contribute to the work we are doing. This may be easier in smaller, less complex organisations, where directors are 'closer' to the service and interact frequently with stakeholders by wearing multiple hats. It is more challenging in larger, diverse and evolving organisations where the environment is more dynamic, change is fast paced, and there are more people and complex issues to consider.

The current spotlight on NFP governance provides many opportunities to increase the social and economic impact of our sector. It is vital that NFP directors don't wait for the spotlight to be shone on their industry or organisation...instead, NFP directors should be the spotlight.

Disability Royal Commission to report in 2020

14 January 2020, "Disability Royal Commission to report in 2020", *The Boardroom Report*, Volume 18, Issue 1, AICD.

In this interview, Fiona Payne, GAICD, chair of WA therapy provider Therapy Focus, who sits on the AICD NFP Chairs Forum and is a speaker at the Australian Governance Summit in March, looks at the governance and policy implications.

A total of 177 submissions have been received by the Royal Commission into Violence, Abuse, Neglect and Exploitation of People with Disability. Here Ms Payne outlines what directors need to know about the main issues.

The Royal Commission has released an Accessibility and Inclusion Strategy — is this a significant step forward as you see it?

It is important that the commission's approach to enabling people to tell their story is outlined, as this will help people know what to expect and ensure accountability. This is probably a document that should have been in place before hearings began.

Lack of clinical governance skills by directors has been raised as an issue by the Aged Care Royal Commission. Is this relevant to disability too?

It is important that those responsible for governing disability services understand what a good service looks like, from both the regulator and the consumers' perspective. There's great value in someone on the board having clinical expertise, so the risks associated with providing clinical services can be appropriately overseen. All of the human service boards I am involved with have a committee that oversees this aspect of their business.

A total of 177 submission have been received by the RC. Which may be important for directors and why?

Each submission from a person with a disability tells a story, and these are important for directors because they are often learning opportunities and a chance to see things differently. Those submissions which describe successful and practical ways for directors to get to know their business better will be of interest, as will those that describe how organisations are managing the risks associated with people providing support to people who are often vulnerable.

The Disability Royal Commission started hearings in November last year. What are a couple of main points to emerge and are you satisfied with the early progress of hearings?

The commission is highlighting the difficulty in changing large systems, despite evidence to indicate better ways of managing the systems. We have also heard how important it is for people with disability being able to make choices about where and how they live.

Other key points from my perspective include advocacy groups demanding that the commission hears directly from people with disability when considering specific issues and the imperative for the commission to provide a safe and supportive environment for people to share their stories.

There are also challenges in providing students with the support they need to access the education that best meets their needs.

Are you aware of any changes already taking place in the sector?

In response to previous royal commissions, boards are exploring different ways to hear from the people who use their services, and get to know their businesses better. Organisations are investing heavily in systems and processes that enable them to monitor performance, especially non-financial risks such as staff engagement, complaints and incidents, regulatory compliance.

Do you think things will change in the disability sector after this RC? Why or why not?

Things must change, in order to honour those people who have had the courage to speak up, and those who never got the chance to. The DRC is an opportunity to raise awareness of the many barriers people with disability face in living the life they choose to lead, and equally importantly, make recommendations about how things can be done differently to reduce and remove these barriers.

What things need to change in your view?

People with disability need to be much more actively involved in deciding how they live their lives. The National Disability Insurance Scheme (NDIS) offers a real opportunity to make this happen. The voice of people with disability needs to be heard at all levels in the organisation, including the boardroom.

As a community, we need to work to reduce the barriers that make it hard for people to receive an education, find a job and live in a home of their choice.

What implications do you think there may be for the NDIS?

The NDIS is a significant enabler of social and economic participation, so the DRC can reinforce this function and recommend ways in which the scheme can be enhanced.

It's still early days for the NDIS, which won't be rolled out fully until mid-2020, and already many changes have been made based on feedback from people with disability and organisations that provide services. More are likely to come. The role of the NDIS Quality & Safeguarding Commission will likely receive significant attention, and early feedback indicates onerous reporting obligations are not achievable or sustainable.

After the royal commission, there will be so much that NFP boards need to focus on. Where should they start?

The most important thing is that directors know their NFP and are passionate about its purpose. There needs to be a strong alignment with their personal values and that of their organisation — they need to walk the talk!

They need to ensure they have the right information to inform their decision making and monitor the organisation's performance. They need to understand the culture of the organization and the value proposition it offers to staff and customers.

They need to invest time and energy in understanding their sector, including the current issues, the market, the opportunities and the risks.

They need to keep up to date with broader governance issues and consider the implications for their NFP.

Understanding the impact of royal commissions on not-for-profit resources

19 December 2019, Understanding the impact of *Royal Commissions on NFP resources*, Governance Leadership Centre, AICD.

Broader implications of the royal commissions.

After a 10-month inquiry, the Royal Commission into Aged Care Quality and Safety released its interim report on 31 October 2019. The report, titled *Neglect*, detailed how the sector has failed to meet the needs of older, vulnerable Australians.

The inquiry investigated aged-care housing, in-home care and care for young people with disabilities living in a residential aged-care environment.

While the government has responded with an additional $537 million in funding for the sector, the report noted that no amount of funding could repair the deep-seated flaws in the system and that nothing less than "a fundamental overhaul of the design, objectives, regulation and funding of aged care in Australia" would be appropriate.

The report identified three areas for immediate attention, including more home-care packages to aid those on waiting lists, a reduction in the 'over-reliance' on chemical restraints, and a reduction in the intake of young people with disabilities into aged-care homes.

The final report is due by November 2020 and is expected to focus on governance and accountability in the sector and provide a road map for the transformation of the industry. Indeed, hearings over recent weeks have had a much stronger focus on the governance of aged care organisations.

While the not-for-profit sector has been welcoming of royal commission hearings and findings, less considered are the extra costs and implications for not-for-profit organisations in responding to the Aged Care and other Royal Commissions.

Some questions were asked in the 2019 AICD *NFP Governance and Performance Study* about the effect of royal commissions on the NFP sector as part of its broader focus on NFP trends and governance. The AICD study, now in its tenth year, is the largest of its kind on NFP governance in the world.

As with any survey, care is needed in extrapolating the results to all NFPs. The 2019 AICD *NFP Governance and Performance Study* represented a small sample of NFP organisations and their experience with Aged Care, Disabilities, and Child Sexual Abuse Royal Commissions may not be reflective of the NFP sector generally.

The study found the NFP sector's response to the Child Sexual Abuse, Aged Care and Disabilities Royal Commissions is having a significant financial impact on NFP resources. For example,159 directors reported their organisation had, collectively, spent $47.3 million on responding to royal commissions — an average of almost $300,000 per NFP.

Costs included out-of-pocket expenses, additional staff requirements, professional fees, impact on insurance premiums, training, record collection and communications relating to royal commissions. Costs for redress and compensation, if required, were not included.

NFP directors also reported significant non-financial costs from royal commissions for their organisation and its stakeholders:

- In some cases, stakeholders of their NFP (including clients and families) became anxious or stressed that their organisation's reputation was at risk because it operated in a sector under investigation in a royal commission.
- Directors reported that the royal commission timeframes, in many cases, were tight, creating extra stress for the organisations. Some NFPs had struggled to provide information required because it did not exist.

Other findings included:

- 29 per cent of directors reported their organisation was involved in one or more royal commissions; and
- of these:
  - two thirds have made, or are expected to make, written submissions;
  - half have provided, or will provide, information requested by Commissioners; and
  - one in five have, or expect to have, staff appear before the Commissioners.

The royal commissions have had varying effect on NFPs. Directors said their organisation was most affected by the Aged Care Royal Commission, followed closely by the People with Disabilities Royal Commission and Child Sexual Abuse Royal Commission.

It is important to note that survey responses and focus-group interviews confirmed strong NFP support for royal commissions. Directors surveyed said their organisation's board and executive team welcomed royal commission findings, no matter how confronting.

Key regulatory updates for not-for-profits and charities

Christie McGrath

9 December 2019, "Key regulatory updates for NFPs and charities", *The Boardroom Report*, Volume 17, Issue 12, AICD.

As another year comes to an end, we thought it timely to provide regulatory updates on new laws and guidance that impact the not-for-profit (NFP) and charities sector. Looking ahead, we have also provided an overview of key issues that members should be aware of in the coming year, including the ACNC Charities Marketplace, underpayment of employees and the Aged Care Royal Commission.

Whistleblowing laws and guidance

ASIC has released new guidance for companies on whistleblower policies. Notably, ASIC has relieved public companies limited by guarantee that are NFPs or charities, and have an annual consolidated revenue of less than $1 million, from the *Corporations Act 2001* requirement to have a whistleblowing policy. In doing so, ASIC recognises that these entities may face a compliance burden that outweighs the benefits that a policy might otherwise offer. The relief only extends to the requirement to have a policy – the substantive whistleblowing protections provided by the Act still apply. Refer here for more information about the protections.

NFPs and charities will need to consider their position in light of the relief granted by ASIC. Those companies exempted from the legislative requirement may nevertheless still wish to implement a whistleblower policy, particularly given the substantive whistleblower protections will still apply. The AICD's *Not-For-Profit Governance Principles* recognise that whistleblowers are an important line of defence against wrongdoing, and encourage entities to establish whistleblower policies.

Modern slavery laws

The Commonwealth Modern Slavery laws have been in force since 1 January 2019 and apply to Australian entities with annual consolidated revenue of $100 million or more. Statements must be submitted annually, with first statements due next year. If your organisation is required to comply, the AICD's director tool is designed to assist directors with their oversight role of modern slavery risk in their operations and supply chains. It also sets out timelines for reporting.

The NSW Modern Slavery Act 2018 remains on hold pending the outcome of a parliamentary inquiry. The AICD has advocated for an exemption for NFPs and charities due to the lower monetary threshold and application of penalties for entities (up to $1.1 million).

Reporting requirements

The Australian Accounting Standards Board (AASB) has released an amending standard requiring additional disclosures for non-government NFP entities preparing Special Purpose Financial Statements (SPFS).

NFPs are currently defined as an entity "whose principal objective is not the generation of profit…"; this is a fairly narrow definition of an NFP, narrower than that applied by the ACNC or the ATO. It means an entity can be treated as an NFP for regulatory and tax purposes and a for-profit for accounting and reporting purposes. The AASB is currently consulting on an amendment to this definition and the AICD is closely involved in those discussions.

The new standard requires an entity to disclose the basis on which the decision to prepare the SPFS was made.

For each material accounting policy applied and disclosed in the SPFS that does not comply with the recognition and measurement (R&M) requirements in Australian Accounting Standards (AAS), the entity must disclose either where it does not comply or that the entity does not know and whether the SPFS overall complies with the R&M requirements in AAS or whether the entity does not know.

If an NFP entity has determined that its interests in other entities give rise to interests in subsidiaries, associates or joint ventures, the entity must disclose whether it has consolidated or equity accounted for those interests in a manner consistent with the AAS requirements. If it has not, it shall disclose that fact and the reasons why, or if the NFP entity has not made this assessment and was not required by legislation to do so, it shall instead disclose that no assessment has been made.

The new standard affects charities registered with the ACNC that have annual revenues of $250,000 or more (that is, medium and large charities), that prepare SPFS and are required to comply with the ACNC reporting requirements, and NFP entities not registered with the ACNC that are lodging SPFS with ASIC, for example companies limited by guarantee.

The new standard applies for annual reporting periods ending on or after 30 June 2020.

ACNC Charities Marketplace

Earlier in 2019, the ACNC Commissioner announced the launch of the Charities Marketplace. The aim of the initiative is to increase the amount of information to help people who want to support charities to understand what each charity does and to make it easier to search charities on the register.

From July 2020, when charities complete their annual information statement, they will be given the option to include a more accurate description of what they do at a program level.

ACNC will provide guidance to charities in time as to what information should be provided.

Underpayment of employees

The ACNC has highlighted that underpayment of employees is an issue in the NFP and charities sector. In fact, PwC identified in its report, *Australia Matters*, that one of the key risks facing organisations today is ensuring employees are being accurately paid for the work they do.

The report suggests that "the vast majority of employers do the right thing by employees, but the chances of inadvertently making a mistake are extremely high and, as we are witnessing, small mistakes made across large workforces over several years add up to very large numbers".

PwC notes that the healthcare and social assistance sector is one of the most at risk, which captures many NFPs and charities.

Directors should seek appropriate management assurances that employees are being paid appropriately and that there are systems and processes in place to ensure that the correct rules and laws are applied.

HR information systems, time and attendance systems, and payroll systems should also be regularly updated.

Aged care sector

It is also worth noting that the Aged Care Royal Commission has turned its focus to governance in aged care, the links between governance and outcomes and how the Commission may look to improve governance in the sector. The Commission has examined two case studies in Tasmanian care homes hearing evidence about breakdowns in communication between senior management, the board, and employees running the facilities. Reports and internal audit outcomes that should have raised red flags did not make their way to decision makers. This was compounded by significant turnover in staff, including management.

The Commission hearings are a timely reminder for directors in the aged care sector — and in other sectors that care for vulnerable people — to test whether legal, risk and compliance systems are being implemented in practice. Boards also need to ask questions regarding information flows and whether they are being advised of the practical consequences of key decisions. As with the Financial Services Royal Commission, this inquiry has also highlighted the importance of culture, and the board's role in overseeing this important part of governance. The AICD has released a practical director tool to help shape the approach to governing organisational culture.

Government response to ACNC review

Finally, by way of update, we understand that the Government's response to the ACNC review is due early 2020. We will keep members updated on the outcome of the review.

CHAPTER 17.

Future trends

Managing the growth in workforce diversity through inclusive leadership

Deb Yates
National Managing Partner, People & Corporate Affairs, KPMG

The companies that succeed in this decade and beyond will largely be those that foster and effectively manage diversity and seize upon the innovation that results from clashing assumptions.

Australian organisations in 2020 are fortunate to operate in one of the most diverse nations the world has ever known. Whilst this creates tremendous opportunities, capturing those opportunities is far from straightforward.

Today, most Australian businesses have set targets for gender equality. Many are years deep into strategies drafted to improve cultural balance. Yet the challenge of managing diversity does not end here.

Rising skills and emerging jobs, springing from the fourth industrial revolution, will also introduce a diversity of thought and approach. We are, for example, seeing data and technology experts embedded into organisations in rising numbers. These new roles will typically be occupied by people with quite different views and backgrounds than those emerging from traditional talent pools.

Managing all this diversity, and capturing its value, is now a core challenge of leadership. Australian business leaders are becoming increasingly aware of this challenge, as evidenced by KPMG's most recent *Keeping us up at night* report of Australian leadership concerns, in which 'leadership capability' rose to number five.

Inclusive leadership: the key to unlocking diversity's potential

The benefit of different backgrounds, perspectives, and experiences cannot be effectively leveraged unless an organisation has leaders capable of harnessing it.

This means leaders capable of stepping confidently into conversations with people who have different experiences, approaches, and ideas and extracting value.

Inclusive leadership is a complex idea and encompasses a range of approaches. At its core, however, is developing a capacity to listen effectively and be aware of your own inherent bias.

An inclusive leader recognises that good ideas, and effective leadership, come in many forms and these forms can be affected by the culture, professional background, and gender.

Inclusive leadership practice means constantly probing not just externalities, but internal biases. Are we overly sympathetic to voices that confirm our preconceived ideas? Are we actively seeking out alternate views to test the veracity of claims made? Are we falling into common traps like the halo effect or similarity attraction?

Successful inclusive leaders will recognise diversity must go hand-in-hand with inclusion. They will be conscious that different groups may be more subtle or nuanced, take longer to respond, or need to be welcomed into a discussion. They will recognise that these tendencies should not necessarily be confused with disinterest or ineptitude.

Why inclusive leadership matters at board level

Although inclusive leadership principles are typically discussed in the context of C-suite leaders, embracing inclusive leadership principles is every bit as relevant for Australian directors.

Good boards in this decade will need the capacity to effectively hear all relevant voices on issues in order to make the best decisions possible for an inevitably complex web of stakeholders.

Boards are charged with recognising and understanding risk. So directors need to hear the signals they are accountable to hear, which means being able to understand multiple styles of communication. The way a marketing executive might communicate, for example, may be very different to how a data scientist might communicate. Yet both are likely to have relevant information.

Furthermore, directors need to ensure a culture of inclusive leadership is embedded at all levels of an organisation to ensure diversity measures secure good return on investment. Significant resources will be necessary to identify and hire diverse talent, but these resources will likely be wasted without inclusive leadership flowing from the board down.

As organisations look to employ talent in emerging jobs, leaders should be mindful of that fact that outperformance and promotion paths may well look different within these fields. Not everyone aspires to graduate out of their specialty and into a generalist management role. Many of those with hard technical skills may require different incentive paths in order to extract their best efforts and retain them within the organisation.

Embracing inclusive leadership will help boards evolve their outlook

More broadly, embracing inclusive leadership principles will provide boards with the lens necessary to become more sophisticated in terms of how they define stakeholder value.

It is now well established that modern corporations should strive for a more rounded view of their place and purpose. A fascinating recent piece of research conducted last year by KPMG into the attitudes of Australian retail investors found that they are keenly aware of the importance of reputation, transparency, ethical behaviour, values alignment, and social responsibility. In fact, a majority (57 per cent) of retail investors say they would accept lower financial returns if it meant companies they invested in always behaved ethically towards customers, employees and community.

What this underscores is that modern boards have deep responsibilities to a range of stakeholder groups, and not just 'shareholder interest' as traditionally defined. Given these groups are diverse, the discipline of creating and applying an inclusive leadership perspective will be invaluable.

5 emerging technologies to watch in 2020

Nicholas Davis

1 December 2019, "5 emerging technologies to watch in 2020", *Company Director*, December 2019, AICD.

Monitoring these 5 emerging technologies will help directors better navigate the challenges and opportunities of a new decade.

Each year, at this time, we see hundreds of articles offering analysis of the trends to watch for the year ahead. In today's business climate, you can bet most of these will reference one or more emerging technologies poised to disrupt enterprises and consumers. But merely being aware of exciting technologies and their potential impact is useless unless you can link them to the governance, strategic and risk-management roles that directors undertake daily. Rather than focus on the actual technologies, here are five cross-cutting trends to track during the next year. Monitoring them will help you and your board better navigate the opportunities and challenges of emerging technologies.

New rules, new duties

Since the Cambridge Analytica scandal in April 2018, an array of global technology companies have faced public and employer concerns around their approach to data privacy, extremist content, the treatment of workers and myriad other issues. Accordingly, in 2019, legislators and regulators were more focused than ever on enforcing laws and designing new controls to hold tech companies to account.

As a result, penalties for technology-related breaches are growing by orders of magnitude for companies from all sectors. In October 2018, Facebook was fined £500,000 by the UK government for failing to protect user data. In July 2019, the UK Information Commissioner's Office announced penalties of £99 million for Marriot International and £183 million for British Airways, highlighting the cost of infringing the EU's General Data Protection Regulation (GDPR) rules. The same month, the US Federal Trade Commission announced Facebook would pay US$5 billion to settle a probe related to the inappropriate sharing of data.

One of the most important themes for directors to be aware of for 2020, therefore, will be the ways in which governments respond to both public concerns and competitive dynamics related to new technologies — whether this is privacy, cybersecurity or new government procurement rules. For directors, this means ensuring your board is monitoring the policy environment related to new technologies and anticipating possible risks for corporate liability. But perhaps even more important is looking for opportunities to leverage new policies for competitive advantage. For example, by creating more trusted relationships with customers.

In Australia, expect policymaking related to technology to accelerate at all levels of government as jurisdictions play catch-up to new international norms. For example, the Department of Industry, Innovation and Science may well release a standalone national AI strategy in 2020 aimed at building the country's competitive edge in machine learning while ensuring fairness and transparency in its use.

Things to watch for:

- Development of new policies/ strategies by federal and state governments.
- A shift from lobbying to collaborative policy development among multinational firms.
- The influence of international regimes such as GDPR — and the fines they impose — on Australian businesses.

New systems beat new technologies

Emerging technologies don't change the world by themselves. It's their evolution from new capabilities to entirely new systems that is revolutionary. Take the spinning jenny — a multiple-spindle machine for spinning wool or cotton. The thread it created was initially weaker than that spun by hand, and on its own it couldn't hope to compete with the quality of production from artisanal workers. But when integrated into factories — supported by new flows of capital, new power sources, access to new types of workers and links to new markets — the jenny, the spinning mule and a host of related inventions collectively revolutionised the textile manufacturing sector and began a major social and economic transformation across 18th-century Europe.

The shift from developing single technologies to building transformative systems is well underway today with businesses and governments focusing much more on systematically building emerging technologies into new and exciting capabilities at scale.

Mobility systems are a good place to look for change of this type in the coming year. Ride sharing has already transformed the mobility landscape for passenger vehicles and 2020 looks to be the year benefits of machine learning algorithms and use of connected smart devices in public spaces begin to be truly felt by Australian commuters.

This is happening in China, where Alibaba's efforts at managing road networks in major cities using AI (City Brain) has resulted in a 17 per cent increase of public bus use and halved emergency vehicle response times in Hangzhou. In its first foreign project, City Brain has reportedly shaved 15 minutes off the average commute in Kuala Lumpur.

Closer to home, the NSW government's success at leveraging open data around public transport systems in Sydney — which allows commuters to remotely monitor how full carriages are — is another example of authorities investing in public technology goods that support greater system-level efficiency.

Another important shift will be from pilots to full launches. Following an 18-month world-first trial in Canberra, Project Wing (part of the US-based X, founded by Google parent company Alphabet) successfully demonstrated that Australians are pleased to receive their latte, burrito or filled prescription by autonomous drone, lowered on a wire to their driveway. In 2019 the Civil Aviation Safety Authority cleared Wing Aviation to operate ongoing drone deliveries in selected suburbs in Canberra and Queensland.

For directors, this prospect of entire systems changing presents a major strategy challenge. It requires being extreme when assessing corporate strategies against different plausible scenarios for future market structures and being more creative. And, given that new systems require new value chains, it will warrant exploring interesting new partnerships among parties you'd not normally expect to see collaborating.

Things to watch for:

- New business models focused on dramatically shifting customer experiences.
- Unexpected partnerships by competitors or leaders in adjacent industries.
- Scenarios and strategies that take new technologies for granted and look at second-order effects.

Solving for sustainability

Australian companies are remarkably sanguine about the world's changing climate. This is likely to shift in 2020 as the costs bite into corporate reputations, profits and perhaps even pose an existential threat.

Take the January 2019 bankruptcy of American utility Pacific Gas & Electric (PG&E) as an example. It could well be the first climate-change bankruptcy in modern history, thanks to the financial burden of PG&E being declared the cause of California's deadliest, most destructive wildfire, the 2018 Camp Fire. PG&E's infrastructure and technology systems weren't adapted for the fact that the state's hottest and driest summers on record have all occurred in the past 20 years.

In the AICD Director Sentiment Index in the second half of 2019, Australian directors nominated climate change as the third biggest economic challenge facing Australian business — and 44 per cent thought climate change should be a federal government priority in the short term.

In 2020, this mood can only increase as public pressure, financial risks and legal threats become far more significant for firms.

Thanks in part to the rising visibility of climate champions such as Greta Thunberg, the changing climate has become the primary environmental concern for people across 28 countries polled by IPSOS in February–March, including Australia (44 per cent).

As rising public pressure turns into widespread action, boards will have no choice but to pay attention.

Sustainability is not just an increasingly popular concern. The Reserve Bank of Australia called out risks from climate change in its October 2019 Financial Stability Review, arguing that physical exposure, the cost of transition and reputational risks significantly threaten the Australian financial sector.

This comes on top of the legal risks that have been telegraphed for both firms and directors. Referencing the landmark 2016 Hutley legal opinion (on directors' duties in relation to climate change under Australian law), the RBA report noted: "[Australian] Firms also face legal risks if directors fail to address the potential exposure of their firms to climate-related risks".

New legal risks linked to environmental impact are part of a global trend: the London School of Economics Grantham Research Institute on Climate Change and the Environment found plaintiffs have turned to the courts to litigate for climate action in 28 countries to date, posing a significant financial and reputational risk to firms regardless of the success of the case.

Aside from risk concerns, there may be opportunities in rethinking business models. Thus, greater board focus on sustainability seems warranted for the year ahead. A focus on more sustainable business operations will have a critical bearing on all kinds of technology-related choices for firms — from source material used for packaging to the carbon cost of your delivery network.

In addition, boards need to be aware emerging technologies can be huge consumers of energy. All of this implies directors should make sure to address climate and environmental risks in all aspects of corporate governance — including in forward-looking technology strategy.

Things to watch for:

- Employee and investor activism around climate change.
- Fraudulent claims of sustainable practices along your value chain.
- Opportunities to leverage the "circular economy" for greater material efficiency.

Increasingly fractious geopolitics of technology

A fourth trend that crosses technological domains is how differing approaches to technological development among the world's major powers is threatening to divide the world in ways that could unwind many of the aspects of globalisation that consumers and companies take for granted.

As foreign policy expert Dhruva Jaishankar has written, three different models of technology development, commercialisation and data use have emerged in China, the US and Europe. Broadly-speaking, the European Union privileges consumer rights over enterprise efficiency, as best evidenced by the advent of the GDPR, and is stepping up its investment in public research funding and innovation grants such as the €94.1 billion Horizon Europe research and innovation proposal. The US has given more latitude to fast-growing firms, even where these seem to create new market distortions or threaten consumer rights. And China has developed a new form of state-backed technological competition where citizen data is widely shared between the government and private companies.

These factors, when combined with a locally competitive, yet globally protected digital market and significant financial resources, has led to Chinese firms such as Alibaba, Huawei, Tencent and JD.com being able to compete successfully with US and European tech giants.

This diversity of approach has already led to geopolitical tensions and trade disputes. Following the Australian government's ban of Huawei in August 2018, the US government put Huawei under an export ban in May 2019, effectively excluding it from US telecommunication networks. In October 2019, some of the world's leading facial-recognition companies, all of which are Chinese, were added to the list by the US Department of Commerce.

China has responded to the bans with diplomatic overtures, making robust appeals directly to companies and has reportedly considered banning rare earth exports to the US. Early in 2019, there were fears that delays around Australian coal imports to Chinese ports were linked to the Huawei ban.

Meanwhile, European companies are doubling down on regulating the technology sector. Following a skirmish with Google over how publishers could be compensated for use of their material in search results, France has pushed for the European Commission to regulate large digital platforms as "systemic" players, in ways similar to influential financial organisations.

For directors, global technology tussles might seem just one more reason for boards to pay attention to geopolitics. But rather than seeing technology as one more pawn on the chessboard of trade wars, directors might reflect on the inverse — that trade agreements are being used to try to control the future of technological systems in ways that pose significant risks to the Australian economy.

Beyond the threat of disruption these can cause to Australian companies, such attempts may ultimately backfire by simply slowing the rate of technology adoption where it is most needed. On this point, as 2020 begins, it's worthwhile diving into Kai-Fu Lee's book, AI Super Powers, which puts forward a compelling case for the ways in which Chinese and US companies are competing on artificial intelligence — and the advantages China has on the application side.

Things to watch for:

- Further bans on technology firms between Australia, China, the EU and US.
- The potential re-entry of Huawei into European 5G markets.
- The rise of highly integrated platform ecosystems such as Tencent's WeChat ecosystem or Alibaba's e-commerce ecosystem outside of China.

Skills shifts become personal for directors

Boards and directors will be under even greater pressure to understand how emerging technologies affect both organisations and markets. While in past years it was possible to delegate technology issues to your CTO or resident tech nerd, the trends, the AICD's Driving Innovation: The boardroom gap report highlights that understanding the dynamics of technology and its impact on corporate governance and business strategy will be a job for all board members.

For directors, this means taking very personally the fact that new technologies are changing the demand for skills at all levels of organisations.

The World Economic Forum's *The Future of Jobs Report 2018* argued that 42 per cent of core skills will be different for any given role by the year 2022. Over the same period, the report found that to be effective, every employee will require an additional 101 days of reskilling.

Boards and directors will need to ensure they step up their investment in knowledge partners, advisers, training courses and experiences — because directors, on average, will require 101 additional days of reskilling during the next three years.

If you break this down, it means that you, personally, should plan for approximately 20 five-day weeks of training between now and 2022.

Given your current commitments, what has to change to fit six or seven weeks of full-time Skill development into your to-do calendar for 2020?

Things to watch for:

- Excuses you will give to your fellow directors why you don't need any additional training.
- Corporate upskilling strategies that focus almost entirely on mid-level high performers, but miss top executives and frontline staff.
- The rise of employee-curated training content.

And five macrotrends that should be on critical global risk radars

Michael Hawker AM FAICD is a former investment banker and a director of companies such as Macquarie Group, Rugby World Cup and Bupa ANZ Group. The former chair of the George Institute for Global Health lists five macrotrends he regards as critical global risks.

1. Technology

The global trend affecting every business, big or small, is the impact of technology. It has changed the breadth of the market. Over time, markets have been where you could walk to, where you could ride to, where you could get a train to, and where you could fly to. But now we can go anywhere in the world. So the market has completely changed and is global. Almost any product anywhere in the world can get delivered anywhere else in the world.

2. Geopolitical risk

The world has gone global before governance systems have gone global. The political framework is still local and broadly geographically based. Very few, if any, OECD governments are discussing with their citizens what they need to do to make their country successful in the changing nature of global competition. Politicians are typically just reacting to the impact global competition is having on their country. Therefore, they are reacting to the political fallout through populist policy formulation, leaving many people whose jobs are changing or being lost without an understanding of why.

Our communities are becoming divided into those who love the change and embrace it — and those who don't. Many people do not understand what the hell is going on with their lives and are basically trying to stop it. That's what's driving the political landscape in the US. It is also happening in the UK and Australia.

For the past 40 years, the world has been primarily governed under one dominant global power providing the opportunity for capital and for people to move and travel freely around the world.

We have had global structures since WWII — such as the G20, United Nations and World Health Organisation — enhancing global communication.

Global power is now shifting with the re-emergence of economically stronger trading blocs with different political systems, such as China, the EU and Russia. Many governments are no longer providing the strong support to these forums that they historically did.

In my view, this change in political landscape has been totally driven by those that benefit from the globalisation and digitisation of global markets, and those that don't. There are a lot of people saying, "I don't like this change. It is driving me nuts. I don't understand what is going on so I'm just going to stop it.

3. Population growth

Understanding demographics by country is hugely important. World population is 7.7 billion; in 1900 there were 1.6 billion people. The world's population is still growing, which is driving economic growth. However, understanding where the working populations are growing, coupled with productivity improvement, will give you significant insight into the impact on each country's relative economic metrics.

It is worth understanding the average age of each country's working population and its forecast trend. India has an average age of about 28; China's is about 37. Russia's working population has fallen by approximately 20 per cent during the past 10 years. This makes it difficult for them to continue to drive economic growth. Western Europe has had the benefit of consolidating with Eastern Europe, increasing its population growth with considerable improvement in their productivity.

Japan has an ageing population — a median age of 47 — and a commensurate shrinking labour force with little or no immigration, thus their high use of robotics to drive up productivity. Understanding country demographic trends helps to predict medium economic outcomes.

4. Climate change

If world experts indicate there is a 95 per cent probability of a risk occurring, you are negligent if you ignore their advice. Currently, scientific experts believe there is more than a 95 per cent probability that the growth in humanity is the cause of climate change Irrespective of whether you believe it or not, most governments and vast numbers of people across the world do. So you've just got to deal with it, as it has a massive impact on the cost of living, energy costs, product content, product recycling, supply chains and value of assets. Business adaptation to climate change is a massive challenge, but also a significant new opportunity.

5. The economic cycle

I would say we are towards the end of the economic cycle. All economic bubbles are driven by asset prices being inflated way above their real value. We are at a point where asset prices are inflated, relative to history. In my view, since the GFC, central banks are trying to push their intervention and support for the markets as far as they can and for as long as they can. So we might have another two years before we get to a downturn or it might happen tomorrow.

How Industry 4.0 will transform Australian business in 2020

Shane Swift GAICD

9 December 2019, "How Industry 4.0 will transform Australian business in 2020", *The Boardroom Report*, Volume 17, Issue 12, AICD.

The Fourth Industrial Revolution, 'Industry 4.0' is characterised by the interconnected relationship between technology, data and people — the more data businesses can collect, interpret and leverage, the better they can drive effective decision making. And this is the key that executives and directors must acknowledge — data is now the lifeblood of your organisations.

As a director in Industry 4.0, and with growing pressures and ever shifting focus on director and board responsibilities, data has become a linchpin to success. The consumption of information previously limited only to board papers is long gone and moving toward real-time insight.

The measures of success as a director in this age of data have shifted, providing new sets of tools to achieve this success. Examples include:

- Solvency — direct insight via financial dashboards tailored to the board
- Regulation — real time breach reporting in any area of your organisation
- Innovation — rapid insight into customer metrics measuring the effectiveness of strategies and operations
- Benchmarking — establishing repeatable and comparable benchmarks and creating a platform to support decision making
- These success measures can be found in almost every area of your organisation from tangible to intangible. For example, at board level, data can inform as to whether to approve management's proposal to invest in a new service or project.

Along with the benefits of the data revolution also come some hazards for boards – directors need to ensure that their roles are distinct from operations and add strategic value. With the accessibility of data rising, there is a temptation to 'flood' directors with operational data. Balancing the demands of insight and the board not becoming part of the organisation's day-to-day operations, remains one of the single biggest challenges directors will face in Industry 4.0.

Following are three key areas where directors can build and strengthen data capability, in order to leverage value.

Have a plan for what you aim to achieve

Take the time to work with leadership to identify the required data and information from the organisation to capture and make available to the board. By identifying specific objectives for what your business must achieve and report on is crucial to effectively building your data capability. Identifying specific problems you'd like to solve, use cases and areas of your organisation that provide the largest value to focus effort and investment will ensure a strategic but narrower approach.

Some questions directors can ask include:

- What data do I currently have available in my business?
- As a director/board member, how can I/we improve our effectiveness by leveraging data?
- What is the right data the organisation must collect and use to inform us as a board?
- Are there areas where I could collect more data? Do I need external support and/or additional technologies to achieve this?

Ensure the organisation has a data management framework

In order to report and work with a board, every organisation must have a data management framework. Understanding data in the organisation and its availability, reliability and accuracy, will see effectiveness elevated.

A data management framework is pervasive in managing contemporary issues faced by an organisation — from tracing obligations from regulators, (and the recent money laundering compliance issues experienced by Westpac highlight this), all the way through to leveraging insights from customer interactions such as Net Promoter Score (NPS). Data is paramount.

Invest in getting the right capabilities

Your organisation and its leadership must 'trust the data'. Making practical and prudent data-driven decisions will support your organisational objectives and unlock value. Key decision makers must be data literate; so they can understand how to interpret trends or changes and make strategic decisions with confidence based on the data.

The understanding of and using data is critical for participating in contemporary business and this Fourth Industrial Revolution. Providing directors with high quality data and information leads to making more effective decisions. Whether it is selecting products and services, capital investments, quality control or training and recruitment, investing in your data capability is investing in the future of your organisation.

CHAPTER 18.

The growing benefits of having a social purpose

More than money

Domini Stuart

"More than money", *Company Director,* February 2020, AICD.

Many organisations are looking beyond short-term profits to embrace a broader definition of success. Here is a four-step guide on how to think about corporate purpose.

Could "purpose" be heading for the same fate as "green", "natural" and "organic" — words that marketers have used and misused so often they have practically lost their meaning? Many companies use purpose and mission interchangeably, though they actually mean very different things. Put simply, a company's purpose is the "why" behind its actions while its mission is what it is trying to achieve. In practice, a clear and fully integrated purpose can provide a context for decision making.

Catherine Livingstone AO FAICD, Commonwealth Bank chair and director of WorleyParsons, is an advocate of using a statement of purpose as a sound organising principle.

Livingstone told the annual New South Wales Supreme Court Corporate and Commercial Law Conference in Sydney in October 2019 that the framework guiding directors' deliberation and judgement has evolved over time. The Memorandum of Association for a corporation used to include an "objects" clause, and the company could not perform any actions outside of, or inconsistent with, its objects.

"We have moved beyond a dry objects statement and, aided by strategy consultants and business management literature, have traversed the landscape of vision and mission statements – the distinction between which has always eluded me – and now recognised the importance of corporations having a clear statement of purpose," Livingstone said in her speech. "Such statements have been used in Australia for some time and increasingly reference stakeholders other than shareholders. The role of a corporation's purpose statement is twofold. From an internal perspective, it guides the evolution of strategy, priorities and decision-making. Externally, it sends a signal as to the intent, nature and commitment of a corporation."

A discussion on the purpose of a corporation at the NSW Supreme Court conference examined the current context, the role of the director and the research of Oxford University's Saïd Business School Professor Colin Mayer CBE and the British Academy on *The Future of the Corporation*.

Mayer, a former economist and finance professor, is an ambitious advocate for rethinking the purpose of the corporation to incorporate a broader public good and ways of embedding this through performance measurement, governance, accounting and regulation. Mayer told the conference that performance "is not only about producing profits, but about generating profitable solutions for the problems of society and the planet".

His ideas are set out in a report for the British Academy, and in his book, *Prosperity: Better Business Makes the Greater Good*. Concerned that inequality, environmental damage and mistrust of business result from an overly narrow focus on profit as a corporate objective, he is keen to re-imagine the corporation to ensure its purpose also includes public benefits that relate to societal and environmental goals.

"I started off with a very shareholder-focused view on the nature of the corporation," says Mayer.

However, watching societies grapple with common issues, even as approaches to capitalism varied, and then as dean of a business school during the global financial crisis, "I realised it was a topic of first-order importance," he says.

"The role and purpose of business in society is critically important."

Sensible business

Supporters of this approach say looking beyond profits makes sound business sense. From customer connection and employee alignment to satisfying a new breed of socially responsible shareholders, they see higher purpose as the way of the future.

"Expectations concerning the role of business in society are certainly changing and the belief that capitalism needs rethinking is now commonplace," says Derryn Heilbuth, managing director of strategic advisory consultancy BWD. As an example, she cites a 2019 survey for Fortune, which found 72 per cent of people agree public companies should be "mission-driven" as well as focused on shareholders and customers. The same poll also found millennials, in particular, are choosing to work at companies perceived to have a purpose beyond profit.

A strong sense of a higher purpose has also been linked to positive organisational performance. For example, The Business Case for Purpose report by Harvard Business Review found that companies able to harness the power of purpose to drive performance and profitability enjoy a distinct competitive advantage.

A higher purpose guides strategy

While there has been much academic research into the impact of mission or purpose statements, Livingstone noted the work of American academic John Mullane, who, in 2002, concluded it was not the contents of the statement that was most relevant in terms of outcomes, but rather the process used to prepare it, and how the finished document was employed in the organisation. Livingstone also referenced 2019 research by Yale University and NN Investment Partners — which manages €240 billion in assets worldwide — that surveyed 200 fund managers across Europe and found investors were willing to sacrifice returns to support ESG or responsible investing goals, up to a point. "Investors said they were prepared to forgo up to 2.4 per cent a year if it meant investments had a positive non-financial impact."

Mullane noted vision and mission statements could be applied to create a sense of common purpose and mould a corporate culture supported by all employees.

"When we look at acquisitions through the lens of our purpose, a lot of opportunities tend to fall by the wayside," says Alistair Field, group CEO and managing director of Sims Metal Management. "Our purpose also helps us to navigate other complex challenges."

Sims Metal Management chair Geoffrey Brunsdon FAICD agrees the company's purpose provides all Sims employees with a clear framework for executing the strategy. "We are the architects responsible for creating a sustainable future for our company, as well as establishing our role in the circular economy — and this is a role we take seriously."

At Breast Cancer Network Australia (BCNA), the purpose statement is frequently used at board level to help determine whether or not a project is actually worthy of investment.

"It is certainly guiding us at the moment as we complete our strategic objectives for the organisation," says CEO Kirsten Pilatti. "We have found it very useful in making decisions for our future, helping us decide what we will and, very importantly, will not do."

More than just another marketing tool?

Is there still a danger of "woke-washing" (brand campaigns promising big change, but delivering little) — a cynical move by brands to cash in on what the public want to hear? Unilever CEO Alan Jope believes woke-washing is already beginning to infect his industry. Speaking at a conference in Cannes in June 2019, he said, "It's putting in peril the very thing which offers us the opportunity to help tackle many of the world's issues."

However, Tom Imbesi, chair of Deloitte Australia, believes that using purpose as nothing more than a marketing tool would be a very short-lived strategy.

"In my view, people will see through a purpose statement very quickly unless it's authentic, driven from the top, owned, real and embedded in corporate culture," he says.

Deloitte's own purpose is to make an impact that matters and, says Imbesi, it's the founding statement of their strategy. "When we look at our clients, we are seeking to make an impact on the issues that are relevant to them, and the same holds true for our people and the community. For example, through our Deloitte Foundation and Responsible Business programs, we're having an impact that matters on those who are most vulnerable in our society."

A push to a longer-term view

Susan Forrester AM FAICD, director and chair of the people and culture committee at G8 Education, believes boards are facing a step change, which will compel them to lead growth by taking a longer-term view. "They have an important role to play in keeping management focused on the long-term health of their companies," she says. "I also believe it's impossible to overstate the importance of board leadership. Naturally, the board should pay attention to short-term performance, but in my experience, the chair must have sufficient conviction, influence and resilience to stand firm in the face of short-term pressures."

Heilbuth stresses the need to embed leadership accountability. "Without standard and verifiable metrics that stakeholders can trust, companies and their executive teams will struggle to effectively communicate how they're creating long-term value," she says.

Finally, Field cautions boards not to underestimate the amount of time and hard work that goes into defining your purpose. "The process took us nearly a year," he says. "You then have to be committed to living your purpose and ensuring that everything — from role descriptions and recruitment processes to decision-making — take your purpose into account. Unless it is integrated into the day-to-day life of your business, you're wasting your time because, after a couple of years, it will be gone."

Case study – Sims Metal Management

Purpose: to create a world without waste to preserve our planet.

Sims Metal Management celebrated a century in business by looking far into the future. "We wanted to make sure we were still operating successfully in 40- or 50-years' time," says group CEO and MD Alistair Field. "As an incoming management team, we felt that aligning long-term planning and our entire organisation to a purpose we truly believed in would create value and drive genuine sustainability."

Once the draft purpose had been approved by the board, Sims brought its global executives together to ensure agreement across the top echelon of the organisation. The new purpose, and the thinking behind it, was then communicated to employees around the world.

"Purpose is only meaningful if it is integrated into how you operate on a day-to-day basis," says Field. "You can only achieve this if employees understand and believe in your aim."

Case study – G8 Education

Purpose: under active review

G8 Education is the largest ASX-listed childcare operator in Australia with 550 centres and 15,000 staff. Three years ago, the resignation of G8's founding MD Chris Scott marked the start of a new era.

"The prior regime had focused on aggressive acquisitions, resulting in more than 500 centres with more than 30 brands," says G8 director Susan Forrester AM FAICD. "There was also a disconnect between our listed status and the associated focus on short-term result — the ASX half-yearly straitjacket — and our employees who, as early learning specialists, did not relate well to financial targets for the centres."

For six months, G8's board and executive team worked with specialist consultants to review their vision, purpose and brand. "We acknowledged that, beyond share price and dividends, our purpose is to contribute to a robust, equitable and sustainable future for all stakeholders," says Forrester. "We also recognised the important role G8 plays in the lives of the children in our care, the families we support and the community in which we operate."

The new vision and purpose is due to be revealed in early 2020. "This will bring all our staff together with an all-encompassing statement about the enormous benefits of early learning," says Forrester.

Case study – Breast Cancer Network Australia (BCNA)

Purpose: to ensure women with breast cancer receive the very best support, information, treatment and care appropriate to their individual needs.

When Lyn Swinburne AO established BCNA in 1998, her purpose was to ensure no Australian has to face a breast cancer diagnosis alone. Since then, the board and executive have reviewed and adjusted this to reflect the greatest need at the time.

"At one point, we really wanted to focus on the healthcare system and ensure it was providing our members with the best care," says CEO Kirsten Pilatti. "Then, for a short time, we focused on empowering the individual."

The latest iteration demonstrates how, as a network, BCNA can exert influence to ensure all Australians diagnosed with breast cancer, and the people around them, can benefit from its actions. This includes those who don't actively engage with the organisation.

"Our recent review underscored the importance of involving key stakeholders — staff, members and supporters," says Pilatti. "The next, very important step is to communicate and live out our purpose in our actions and operational plans."

5 important questions to help not-for-profits determine purpose and strategy

1. Why does this organisation exist?
2. What does it do?
3. Who does this organisation benefit?
4. How will it achieve its goals?
5. What does success look like for this organisation?

A purposeful future: what is profit in 2050?

Kristin Michaels

19 December 2019, *A purposeful future: what is profit in 2050?*, Governance Leadership Centre, AICD.

Is the division between the for-profit and not-for-profit sectors still relevant?

The history of things

The company: It is generally agreed that these now-ubiquitous structures were born in the 1600s, before really hitting their stride in the late 1700s when the concept flourished in the United States. In discussing the nature of business in 2050, I start in the past, because, relative to human development, something born a few centuries ago is only just learning to walk!

Plenty has changed since the Dutch East India Company set out to monopolise the spice trade: industrialisation and urbanisation, antibiotics, anaesthetics and longer lifespans, the democratisation of technology, and a growing inequality of wealth. Yet over the same time period, the essential structure of 'for profit' (FP) companies has not. The FP company structure continues to enable limited liability and joint stockholder ownership, and companies continue to be created to pool money and enable high-risk, high-investment, high-reward activities (think sugar, spices, slaves, gold back in the day).

Separately, we've created the not-for-profit (NFP) organisation, a 'company lite' version, to enable social good. Same, same, but different.

Demands on both the for-profit and not-for-profit sectors have increased over time: more transparency, greater accountability and regulations, regulations, regulations... But is this duality right for society anymore? Should we separate NFPs from FPs? Or indeed, FPs from NFPs?

This begs a larger question: should profit be separate from purpose? If every company has a purpose and every purpose has some value, and plenty of NFPs make a very healthy profit, should we retain different structures?

The world is changing

If you find it difficult to envisage 2050, you're not the only one. In fact, futurists tell us that across all humankind, we can only conceive four different future scenarios. That's right, general consensus among our most forward-thinking imaginations only generates four possible futures: one that's more or less like now (continuation), one that's positively transformative (game changing), one that's degenerative (collapse) and one that's rigidly limited (disciplined). All are possible, some are probable, but are any preferred?

What we can all agree on is that the world is on the cusp of great social, environmental and economic change. Key markers indicate we're approaching a threshold. These threshold moments appear when there's increasing complexity (such as the Internet of Things) and emergent behaviours arising (such as global activism in which children are rejecting schooling to campaign on climate change). The impact of accelerating technological change on human beings, and our social and economic behaviours, is unprecedented. In the blithe brevity characteristic of our digital age, 'change is the new normal'.

What is interesting is how markets are responding to changes and, at the same time, how we are seeing the effects of genuine consumer activism. Among my social circle (noting that I live in an inner city 'bubble'), it's difficult to organise a straightforward social event these days; some will only eat organic, another may boycott a venue in protest of wage disparities, others must be within walking distance because they don't use fossil fuels and, always, there are the ever-growing ranks of vegans.

Comically, these demands mirror the famous early 90s coffee scene from *LA Story* but, significantly, these individual choices are based on an individual's perception of 'good', and this 'good' is driving both new market engagement and conscious disengagement from 'business as usual'. These ethically minded consumers are driving a conscious economy that's forcing market change, to which companies must respond.

To clarify, I'm not suggesting that companies aren't already shifting to meet these emerging market trends — the new normal is all about change, after all. The question I pose is: Can we expect current governance and company structures to handle these changes?

Corporate social responsibility – what now?

In December last year, Professor Bryan Horrigan contemplated whether corporate performance measures should include a social license to operate. Given social license may be viewed as a link between FP and NFP organisations, this suggestion shows how thinking is changing. While Horrigan rightly concludes 'a company's performance, overall governance, and social licence to operate are all inter-connected', this is an emergent element of the complex modern corporate environment.

Does this inter-connection mean we'll just see a mollifying growth in corporate social responsibility (CSR) programs, or some forms of CSR that blur the lines between a FP company and its NFP recipient-partner? Does having a social license to operate inherently make you 'good', or just 'good enough'? And according to whom? Ultimately, it is according to your shareholders – the ones who pool the money to fund the risky activities, remember? But, in this inevitable shake-up of purpose and structure, I hope we reach something more robust.

Larry Fink's Annual Letter to CEOs in 2018 called for 'a new model of shareholder engagement'; one that properly integrates 'environmental, social and governance matters' in investment. This year, he wrote of the inextricable link between purpose and profit and the expression of purpose increasingly demanded by millennials in the workforce. Fink highlights that the largest transfer of wealth in history is occurring right now, from baby boomers to this new generation of purpose-driven consumers. Another emergent element, another threshold, signalling movement towards this newly conscious economy: the focus on social improvement rather than profit. In this paradigm, human benefit, rather than financial gain, could define profitability.

And while we're on governance

The Australian National University recently released research that showed that companies making above-average profits were more likely to breach their environmental or social obligations than poorer performing firms. The work showed internal corporate governance measures and increased regulation doesn't always prevent poor corporate behaviour — a theory backed up by plenty of contemporary evidence.

Governance is not #winning at the moment. High profile, large-scale scandals suggest that either we're not serving governance well, or governance is no longer serving us.

A similar question was posed by the AICD's *NFP Governance and Performance Study:* 'Is the current model of NFP governance sustainable?' The emerging elements of threshold change in NFPs include: gender equity on boards; the loss of 'kitchen-table' governance; increasing risk and regulation; sustainability issues; and declining community trust in NFPs. Importantly, it is concluded that we mustn't 'assume a governance model that works now will be as effective in the future, as NFP governance goes through a period of unprecedented change'.

Like everything else, governance is getting more complex. And entropy loves complexity.

Concluding with the start

Companies operating in a conscious economy — an ethically competitive marketplace driven by a generation of consumers who believe the corporation's role is to improve society with each and every action – would look very different to our current company descendants of Dutch East India.

I propose that in the not too distant future we will not need a divide between FP and NFP; it's not a divide that will serve future generations or the future increasingly conscious consumer. If profit becomes human-centred, there's no need to define a difference. Philosophically, and ultimately structurally, a company could only exist to improve society. We need these new structures that are responsive to social change and consumer demands; structures that work for the common goal of social improvement, and we need to govern those structures true to that purpose.

To this end, we must start appointing values-based directors. Directors who are able to govern unblinkered, with not only an eye, but also a hand firmly on those four possible futures. Directors who are willing to consider that what is now, may not always be. But that alone is not enough, we must also lay the path for them; engage them now and engage them often in defining what a corporation could and should be.

Building a new generation of directors in step with a powerful new generation of consumers, law-makers and change agents will yield profound social consequences: new ways of operating, new ways of understanding, new ways of structuring, governing and distributing our collective resources in a conscious economy.

The question is not whether we should act to meet this change, but when.

And the answer is now.

What is the purpose of the corporation?

David Walker

1 December 2019, "What is the purpose of the corporation?", *Company Director*, December 2019, AICD.

As traditional expectations of corporations are tested, corporate purpose and the role of shareholders are challenging the future of capitalism.

Almost 50 years ago (September 1970), American economist Milton Friedman famously put the case for a constrained view of the purpose of the corporation. In a *New York Times Magazine* article — "The Social Responsibility of Business is to Increase its Profits" — Friedman wrote that corporate executives have a direct responsibility to their employers, the business owners — that is, the shareholders. That meant executives should "conduct the business in accordance with [the owners'] desires, which generally will be to make as much money as possible while conforming to their basic rules of the society, both those embodied in law and those embodied in ethical custom". For example, he wrote, if a corporate CEO wants to help a worthy cause, he should use his own money, not that of his shareholders.

The economist's view was so influential, particularly in the US, that it became known as the Friedman Doctrine. Yet recently, particularly since the 2008 global financial crisis (GFC), the position, also known as shareholder primacy, has been increasingly subjected to criticism in its country of origin. The opposing view — that companies should consider "stakeholders", as they were dubbed in 1984 by another business thinker, Edward Freeman — has now become mainstream in American business. The Washington DC-based Business Roundtable, which counts as members the CEOs of major US corporations, made headlines earlier this year when it revised its longstanding *Statement on the Purpose of a Corporation.* It moved the roundtable away from Friedman's constrained, shareholders-first view by declaring: "We share a fundamental commitment to all of our stakeholders".

The Business Roundtable statement may have little formal effect, but flags growing concern at the top of many businesses across the developed world about what voters expect of them. Signatories included Amazon's Jeff Bezos, BlackRock's Larry Fink, JPMorgan's Jamie Dimon and Fox Corporation's Lachlan Murdoch. The Council of Institutional Investors and other investor bodies expressed concern over this statement, stating it undercuts the notions of managerial accountability to shareholders.

Best interests

While the debate in the US impacts Australia, particularly because many of the signatories helm companies with operations here, it is important to note that directors' duties differ between the US and Australia, and the two systems should not be conflated. It is a widely accepted view that the current formulation of the *Corporations Act 2001* (Cth), which requires directors to act in the best interests of the company, allows consideration of stakeholders, including customers and employees, beyond shareholders. The issue was expressly examined in the banking Royal Commission, with Commissioner Hayne emphasising that acting in the best interests of the corporation demands consideration of more than the financial returns to shareholders. With regard to customer interests, Hayne remarked companies are not faced with a binary choice between the interests of shareholders and those of customers. Over time, he argued, the interests of different stakeholders will converge.

As part of the Forward Governance Agenda consultation, the AICD explored how directors are interpreting the best interest duty in practice. Nearly half of members responding to the consultation said they balanced the interests of shareholders and stakeholders, while another 32 per cent consider stakeholder impacts as relevant to the interests of shareholders as a whole (this latter formulation being the more generally accepted understanding of the legislative duty). Notably, 16 per cent of respondents consider the interests of shareholders as a whole.

There is some evidence the community would like business to go further. For example, the 2018 Committee for Economic Development of Australia (CEDA) *Company Pulse* report found 72 per cent of Australians believe business should place equal importance on economic, environmental and social performance.

A new framework?

Further out on the spectrum stands Colin Mayer CBE, a corporate revolutionary with a classic management academic's resume, who recently spoke at the Supreme Court of NSW Corporate and Commercial Law conference in Sydney on 29 October. Mayer has been a Harkness Fellow at Harvard University and a Houblon-Norman Fellow at the Bank of England. Now he's the Peter Moores Professor of Management Studies at Oxford's Saïd Business School — and the best-known and most ambitious voice calling for transformation of corporate purpose.

Mayer has set his ideas out both in a report for the British Academy, a humanities group, and in a book, *Prosperity: Better Business Makes the Greater Good*. He would move far away from the Milton Friedman concept of the corporation, which he calls "no longer tenable as a framework for business in the 21st century". Mayer worries that inequality, environmental damage and mistrust of business are all a result of over-concentration on profit.

He would rebuild the corporation around the idea of "corporate purpose" — the reason a corporation is created and exists, what it seeks to do, and what it aspires to become. That corporate purpose would include not just profit, but also public purposes that relate to societal goals.

Mayer's agenda

Mayer wants "profitable solutions to the problems of people and planet", but is adamant the route to profit has to change dramatically using the following levers:

- Shareholders don't act as owners in any meaningful sense, he argues, and their influence on company decisions should be tied to support corporate purposes as well as their rights to derive financial benefit.
- Corporate governance, instead of aligning the interests of management with shareholders, should be legally required to aim at achieving the implementation of corporate purposes.
- Regulation, together with competition, no longer moves fast enough to keep the interests of businesses and society aligned, so companies must be encouraged to incorporate public purposes in their corporate purposes.
- Corporate taxation currently allows too much tax to be earned in low-tax jurisdictions, and interest payments on debt should no longer be tax-deductible.
- Investment plans must incorporate public purposes because privatisations, public-private partnerships and other such arrangements have failed.
- New measures of corporate performance are needed to show a company's effect on human, social and natural capital.

There is a broader conversation going on. In the US, Elizabeth Warren, a leading Democrat candidate for the presidency, has to propose her Accountable Capitalism Act, which would require corporations with revenues above US$1 billion to comply with a federal charter making executives accountable for their decisions. The charter could be revoked for "repeated and egregious illegal conduct". These corporations would need to have employees select 40 per cent of their directors, and both directors and officers would be subject to stock sale restrictions. Warren draws a parallel with existing "benefit corporations", which can balance the interests of all stakeholders.

Purpose in practice

Searching questions have been asked about the workability of the Mayer model. Australian economist Nicholas Gruen is disappointed with the alternatives being offered to traditional corporate governance arrangements by thinkers such as Mayer. "There's nothing wrong with the sentiments," he explains, but finds the sentiments rarely able to be translated into actionable principles. "It's really surprising to me how poorly articulated this is," he says. In her address to the Supreme Court of NSW Corporate and Commercial Law conference, Commonwealth Bank of Australia (CBA) chair Catherine Livingstone AO FAICD endorses the importance of the concept of a corporation's purpose, but calls the proposal to regulate it by law "problematical".

Statements of purpose have been used by corporations in Australia for some time, Livingstone noted. Increasingly, they reference stakeholders other than shareholders, she says, citing as an example CBA's stated purpose "to improve the financial wellbeing of customers and communities". Such statements, in Livingstone's view, guide "the evolution of strategy, priorities and decision-making, and send a signal as to the intent, nature and commitment of the corporation.

Regulating purpose will likely lead to a number of unintended consequences, according to Livingstone, including constraining "directors from taking difficult decisions, for fear of straying from their now legally defined purpose" and "a shift away from the corporate structure as a preferred vehicle for capital".

Elizabeth Bryan AM FAICD also recently talked about the benefits of companies themselves defining corporate purpose. The Insurance Australia Group (IAG) chair told the 2019 Stockbrokers and Financial Advisers Association (SFAA) conference that the company's stated purpose — "making your world a safer place" — had allowed it to expand its offering and raise profits at the same time, by letting the company think about services that stop insured risks materialising. "Returns on mitigation money are much higher than returns on remediation money," says Bryan. "If we can do things for you before something nasty happens, then you are happy and better off, and we are happy and better off."

Gruen notes such win-wins are hard to identify and achieve. Bryan stresses, each one depends on having a clearly defined purpose "very tightly linked with your business model". If it is not, she told the SFAA, "it becomes a form of philanthropy. Then you get down to having really hard conversations with your shareholders. There's no way you can reconcile shareholder return requirements and a weak version of something that is a disguised bit of philanthropy."

Bryan says that intangible assets "have become much more important than they used to be" and this makes trust vital to maximising long-term corporate value. "You can't really, in the interest of the shareholders... trash the trust of society, the trust and allegiance of your customers, [or] your brand."

The Mayer proposal would pose middle managers with a huge new challenge, which Mayer himself admits. "The greatest problems of all in doing well by doing good are… inside the corporation itself," he says. Managers "unfamiliar with the processes required to promote people and planet as well as profits" are unlikely to be supportive. The net effect would be to give not just boards, but an army of corporate managers a challenging task. They would have to manage "capitals" they cannot measure and trade them off against profits, guided by their company's corporate purpose.

Mayer's insistence that companies must start measuring not just financial capital, but human, social and natural capital, would also be very difficult in practice. Luigi Zingales, a professor at the University of Chicago Booth School of Business, points out these capitals are very real and important. But most economists agree this supposedly central measurement task is, right now, impossible even at a national level. We simply lack the statistical tools to do it.

Tough cases

Zingales, with co-author, Oliver Hart, a Nobel laureate in economics, has his own suggestion. They argue a company's prime objective should not be shareholder value, but shareholder welfare. They see welfare as a broader term; one that can include non-monetary benefits ranging from individual freedom to environmental protection.

A former president of the American Finance Association, Zingales is no revolutionary. He agrees with Friedman that CEOs have no right to simply spend shareholders' cash on good deeds. But he also sees tougher cases that Friedman never considered.

Take Google's Dragonfly project, designed to deliver a censored search engine to the Chinese audience as an alternative to the more heavily censored Baidu search facility. Many Google employees opposed Dragonfly on the grounds the company was accommodating an authoritarian state. No private philanthropic alternative was available here; Google simply had to decide which way to move. It ultimately cancelled the project — an astonishing withdrawal from the world's second-largest market, and one that may cruel its future in China. It may be the costliest corporate move in history triggered by ethical concerns. Zingales argues that in such cases, companies should ask two questions. The first is whether profitability itself compels an action. Had Google not cancelled Dragonfly, for instance, it might have faced an even more damaging exodus of coders and managers. If that was so, its CEO was right to act.

But if Google would have profited from Dragonfly, Zingales argues, then the shareholders, not the CEO, needed to decide whether to pass up that profit. In contrast to traditional understandings of the role of the board and shareholders, Zingales says, the board should "ask the shareholders what to do". That, of course, would mean more shareholder votes. Zingales believes its effect would be to involve large shareholding funds more deeply in some company decisions. Meanwhile, more individual investors would choose their funds on the basis of the funds' ethical preferences.

The Google example illustrates the difficulty of asserting that companies must act ethically without practical guidance on how and who decides the ethical framework. Sydney barrister and leading corporations law expert Dr Robert Austin emphasised this point at the Supreme Court of NSW conference. "Frequently, the message [to directors] is little more than that you must apply 'ethical considerations'," says Austin. "But who decides on those ethical considerations and on how they resolve the problem confronting the board? Replacing the maxim 'behave ethically' with the idea that corporations should adopt and be held to their corporate purpose will be a step forward, but only if corporate purpose is expressed in practical terms providing real guidance."

Friedman himself acknowledged the importance of the profit motive being constrained by ethics. It may be that nothing in corporate purpose, culture or trust necessarily collides even with Friedman's view of the world, let alone the outlook of Zingales and other corporate philosophers. University of Illinois at Chicago economist Deirdre McCloskey, a liberal admirer of Friedman, argues most people forget the rider he put on his famous 1970 quote — the rider that subjects corporate conduct to the constraints of "law and... ethical custom".

So even according to Friedman's worldview, corporations and their boards need to understand the ethical customs of their times. In an era with new ethical boundaries and heightened ethical sensitivities, directors face two new challenges. First, their job now requires much more awareness of the social context in which their companies operate. Second, they need to make a greater number of difficult calls between raw profit and corporate reputation.

To Bryan, that makes the director's role more interesting. It is, she says, "a much more sophisticated job to get right than an argument that simply leaves you maximising shareholder returns." The task of reconciling competing interests, even with shareholder returns first among them is, in contrast, "a very nuanced, skilled, experienced job".

"What people are saying is: 'Is the corporate governance community up to it?' Well, it has to get up to speed if it's not up to it."

CHAPTER 19.

Dealing with climate risk

Why directors can't ignore climate risk

Angus Armour FAICD

14 January 2020, "Why directors can't ignore climate risk", *The Boardroom Report*, Volume 18, Issue 1, AICD.

Australians have been shocked by the extent and ferocity of bushfires over past months. We all share a sense of loss and grief for the families and communities that have been devastated.

There is an immediate task for us as a nation to assist those families and communities. Beyond recovering from tragedy and disruption, and rebuilding the physical damage caused by the fires, the economic consequences for regions that rely on tourism and agriculture will be severe. Leaders of local organisations will be doing the essential work in getting these communities back on their feet and the AICD will assist our members involved in that effort.

Beyond that immediate task, we must take stock across every sector and ask whether we were prepared, what we could have done to mitigate the effects of the fires on our organisations and staff, and what we should do now to prepare as scientists tell us future summers will be longer, hotter and drier.

In his 2008 climate change report, economist Ross Garnaut AC wrote that "fire seasons will start earlier, end slightly later, and generally be more intense. This effect increases over time, but should be directly observable by 2020."

We have seen the catastrophic consequences of climate change this summer. While it may not be the only cause of these bushfires, we cannot ignore scientists who tell us their unprecedented severity is due to the effects of global warming.

In the 12 years since the Garnaut report, climate change and energy policy have been mired in party politics. For years, the AICD's members — through the Director Sentiment Index — have nominated climate change and energy policy as their top priorities for the federal government. The scale of these fires, their wide-ranging effects and impact on critical infrastructure show that the risks from climate change cannot be isolated and contained.

Australia needs a consistent and enduring bipartisan policy framework in the same way we approach defence and infrastructure — national challenges that extend beyond the term of any one government.

But we cannot think of the challenge through the prism of energy policy alone. We will need to transition the economy as we shift to less carbon-intensive forms of energy production and assist regional economies and communities through that transition.
We must foster innovation across the

economy to build our competitiveness. We must build and acquire the skills and capabilities the workforce and our economy will need, and adapt our education system. This is a "joined-up" policy challenge we must meet, aligning and focusing our national and state policy settings to prevent gaps and optimise our capabilities.

It is also clear from this crisis that Australians will not accept politics in federal-state responsibilities when lives are at stake. We need a pragmatic federalism with forums for cooperation between governments that can be convened rapidly at hours of need. Our preparedness at the national level will come under scrutiny in coming months. The AICD will be part of the conversation on whether we have the right national and state governance structures to address urgent challenges that cross state borders and whether the Council of Australian Governments needs greater prominence.

We also need to listen to our emergency response leaders when they call for extra resources to confront the increasing threats they face. We owe it to those who have selflessly put themselves in harm's way to learn the lessons and prepare for the next emergency, in a world in which they will be more common.

Many Australians have friends, family or colleagues who have been directly affected. We will soon learn how many businesses and organisations have been devastated by the fires and their aftermath.

This bushfire season should prompt directors to reassess how extensively their organisations' risk management frameworks have dealt with the risks — immediate and secondary — from natural disasters and extreme weather.

Ensuring organisational resilience and the safety of staff is core to directors' duties. In its September 2018 report on climate risk disclosure by Australia's listed companies, the Australian Securities and Investments Commission said: "directors and officers of listed companies need to understand and continually reassess existing and emerging risks (including climate risk) that may affect the company's business".

Organisations also need to consider if their policies are adequate in supporting staff who are assisting in relief efforts. The volunteer spirit and generosity of the Australian community has been inspiring during this crisis. It is our responsibility to support staff with clear and certain policies when they make personal sacrifices to help their communities.

News coverage of the fires has turned global attention to Australia with pictures that conflict with our traditional image as a natural paradise of fauna and flora, and a safe and secure place for visitors and students. Globally there is a message of support and concern for Australians who have been impacted.

I recall the images in Dorothea Mackellar's *My Country* — "I love a sunburnt country... her beauty and her terror..." Australia remains a natural wonder despite the devastation of these fires, and as "...grey clouds gather and we can bless again, the drumming of an army, the steady soaking rain", we will recover.

To me, these are comforting images of endurance and resilience, and perhaps that's a stronger image to present to the world.

CHAPTER 20.

How do we stay close to our customers today?

This organisation put their future in the hands of its customers

Lucinda Schmidt

1 December 2019, "This organisation put their future in the hands of its customers", *Company Director*, December 2019, AICD.

Yarra Valley Water sought the help of its customers to assess its new strategic plan. The governance and culture lessons are relevant for all boards.

Imagine handing over your organisation's five-year strategic plan to 35 customers. Imagine paying those customers to debate the plan, reshape it and present it directly to the board. And imagine the board accepting all of the recommendations from this 'citizens' jury' and setting seven strict targets for your organisation to meet based on its findings.

Yarra Valley Water (YVW) did this two years ago. That bold approach encapsulates the transformation of Melbourne's largest water company during the past 18 years. YVW benchmarks as a top-performing utility for staff engagement, productivity and diversity, and also has a strong commitment to the United Nations Sustainable Development Goals (SDG) and innovative community programs helping victims of domestic violence and financially vulnerable people.

The company's journey has lessons for all directors. "Collaboration with the community is critically important for us as an organisation," says Sue O'Connor FAICD, who has chaired YVW since 2015. "No organisation is an island — it operates in a community, an economy and an environment. It's important for boards to think long and carefully about SDG or whatever mechanism, and which goals you can make the biggest societal impact on."

The transformation began in 2001, when a new head of people and culture used Human Synergistics' Organisational Culture Inventory tool to measure and map YVW's preferred, and actual, cultures. During the next nine years, the company experimented with various programs to close the significant culture gap, moving from competitive, power-based and avoidance behaviours to what managing director Pat McCafferty GAICD describes as "humanistic, constructive, achievement-oriented" behaviours.

"There was no silver bullet. We tried lots of things and some didn't work," says McCafferty, who joined YVW in 1995 and has been managing director since 2014. "We started to tailor the best bits from different theories to achieve a culture that was about the right thing to do and making a difference for the community and our customers."

Crucially, says McCafferty, the board has encouraged management to stay the course, although new directors often ask him, "What's all this about culture?"

"Then they see how open, transparent and collaborative we are, and they become champions of culture," says McCafferty. He adds that a 2017 Aon Hewitt Best Employer award with an 83 per cent engagement score from the company's 600-plus staff was icing on the cake. "For a large, government-owned organisation, that's pretty remarkable."

He also notes that in the highly regulated water industry, the state government sets water policy and keeps a close eye on financial, health and environmental issues. "That means the board is trying to get assurance we're complying with all that," he says. "That comes down to culture."

O'Connor, who meets weekly with McCafferty, usually face-to-face, also emphasises the important role of culture. "It's the 'secret sauce' of the organisation," she says.

"Boards need to be sure they spend enough time thinking about it, that the right resources and systems are being worked on and that the board itself is reflecting the culture it wants the organisation to have."

This year, for the first time, the YVW board participated in an annual culture review. O'Connor says the key message was: "How do we ensure we use our culture to do all the things we could do, rather than being conservative?

High-performing organisations have to strive for something. If you aim to be the same as last year, you'll be slightly worse."

More than a utility provider

YVW is aiming to go "from great to magnificent" during the next four years. Within that context, it makes sense the organisation sees its role as much more than providing water and sewage services to almost two million people and 56,000 businesses across 4000sq km. In 2015, it was the first water utility in Australia, and one of the first in the world, to sign the SDG commitment. "Our people came to me and said, 'This is the right thing to do,' so I just did it," says McCafferty. "I knew the board would support it. The SDGs are all about human health, the health of the planet and a fair and equitable approach for everyone. For us, it was a bit of a no-brainer to commit to them."

YVW is now well on the way to generating 100 per cent of its own energy by 2025. In 2016, it commissioned a $29 million plant to convert food waste to energy, which powers the neighbouring recycled water plant and feeds back into the grid. As well as supplying 25 per cent of the company's energy requirements, it uses 170 tonnes of organic waste each day that would otherwise go to landfill. A second plant, scheduled to open in 2021, plus solar panels in the car park at head office in Mitcham, in Melbourne's outer east, will account for another 50 per cent of YVW's energy needs.

Under the SDG principles, the organisation has also committed to doubling its social value by 2020. In 2017, it launched a domestic violence support program in response to Victoria's 2015 Royal Commission into Family Violence, which found that providers of essential services have an important role to play. McCafferty asked the board to listen to recordings of several phone calls to YVW's contact centre, where women were crying and their partners yelling threats to not pay the water bill. "There was not one dry eye," he recalls, adding that the whole board then attended a training session on family violence.

Other initiatives include the Choose Tap promotional campaign, which urges people to opt for tap water instead of bottled water or sugary drinks. It donated a "fatberg" to Melbourne Museum to highlight how wet wipes combine with oils and fats to create huge sewer system blockages. And YVW organised the

Thriving Communities Partnership — with 45 partners and 170 participating organisations from the water, energy, banking and telecommunications industries — to ensure vulnerable people who can't pay their bills have access to essential services.

Of course, as O'Connor acknowledges, there is a limit to how far YVW applies the SDG principles, keeping in mind its purpose "to provide exemplary water and sanitation services that contribute to the health and wellbeing of current and future generations". For example, its expertise in bugs and microbes means converting organic food waste into gas makes sense, but converting plastics or paper does not.

Board contribution

"What does a water utility of the 21st century look like, what is its role, where does it start and finish — this is where the board is making its biggest contribution at the moment," says O'Connor. "We have lots of conversations about purpose, dealing with multiple stakeholders and collaboration with the community."

The board has also increased its focus on risk management and how it balances short- and long-term risk. O'Connor says it needs to balance six-month and 100-year timeframes, bearing in mind that recent repair work was on 140-year-old pipes laid because of decisions made in the late-19th century. Other significant challenges include projections of the Melbourne population doubling by 2031; a 30–50 per cent reduction in stream flows during the next 30 years because of climate change; and 50 per cent of customers at times struggling to pay their utilities bills.

The nine-member board is reviewed by an external specialist every two years. The most recent review said the board had great clarity and alignment on YVW's purpose and strategy, and a constructive approach. The main area for improvement was for some directors to learn more about the water industry and make greater use of their expertise in other industries. "The thing you always worry about in a high-performing organisation is hubris," says O'Connor. "Holding up a mirror is very important."

The banking Royal Commission also highlighted another danger. "There's a real risk around not collaborating fully and authentically with our community," says O'Connor. "The Millennium Drought [2001–09], when Melbourne decreased its water usage by 30 per cent, reinforced how much the community is prepared to engage with what needs to happen. We need to use the community as a true collaborator."

Citizens' jury

Yarra Valley Water took listening to their customers to an unprecedented level.

When preparing for Victoria's Essential Services Commission's five-yearly prices review in 2017, Yarra Valley Water gave its draft strategic plan to a "citizens' jury" of 35 customers, selected from 30,000.

The jury was asked to answer one question: How do we balance price and service in a way that's fair for all?

Across five Saturdays and one evening, the jury nutted out what they expected (safe drinking water, reliable service, timely response) and what they valued (fair access for all, water conservation, protecting the environment). Two or three directors sat in on every session, but were not allowed to speak unless asked a question.

"On the first Saturday, the facilitators asked the jurors what was on their minds," says O'Connor, who sat in on three sessions. "Every issue they raised was something we'd discussed as a board, except one — and I realised that was the one the board should discuss. I have great faith that, given the right information and the right processes, a citizens' jury can be invaluable."

Within 14 days of the jury presenting its 10 recommendations to the board, eight were accepted in full and YVW went beyond what was recommended for the other two. Seven targets were set to reflect what customers expected and valued.

"We are all-in on those," says McCafferty, adding each missed target means the company returns $1.5 million to its customers in reduced prices.

It met five targets in the first year — factoring in that a hotter, drier year put extra strain on delivering water and sewerage services — and returned $3 million in price reductions.

"We step back while jurors set the future of the business," says McCafferty. "You're putting your faith in the wisdom of crowds. For us it was the natural next step to really get the juice from community insights."

How Yarra Valley Water accelerates innovation

We don't call it innovation, instead we ask what are the next big steps we need to take to achieve our strategic goals. We do not just focus on technology and digital. It is about re-imagining your business models. We are driven by our purpose. Improving the health and wellbeing of present and future generations drives everything that we do. Our strategic priorities and creating value for communities are the lights on the hill.

The third element is culture, ensuring people understand what their role is and that they are encouraged and have permission to try new things as long as they understand it must relate to the strategic priorities. People need to understand what risks they can take and that it's OK if not everything works.

We do regular testing of staff on how well they understand the strategy and priorities. In our last survey, 96 per cent were able to say they understood the strategy, priorities and how their role contributed to that.

Items relating to the systems and processes around leadership culture are regular board agenda items at committee and board level. We carve out time in our board agenda — every second meeting — to look at what are the big and small things we need to do.

We use committees for oversight so we have more time in the board for foresight. Also, we spend a lot of time talking to people outside the utilities sector on things outside the industry.

Director development is a big focus. Because this is a different way of thinking, you have to be overt. We visit other organisations and attend conferences. We've looked globally for some courses, but not found what we wanted, so we found it better to visit organisations and see what they are doing.

I can't overestimate the importance of clarity of purpose and strategic priorities, and a constructive culture. If you give staff the skills, direction and support, then magic happens.

Australia's public sector is missing this one vital area for digital transformation

30 October 2019, "Australia's public sector is missing this one vital area for digital transformation", *Company Director*, November 2019, AICD.

To strengthen Australia's public sector and ensure better accountability, organisations must digitally transform and maintain a strong customer focus.

What would happen if you designed services for the disabled to look and feel more like Uber? Imagine if people with a disability were able to control the process of finding the carers they needed to match their interests, needs and circumstances? And what if, in the process, people who wanted to support people with disabilities could find the right mix of time and commitment to suit their needs and have all of the insurance, tax and payroll issues taken care of – and have their pay and conditions protected as well?

That's the kind of thinking that inspired Hireup, an Australian venture started by brother-and-sister social entrepreneurs Jordan and Laura O'Reilly. They've harnessed the power of cloud-based digital platforms and human-centred design to make the process of finding and employing carers for people with disabilities faster, cheaper, better paid and centred on the person with disability. During the past five years, that equates to 1.9 million hours of support provided, 21,000-plus connections made and $13.3 million saved.

How do some of the basic interactions with government get to be not just faster and more convenient, but redesigned around the needs and preferences of the people who use them?

Service NSW has grown over the past seven years to be one of the world's most effective customer service platforms (physical and virtual). It has stripped out costs, improving quality and often exceeding the expectations of customers. It consolidated 100 websites, 400 different shopfronts, more than 100 call centres and 8000 phone numbers. In August, it was listed in the top 10 of the "Great Place to Work" rankings — a first for a government agency.

Globally, Denmark, Singapore and the UK are the governments Australia is looking to for inspiration. The Danes have a common identity platform and have mandated the use of digital services – no printing of paper forms for them. Singapore has invested heavily in the use of connected data and upskilling their public servants in digital tools and techniques. The UK has built, it says, "digital services so good that people prefer to use them" — gov.uk is a central portal for all online government services. These are stellar examples that Australia could well emulate.

These are all instances of digital transformation in government and the public sector. They are vital to Australia's economic and social progress — as well as strengthening democracy and accountability, we argue they should be the subject of a "national mission" to dramatically step up the pace, intensity and impact. In Australia, the digital transformation story for government and the public sector is missing half its plot — the most interesting half. We have defined "digital transformation" as a way of rethinking the entire business of governing, government and the work of the public service; to better serve citizens and customers in a democratic society, and across all levels of government.

While there are great examples of digital technology making big improvements to current government and public sector services and practices, there aren't as many where digital disruption has forced bigger changes to the way we do government in Australia, as it has in areas such as retail, entertainment and banking.

As Peter Shergold AC FAICD, former head of the Department of Prime Minister and Cabinet and chancellor of Western Sydney University puts it: "Billions of people can stay connected through pervasive mobile devices, access vast amounts of newly created data, be assisted by capable machines and robotic process automation, and yet find it ever harder to talk to each other about how to find solutions to the wicked problems of human existence."

We agree and have mapped out some of the ways in which, by taking a more ambitious look at what technology and digital tools can offer, we can change the way we develop policy, impose regulation, and design and deliver services.

What we should be seeing are much bigger changes in both the work of the public sector and the way the public sector works. What we ought to expect — through the imaginative use of new technologies already impacting how we learn, are entertained, shop, travel, and exchange trust with business and each other – are improvements in levels of integrity and legitimacy in the role, purpose and function of government and the public sector.

These are technologies becoming more familiar and pervasive — such as websites that serve up personalised content, chatbots, cognitive assistants such as Siri, Alexa and Echo, and customer improvements and data insights using AI and machine learning. They are making their way into government and the public sector. Their full potential — and learning how to handle the risks as well as the opportunities they bring — needs to be tested more urgently and at scale. This has to match digital transformation's significance for success in the digital global economy and for a stronger and more accountable democracy.

What to do?

- Declare a "national mission" to dramatically up the ante on the collective efforts of governments across Australia to speed up and intensify investment and invention in our digital government journey.
- Match that with more and better-focused investment, especially in the necessary shared public digital infrastructure, which ought to serve a national purpose.
- Change the way digital tools, platforms and services are designed, procured and implemented to maximise speed, value and reuse.
- Lift the skills and capabilities of digital ways of working, something the NSW government is now starting to do.
- Bring together clever, inventive and experienced leaders, thinkers and practitioners in policy, technology and innovation to take a collective approach — not so much to digital transformation but, more fundamentally, to the transformation of government itself.

Getting this right is about a lot more than saving money and time, and making life more convenient for citizens and customers of government services. There is nothing wrong with that, of course. We need more and better ways to keep improving how we "do" government.

But what's really at stake is something much bigger — inclusive prosperity, trust and confidence in good government, and finding solutions to some of the big challenges we face so people live their best lives with hope and opportunity.

It's that important.

CHAPTER 21.

Sports governance

Governing the Sydney Hobart Yacht Race

Paul Robinson

1 December 2019, "Governing the Sydney Hobart Yacht Race", *Company Director*, December 2019, AICD.

Commodores Tracy Matthews and Paul Billingham reflect on a board partnership behind the world-famous event.

Boxing Day sees Sydney Harbour churned into a washing-machine frenzy by hundreds of spectator craft, not to mention a fleet of more than 100 racing yachts jockeying for position before rounding South Head and setting sail for Hobart, 628 nautical miles (1163km) away. Hundreds of thousands of people are crammed into every vantage point on the foreshore to watch the start of one of the toughest bluewater races in the world.

The Rolex Sydney Hobart is a world-scale sporting contest and for the past 74 years it's been run not by a government, federation or peak body but by two sailing clubs, the Cruising Yacht Club of Australia (CYCA) and the Royal Yacht Club of Tasmania (RYCT), with the bulk of the hard yards handled by crack teams of volunteers.

This year is the race's 75th anniversary. With an expected 170 yachts, the fleet will be double its normal size, throwing up unprecedented logistical considerations. The on-water aspect of the race, from the starting gun to race end at Hobart's Constitution Dock, is handled by a professional team; the land-based activities by volunteers. As the 2018 race finished, planning for the 75th began. For the commodores involved, effectively chairs of their respective boards, this means cooperation is crucial.

Cooperation counts

Headquartered in Sydney's Rushcutters Bay, the CYCA boasts 3000 members and 212 boats on its marina. Billingham has been on the board for 14 years, this year his last as commodore. The CYCA owns the Rolex Sydney Hobart event, but the contribution of its RYCT "finishing partner" in Hobart towards what is now a weeklong celebration of the race's completion is essential. Billingham values a relationship grounded in trust and 74 years of history.

"Both clubs are volunteer organisations — they have professional management, but essentially the boards are doing this for love of the sport and their clubs," he says. "The relationship between the two commodores is important, not so much in terms of the details of the race organisation, but in ensuring the checks and balances are in place and there's a real understanding about what we're trying to achieve and how we guide our executive towards that outcome."

Matthews has been a RYCT member for 24 years, joining the board in 2008. This is her third year as commodore and she says her long personal relationship with Billingham makes it easier for the two to work together.

"Coincidentally, we're both chartered accountants by training, and it helps that we have some common acquaintances," says Matthews. "We've had a high level of trust between us right from our very first discussion about our desired outcome. If we're clear about what our purpose is and make our decisions in the best interest of the organisation towards achieving that purpose, we can't go far wrong."

The personal relationship between the pair dates back to 2013, when Matthews was appointed RYCT rear commodore and a conscious decision was made to widen the club-to-club bonds. "Prior to that, the relationship was only at the commodore-to-commodore level and we felt to have a good succession of relationships, it needed to be deeper than that," says Matthews.

"That year we started involving commodore, vice commodore and rear commodore in the club-to-club relationship building. I also shared a view that for the 75th Sydney Hobart to be successful, it needed to be successful for our clubs. We needed to be making decisions in the best interests of our clubs and of our members. Otherwise, why as an organisation would we be doing this? We made a decision to work towards the 75th with the view of making it a celebration for both of our clubs."

Billingham regards the twin-club relationship as an organic development that has adapted as required. "The challenge in clubland is in the way the constitution is put together," he says. "The CYCA constitution requires our entire board to be re-elected every year. It's quite hard to bring succession and continuity to the board, but both clubs have sought to do that. We've built a number of relationships among the senior ranks so that the two boards and CEOs work more closely beside each other. The committee structure works well, but you've got to put effort into it. It's not just a question of ringing up to have a conversation about the race. We do a lot more partnering in other activities and cross-promotional events. It's almost holistic."

This broader relationship during the past six years has contributed to an expansion of the race finish experience, with the development of an event village at Constitution Dock. "The welcome the competitors get in Hobart is fantastic," says Billingham. "It's become a real destination, a five-day party with entertainment and fireworks. That's happened because [both clubs] saw an opportunity to celebrate the finish. Innovation of an established, well-known event is important, and that's the conversation I have with Tracy — how do we look at this and make it better?"

Growth of governance

As the Sydney Hobart has grown to become a world-class sporting event, improved governance structures have become imperative. Matthews notes the volunteer-driven nature of sporting clubs puts an "interesting" complexion on the required reporting and governance structures. "We have boards that oversee the operations of the club, then we have committees of volunteers sitting alongside the professional staff," she says. "We've done a lot of work over the past six years to clarify roles and responsibilities — not just between volunteers, staff and the board in one club, but between the organisations."

The disastrous 1998 race, in which severe storms sank five yachts resulting in the loss of six lives, made a clearer governance structure and lines of responsibility imperative. Billingham agrees that clarification of the governance framework and responsibilities was necessary, but notes the race was even then regarded as one of the safest in the world, with the entry qualifications, medical, safety and radio checks already rigorous. "What 1998 did was speed things up," he says. "We're not complacent, but we're really just polishing what we have, finessing it through our constant review process. We've got a highly experienced race committee, with a number of senior lawyers and barristers, even a judge, and we're constantly trying to find the holes in what we do. The post-race debrief takes place in early February. All of the key aspects of the race are assessed then our planning and risk committee gets those reports."

However, there is no way the event would run without volunteers, says Matthews. "We just could not perform the tasks over the period of time required with paid employees alone. For example, in Hobart we man five different sites that must be available 24/7 from the time the first boat leaves Sydney to when the last boat ties up in Hobart, five days later."

However, despite the heavy reliance on long-term volunteers, some of whom have worked on the race for more than 25 years, Billingham and Matthews are adamant the Sydney Hobart is a totally professional undertaking. "Paul and I don't get involved in the day-to-day operational matters," says Matthews. "All communications between the clubs at an operational level are through the general manager and CEO. Our volunteer committees report through the general manager."

Risk ratio

Billingham says much of the governance revolves around mitigating risk. "A lot of things can go wrong," he says. "We've brought in standard operating procedures for our volunteers, everything from understanding the safety regulations to how they interact with visitors and control crowds."

The logistics are mind-boggling with hundreds of thousands of spectators, hundreds of competitors, a fleet of racing yachts and intense media scrutiny. "Sydney Harbour on a sunny Boxing Day is a nightmare," says Billingham. "We've got to make sure racing boats don't go into the spectator fleet, so we work with Maritime Services to manage that risk. We've got 16 helicopters plus drones in the sky, so we work with the Civil Aviation Safety Authority to mitigate that risk. Most of our year is spent with the planning and risk committee, making sure we've sorted every possible risk and know where the challenges are."

He stresses that's why good partnerships are important. The event partners with state governments, Waterways and Channel 7. In Hobart, TasPorts, Tourism Tasmania and Events Tasmania are key stakeholders.

"You put in place what you can and make it very clear what you can and can't do," he says. "Our biggest challenge [in Sydney] is the exclusion zone. The Water Police operate that and limit the number of boats allowed in. This year we're going to run three start lines to try to stop boats running into each other."

For the 75th, a major challenge is accommodating the racing armada in Hobart. "Our biggest problem is how to fit all the boats," says Billingham. "Normally we get 100, this year we'll have 170. And the boats today are a lot bigger, their draught is deeper and they're not equipped to berth alongside a rock wall."

Media spotlight

As with all premier sporting events, media attention can be relentless — another risk that Billingham says the Sydney Hobart planning team factors into its calculations. "We have a detailed emergency management plan, which we update every year. We run training and scenario planning. The event is in the global press spotlight for five days. As we found last year with the protest with *Black Jack* and *Wild Oats XI*, the press doesn't wait — they want an immediate response. They're literally sitting with us in the finishing area and if there's any issue, you can expect 20 cameras in front of you wanting answers. We have packaged responses for different scenarios that we can roll out, so we're not thinking on the front foot."

With so much on the boil as Boxing Day looms ever closer, both commodores are confident their personal relationship is one thing that's under control. "Paul and I will touch base if there's something we need to have a chat about," says Matthews. "There have been occasions when we've needed to have strong discussions, but because we have a good relationship and a constant focus on what our outcomes need to be, we've been able to resolve them and move forward."Billingham agrees. "Tracy and her partner are spending Christmas Day at my house. It's way beyond a business relationship — it has become a friendship. And my vice commodore will succeed me, her vice commodore will succeed her, and the relationship will continue. The idea is to make it seamless and that builds confidence and trust. It means everything runs a lot smoother and when you have a problem that could become a huge issue, you just pick up the phone and have an honest conversation."

Will Cricket Australia ever regain the public's trust?

Ashley Gray

1 October 2019, "Cricket Australia ever regain the public's trust?", *Company Director*, October 2019, AICD.

Eighteen months since Cricket Australia's ball tampering scandal in South Africa, the new CEO and chair outline how they are working to restore faith in the game through better governance.

Kevin Roberts normally drives to work, but on the first day after the 2018 ball-tampering scandal in Cape Town, South Africa, he caught the train. "I was carrying a Cricket Australia (CA) backpack," recalls the CA CEO. "I found, subconsciously, I had turned that backpack around so other people on the train couldn't see the logo. For the first time, I found myself unable to be proud of the sport I loved."

Roberts, a former NSW Sheffield Shield batsman and lifelong cricket devotee, wasn't alone in feeling devastated by the revelations of "Sandpapergate". A nation of cricket tragics wept. Premeditated illegal ball tampering, endorsed and encouraged by the test captain and his deputy — and caught on camera for a shocked sporting world to digest — shone a light on the "winning without counting the costs" culture of Australian cricket. Key to the controversy was that cricket is more than a game, it's a $400m business (2017–18 total revenue).

On-field aggression and combativeness — the so-called "Australian way" — dated back to the eras of Ian Chappell in the 1970s and Steve Waugh in the 1990s, but had been, for the most part, successfully self-policed, with a general agreement never to "cross the line" — even though consensus outside Australia was that "the line" was quite often crossed.

During the heated test series in South Africa, it wasn't so much that captain Steve Smith, vice-captain David Warner and Cameron Bancroft had crossed that line, it was more they didn't seem to know where it was, or if it even existed anymore. Australian cricket's moral compass was askew.

The ramifications were swift as CA scrambled to repair the public's trust. The board slugged Smith and Warner with 12-month bans, and a nine-month suspension for Bancroft. Coach Darren Lehmann quit amid claims he'd enabled a "win at all costs" culture. The carnage wasn't confined to the dressing room. Fingers were pointed at Cricket Australia and the board, which, it was claimed, was guilty of tolerating the team's worst excesses.

When Smith later revealed to Fox Sports that then CEO James Sutherland had told him, "We don't pay you to play, we pay you to win," it seemed to confirm everyone's worst fears. Board member Bob Every AO FAICD quit, citing irreconcilable differences with then chair David Peever. "I opposed David Peever being re-elected," he says. "Being a lone voice, I resigned on principle."

Former Australia captain Mark Taylor joined him later in the year, along with fellow board member Tony Harrison. The long-serving Sutherland, now tethered to a discredited ethos, also called it a day.

The public soul searching wasn't over. Under pressure to drive change, Peever announced an independent review into the organisational culture of the game to be undertaken by not-for-profit organisation The Ethics Centre.

It turned out to be one of the biggest kicks up the backside in Australian corporate history. Conducted by the centre's executive director, Simon Longstaff, it found Cricket Australia to be "arrogant and controlling", treated its players, who behaved as if they were in a "gilded bubble", as "commodities", and "failure to create and support a culture in which the will to win was balanced by an equal commitment to moral courage and ethical restraint". The review also accused Cricket Australia of "bullying" people it disagreed with. Proffering 42 recommendations for change within the organisation, many relating to corporate governance, the review was damning. Peever left his post within a week of its release. So, too, did high-performance unit manager Pat Howard, and general manager of broadcasting, digital media and commercial Ben Amarfio, architect of the sport's record $1.2 billion TV deal, who was escorted from CA's Melbourne head office.

Righting the wrongs

If 2018 was Australian cricket's annus horribilis, it was also a time of renewal and refocus. Part of that renewal involved Roberts, who was promoted into Sutherland's vacant CEO position, and Earl Eddings GAICD, former president of North Melbourne Cricket Club, who became the new chair. Eddings had served on the board since 2008 and Roberts also had board history, but was best known to the public for handling the protracted, and at times rancorous, player contract negotiations with the Australian Cricketers' Association (ACA) — a series of standoffs in 2017 that did neither side any credit.

Their combined love for cricket and deep desire to steer the game to a higher moral ground, restoring the public's faith in a sport that once defined the nation, helped them navigate through the most difficult period in Australian cricket history.

In hindsight, Roberts admits the last year and a half — the review in particular — served to shock the organisation out of its comfort zone. It also forced him to lift his game. Playing professional cricket in the public spotlight had hardened him to criticism, but none of his previous management roles with sporting apparel brands Adidas and 2XU had prepared him for the intense public scrutiny that comes with one of the most high-profile executive roles in Australia.

"My take on the review was it was referring to the real experiences people had with Cricket Australia," says Roberts. "It's not for us to dispute how we've made them feel in those interactions. It provided a great opportunity for the organisation to reset."

As he had sought to do when the sandpaper scandal unfolded — holding regular meetings at Cricket Australia's headquarters in Jolimont Street, Melbourne, to reassure staff they were valued and in no way responsible for the events in South Africa — Roberts began the push to make CA a more inclusive and empathetic organisation. No longer would it "privilege combativeness over collaboration" as The Ethics Centre maintained it had. "I came in during a period when it was really important to rebuild trust," he says. "I'm proud we are now committed to being a purpose-led organisation. We are serious about living up to the expectations we have of ourselves and the community's expectations."

Director action

Cricket Australia chair Earl Eddings GAICD on how to build a strong and cohesive board

"You are a custodian of whatever case you're looking at. You have to try to put that organisation in a much better spot while you are there. Your needs are superfluous to the needs of the organisation."

"You need to have a lot of courage, especially in a crisis. When the media gets a sniff of blood, they go hard at you. But you have got to hold true to your beliefs and the board. And the board has to be courageous together."

"Be very clear about what the board and the organisation is trying to achieve. Any strong strategic plan and understanding of the landscape in which you work is really important so you don't get distracted by issues. Cricket, and sport in general, are very issue-rich environments, so you can easily get distracted and be reactive to what is coming out in the media. Understand where the light on the hill is for your organisation."

"Have a lot of honest conversations at board level. If things aren't working, is it the board, management or a combination of both? It comes back to having the courage to make the hard decisions when you need to make them."

Restoring trust

The term "engaging stakeholders" is possibly the most overused phrase in the corporate world. But Eddings knew it was essential to reinvigorate faith in cricket's broad church and reconnect with everyone from the ACA and state associations to sponsors, the media and grassroots clubs. That would mean the board becoming more operational and taking a greater interest in management's progress. "The mantra we have had is, 'Put cricket back into cricket'," says Eddings. "Making sure our stakeholders are being heard and us being far more respectful to them. Making sure our volunteers, our grades, people who play cricket around Australia... OK, these guys are listening, they're authentic and have the best interests of cricket at heart."

For Roberts, the blurring of the lines between board and management was a necessary development. "As you would appreciate after the events of last year, the board needed to know the organisation was operating in the optimal way and genuinely changing. As CEO, or in a management position, it would be easy to push back on that."

The relationship between the board and executive is a lot closer — they continue to have a three-day brainstorming session every year — and while the partnership between Roberts and Eddings may not be quite as fruitful as the 1960s test batting partnership of Bob Simpson and Bill Lawry just yet, their respect for each other is the cornerstone of the new administration.

"The word I'd use to sum up the relationship between Earl and myself would be 'trust'," says Roberts, who converses daily with Eddings. "When you have trust, you can address all the things you disagree on. But you're doing it in an environment where you know it's about working with each other in the best interests of the organisation."

The board is now also a tighter unit. It needed to be after the strain of Sandpapergate and the falling out between Every and Peever. "There is more teamwork now," says Michelle Tredenick FAICD, a Cricket Australia non-executive director since 2015 and chair of its new people, culture and ethics committee, which includes Eddings. "You come through a crisis together and build a lot of bonds and trust. Earl is very focused on our relationship with our stakeholder and we are much more involved with all of our partners."

Eddings refuses to be drawn on the argy-bargy that dogged the board at different points last year, but acknowledges it was a time when tough decisions had to be made. "We've had a 30-40 per cent turnover in our board and probably more in our management team," he says. "We made some really hard calls. There were changes at management level that were difficult, but necessary. You build relationships with people, but sometimes you have to make a call that best suits the organisation."

A key development arising from CA's annual brainstorming is that every paper submitted to the board must now outline risk and ethical concerns. Because lack of ethics was at the core of the Longstaff review's scathing critique of the organisation. Its primary recommendation is the establishment of an ethics commission, with members nominated by CA and agreed on by state associations, the ACA and Cricket Umpires Australia to "hold all participants in Australian cricket accountable to the ethical foundations of the game". Neither Roberts or Eddings want it to be a "tick and flick" formality exercise, and the chair says the first meeting of the Australian Cricket Council in a few months — another Longstaff recommendation — will determine its reach and composition.

Eddings notes executive remuneration will continue to be assessed 70 per cent on performance and 30 per cent on values. A new online system will enable stakeholder feedback on behaviours.

Change on the way

Cricket Australia says it is busy addressing 41 of the 42 review recommendations. Excusing star players from Twenty20 internationals to play Sheffield Shield and grade cricket proved impractical. Some recommendations include tying a "character and behaviour" clause to the annual Allan Border Medal award and senior management receiving additional training to develop communication skills. But none of it will count for anything if the men's test team is still trash talking opponents on the pitch.

Under coach Justin Langer — whose appointment was questioned by some who thought he had contributed his fair share to the sledging culture CA is trying to moderate — code-of-conduct breaches have dropped to zero and the board has licensed selectors to use character as well as performance as criteria for selection. A review led by former test opening batsman Rick McCosker led to a players' pact. Together with the concept of "elite mateship", scoffed at by the grizzled old guard, it has helped reinforce the commitment to a new "Australian way": less yappy mongrel, and more stoic bulldog.

"In the context of the men's test team, we have got me, Justin Langer and [captain] Tim Paine," says Roberts. "I can safely say we're all very strongly aligned. Our non-negotiable expectation of ourselves and the players is to compete with respect on every ball."

After the drawn-out pay dispute over revenue sharing soured relations with the ACA, the Longstaff report made a point of instructing the warring parties to "establish a constructive working relationship". Roberts and ACA president Greg Dyer were at the coalface of those difficult contract negotiations, but with goodwill on both sides, the two organisations are now focusing on common goals. "It's very positive," says Dyer. "Earl and I talk once every three to four weeks. We meet at board level and if there are issues bubbling, I'll text or email him. Previously, interaction between the boards was pretty much non-existent."

A work in progress

The rehabilitation of Cricket Australia hasn't been without its hitches. Recently, *The Sydney Morning Herald* journalist Malcolm Knox accused the organisation of inflating participation figures to attract sponsorship dollars, while club membership was left to flounder. Roberts issued a public rebuttal, but the perception remained of an accountability problem — a reminder there is still work to be done to address issues of transparency. It also raised questions in the wider cricket community about whether CA was fair dinkum in its commitment to change.

"Our key learning out of that is we need to be more specific in terms of how numbers are counted," says Roberts. "It's on us to make sure we're clearer."

Eighteen months after Cape Town, both executives are satisfied CA is getting its house in order — but not complacent. "With culture, it's something you've got to keep working at, keep your eye on, keep nurturing," says Eddings, who has ensured he will remain Cricket Australia chair for the next three years by taking one of the independent director roles on the board. "It's not: we've done the ethics report, so now we're right."

Roberts concurs: "We have made a commitment that it is not a box-ticking exercise. We say we can focus on this recommendation, be true to it and at the same time take it a lot further. I'm really proud of the way the team carries itself on and off the field." It's safe to say his backpack is turned the right way around now.

CHAPTER 22.

On boardroom leadership

Issues facing directors today as they prepare for the future

Richard Goyder AO FAICD
Chairman, Woodside Energy Ltd, Qantas Airways, AFL Commission

As boards face increasing scrutiny of their deliberations and decisions, it is vital that directors do not respond by retreating into a mindset that is so risk-averse it stymies investment, innovation, and creativity. Hunkering down may seem the easiest option but does not necessarily deliver the best outcomes for companies and their stakeholders. No company wants to end up in a place where inaction is the default position for fear of failure or negative headlines, or concern about regulatory 'overreach'.

Business is all about understanding and taking appropriate risk, and it is incumbent on boards to enable management to make the right decisions, in the knowledge that some risk is inevitable. There are fundamentals you need to get right, around integrity and values, then you do need to ensure systems and processes are able to be relied on.

Boards need to find a way to help management do things, rather than finding ways to stop them. Reputation is crucial, but the best way for a company to build its reputation is through actions, not through inertia. The role of the board is to ensure management have the time and ability to build the company sustainably, considering the needs of all stakeholders. When that's done properly, reputation follows.

There are times when immediate challenges demand attention — for instance, if you face a crisis or big acquisition — but it's important that a board factors in time for long-term strategy, innovation and critical thinking. Are we making the appropriate investment? Are we allowing appropriate risk taking? Are we taking a longer-term view?

No board can foresee all the risks. But we can make sure we are challenging the status quo while giving management teams the capacity to consider and implement strategies that are going to be better for the company over the long-term, even if they involve a hit to short term earnings.

It is essential to have a culture that accepts that mistakes happen. Innovation can't be outsourced or confined to a bubble, it has to be mainstream. When things go wrong, it is crucial that mistakes can be elevated appropriately and quickly. That's your safety valve — bad news travelling faster than good news so that you can deal with it.

Board composition

In some ways, we still run boards the same way we did 30 or 40 years ago, even though communications technology has changed significantly in that timeframe. For instance, there is scope to change how boards meet and make decisions to take account of the fact it is now much easier to keep people informed.

Advances in technology also mean that directors now need to be across topics ranging from data science-driven improvements in safety and medical research to the challenge of cyber security. Boards are going to need to bring in new perspectives, and directors are going to need new skills.

Diversity is incredibly important, and not just gender diversity. We need to ensure we have people with a diversity of technical skills and capabilities, diversity in age, as well as those of us who have scars from decisions that didn't go so well. These perspectives may come from directors, or from expert advisors to the board.

In the case of Woodside and Qantas, we are making capital decisions that are 20 plus year decisions and it is hard to know what the world will look like then. It is important that we have voices around the table that challenge how we are thinking about the future.

Social issues

Businesses in Australia have taken a stand on a range of social issues — and sometimes boards have been criticised for it. I think businesses have a right to say: this is what we think, whether on same sex marriage, climate change or reconciliation. At the end of the day, we are talking for thousands of employees to whom these issues matter, as well as many thousands more stakeholders amongst our customers, suppliers and communities.

Woodside and Qantas both take climate change seriously. Our stakeholders care about this and as a board we spend a lot of time making sure that we will continue to play a role in a lower carbon world.

This is why I object to groups that try to use our AGM as a megaphone for their political cause. An AGM is the one time a year that our shareholders, and in particular our retail shareholders, can question the board and management. Increasingly, they are instead hijacked by activist shareholders, who in some instances have only one share.

The issues these activists raise are material issues that we already take very seriously. But our retail shareholders, who have invested a significant part of their personal savings, shouldn't be sidelined so activists can pursue their political agenda. Our larger shareholders need to support us on this, rather than siding with simplistic AGM resolutions.

Personal reflection

Despite its challenges, I love being a non-executive director — I'm learning all the time and the journey continues. There are inevitable risks, you won't always make the right decision and there will be regrets. I regret that we at the AFL did not speak out sooner against the racist booing of Adam Goodes. If you know what's right, make sure you enunciate it, be really clear about where you stand and put processes in place to make sure you don't get it wrong in the future.

While I’m passionate about my board roles, I don’t believe executives should automatically think the next logical step is being a non-executive director. By its definition it is non-executive, so you have to be able to take a step back from the day-to-day and some people struggle with that because they are used to having their hands on the lever.

My advice is to really reflect on it, be wise in choosing which company to be involved in and make sure you can create and add value because if you get it right, it can truly be invigorating.