AUSTRALIAN INSTITUTE *of* COMPANY DIRECTORS

Australian Governance Summit 2017 Reader

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AUSTRALIAN INSTITUTE
of COMPANY DIRECTORS

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Introduction

The business environment in Australia is evolving rapidly with pressures from around the world influencing domestic activity. As organisations adjust and respond to these impacts, directors find themselves facing new and unique challenges in the boardroom.

In 2017, the Australian Governance Summit focuses on directing in a complex environment where governance is agile, moves beyond compliance and deals with the real world matrix of risk and opportunity. The event features the latest governance and business trends, robust discussions and exclusive networking opportunities for experienced directors and executives from across Australia. Attendees will explore current and emerging organisational issues and ways in which they can respond to these complicated and often interconnected challenges.

This *Australian Governance Summit 2017 Reader* follows the summit program and provides a selection of expert presenter submissions and recently published articles and book 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 during this year's summit.

CHAPTER 1:

How future-proofed is your board?

Five tips for hiring tomorrow's boards today

Peter Murphy
Queensland General Manager for Davidson Executive and Boards, September 2016, "Five tips for hiring tomorrow's boards today", *The Boardroom Report*, Volume 14, Issue 8, AICD.

If boards are going to be prepared for the future, they need to hire for the future. As the pace of change increases, it is more important than ever for boards to renew themselves. But how do they know today the people they will need tomorrow? Peter Murphy, General Manager, Queensland Davidson Boards and Executive, gives his tips for futureproofing your board.

The time and resources spent on working out the skills needed to replace a board member can be as exhaustive as the process of finding the right person. The age-old approach of identifying potential candidates from a narrow and closely known network is no longer acceptable as it leads to stale thinking.

While the old methods for hiring no longer work, the recruitment requirements of boards are becoming more complex. Boards increasingly need not only to hire for the skills they need now, but also the skills they will need in the future. It is a perplexing conundrum that many boards face: how do they hire today the board directors that they will need tomorrow?

The answer begins with getting the process right. If a board truly wishes to identify new and innovative thinkers that will be able to guide the organisation through change and disruption, they have to hire differently. Here are five tips on how to run a board recruitment process that is adapted to the realities of the ever-changing world and will renew your board for the future.

1. Find passive candidates

A passive candidate is someone who isn't actively looking for a new board role, but given the right opportunity would be open to discussions. If you don't look for the passive candidates, you haven't scoured the entire field. You could miss the person who is perfect for your board.

The CEO of Entelo, Jon Bischke, recently said: "One way big data is impacting recruitment is around using social data to identify people who are more likely to be open to new opportunities." In-depth data analysis can quickly summarise important information to help you identify passive candidates.

There are a few software programs like Promptcloud, Datahut, Heritrix that aid in the collation of available data. There are competitive intelligence tools such as BoardTracker, Copernic AGENT or CIRadar that can assist in identifying passive candidates and uncovering in-depth information on them during the search process.

2. Create a digital/technology sub-committee to identify candidates with the right skills

This committee would be in charge of identifying potential candidates who understand innovation and disruption. More and more Fortune 500 companies in the US are forming these sub-committees. For example, Morgan Stanley created a technology committee way back in 2011 to fill a gap that existed due to the board falling short on understanding IT issues.

3. Use psychometric, predictive tools

Innovative tools that look beyond someone's written CV are now readily available. Properly used, a psychometric tool can confirm deep personality traits of candidates and provide an overview of how they will work with the existing team and whether they match the board's desired skill-sets for the future.

4. Get serious about diversity

It is increasingly important for boards to be diverse so that they can perform at their best. It should be a mandatory approach. Think seriously about what diversity can bring to the board. Diversity of gender and race are incredibly important. Also look at the diversity of experiences, education and industry knowledge that could be helpful and that the current board members do not have.

By challenging your normal path when recruiting, you may uncover a truly independent thinker who will bring an outsider's point of view and challenges the status quo. If done successfully, this will bring a fresh diversity of thinking.

5. Recruitment should be speedy and efficient

While it is important to be thorough, it's important to send a message about how your organisation does business by how you recruit. By running a quick, understandable and efficient process, you are demonstrating to applicants that you are moving with the times. If a board takes too long to appoint or get back to candidates, they will lose top talent.

Inside the boardroom

Holly Ransom
Non-Executive Director, Port Adelaide Football Club, July 2016, "Inside the boardroom with Holly Ransom", *The Boardroom Report*, Volume 14, Issue 6, AICD.

In March 2016, Holly Ransom became the youngest director of an AFL club when she was appointed to the board of Port Adelaide Football Club. She is also CEO of Emergent, a leadership and strategic advisory company, a co-chair of the United Nations Global Coalition of Young Women Entrepreneurs and chaired the G20 Youth Summit in 2014.

A well-known commentator on intergenerational economic and social challenges, Holly spoke to The Boardroom Report about what young people bring to boards, how government and corporates can work together to solve problems and why sometimes we need to push ourselves to our breaking points.

Boardroom Report (BR): You consult to companies on how to get the best out of intergenerational teams. What advice do you have for organisations looking to attract and get the best out of young talent?

Holly Ransom (HR): One of the biggest things that I notice with top young talent is they want to be connected into an organisation that has a significant purpose – something bigger than delivering shareholder returns. To engage with this generation of young people you have to make them feel like they're engaged in something meaningful. On top of that they want to feel like they're more than a cog in a wheel. They need to be able to see the significance of their contribution to the broader mission of the organisation.

BR: Do you think it's necessary to have more young people on boards? What can they bring to a board?

HR: We're living through a great demographic shift where 50 percent of the world's population are now under 30. By 2025 three quarters of the workforce will be millennials. As a group they think differently, they have different career goals and have different tastes as consumers. So one of the big things they bring to the board is that understanding. They bring different perspectives to the board debate to create a more robust discussion.

BR: As the youngest person on many of the boards you're on, have you ever struggled with confidence to question managers and other directors who are older than you?

HR: It's definitely a challenge. There's always that difficulty of not feeling at place in the room and wondering if you can really ask that question. But you have to remind yourself there's a reason you're there. As a director, you've been brought in to contribute because the people around the table see the value in the experience and the insight you can bring.

BR: You are strong advocate of the government, not-for-profit and corporate sectors working more closely together. Are there examples you've seen or have worked on?

HR: An example would be the work we did through the G20 on youth unemployment. On an issue like that, the Government can't go it alone. You have to bring business to the table because ultimately it's businesses that create jobs, not governments. And you have to have involvement from not-for-profit organisations to put social protection mechanisms in place.

Generally I think we're just scratching the surface on how we think creatively about collaboration between the sectors. I look at something like US site challenge. gov, which allows the public citizenry and private organisations to submit solutions to challenges that we face as a society, and get really excited about the new ways of thinking that will open up.

BR: As a director, how do you go about making strategic decisions, say, with Port Adelaide's China strategy to spread the game there?

HR: The challenge for any board is looking at the organisation's mission and vision and thinking how do we make strategic decisions that position us to get there.

At Port Adelaide we think about how we support the club, how we take the club to new fans, where those fans come from, who they are and what they look like.

I think Port Adelaide is on to something quite incredible with what we're doing in China. We look at the statistics and it's mind-boggling. We had 4.2 million people watching our last game of AFL football there, the highest rating game we've ever seen.

BR: You recently completed an Ironman triathlon (3.86km swim, 180.25km cycle, marathon run). What did you learn in training and competing for the event that you have taken across to the rest of your life?

HR: The ripple effects of Ironman have been extraordinary.

One lesson, and it's counterintuitive, is the importance of training to hit breaking points. In an Ironman you don't know when or how often they're going to come but you can bet your bottom dollar they will. That was an interesting reflection on how we do strategic planning and operational rollouts in a corporate context. Quite often organisations aren't stress testing ideas and not preparing for those breaking points.

BR: You've talked about your struggle with depression a few years ago. You still managed to make an immense contribution to the community and issues that you care about during that period. How do you work through a low period to keep doing that?

HR: I was given a great piece of advice that you have to be ruthless on your energy management when you're in a state like that. Things that are an absolute priority and need to get done, make sure they still get done. But clear the rest away. You have to consciously think about what it is that energises you, both people and activities. You also have to make sure you're getting the right help. You can't expect yourself to find your way out of that pit on your own. I had a great doctor and a great psychologist, both of whom were a key part of helping me through that and I'm incredibly grateful to both of them.

BR: You and the organisations you work with have excellent engagement with stakeholders and customers on social media. How should an organisation go about building its social media profile?

HR: You have to have a genuine reason to be on social media. A lot of brands just feel like they have to be seen there. They're on there but they're using it as a one-way mouthpiece.

They're talking at people. They're not facilitating a two-way conversation. It's really important to understand at first why you're there. Is this a vehicle for answering questions? Is this an information outlet for people to reach us? And then you need to be able to back that up with how you engage.

You have to be genuine too. If your voice is inauthentic, people can sniff that from a mile away. People want to connect with real people, with brands that have a genuine voice and don't sound like some kind of robot.

Checklist for assessing board composition

AICD
2016, *Checklist for assessing board composition*, Board Composition, Director Tools, AICD.

The ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations 3e* (2014), introduced a number of substantive changes, including a number of governance practices that were previously noted only in the publication's commentary being elevated to recommendations, meaning that they must now be reported against on an if not, why not basis.

One such change, under Recommendation 2.2, is the need to disclose the company's board skills matrix which shows the mix of skills and diversity that the board currently has or is looking to achieve in its membership.

Many of the larger listed companies have been using a board skills matrix of some description for a number of years to assess the current skills, background and experience of those on the board and to identify any gaps that may exist. Until recently, however, most companies have chosen not to disclose this matrix and have instead limited their disclosures to a broad statement of the mix that the board has determined it requires and confirming that the composition currently satisfies this mix. Disclosing the company's board skills matrix will require careful consideration to ensure that, on the one hand, the disclosures are meaningful for investors and, on the other hand, do not include commercially sensitive information.

Other boards, particularly of smaller listed companies, may not have formal processes in place by which they assess their composition. However, putting more rigorous and transparent processes in place to assess board composition is good practice not only for listed companies but also for unlisted organisations with boards, including both for-profit and not-for-profit organisations.

Following are some key questions to assist boards when assessing whether their composition, and their approach to determining composition, is appropriate in their organisation's circumstances. These questions are applicable to both for-profit and not-for-profit organisations.

Board size

Is the board of an appropriate size, such that it:

- discharges its workload effectively?
- has productive discussions?
- is able to plan for orderly succession?

Mix of skills, experience and backgrounds

Does the board comprise an appropriate mix of skills, experience and backgrounds that aids decision-making and enhances board effectiveness, particularly having regard to the organisation's needs?

Is the mix of skills, experience and backgrounds on the board aligned with the overarching strategy of the company?

Do all current board members bring skills and experience that are relevant and useful to the board? While there can be a tendency to focus on having technical or other specific skills on the board, it is important to have a good cross-section and generality of skills present on the board.

Policies and practices

Does the board have appropriate policies and practices to enable orderly board succession?

Is the board, at appropriate intervals, undertaking regular and rigorous assessments of the skills, experience and backgrounds that are desirable on the board, with a view to identifying and addressing potential gaps?

Does the board employ a skills/experience/ background matrix as part of its assessment of its composition?

Has the board adequately considered its approach to gender diversity including, where appropriate, formulation of relevant policies?

Other considerations

Has the board properly considered and taken account of changes that are likely to occur in the short to medium term (for example changes to strategy, changes in the external environment) when determining its desired size and mix of skills/experience/ backgrounds?

To the extent there are gaps in desired skills and experience that reside on the board, has the board adequately considered whether and how the board might benefit from the professional development of current board members?

Beyond having the right mix of skills, experience and background present on the board, does the composition compliment the culture, engagement and style of the board?

Guidance for preparing a board skills matrix

AICD
2016, *Guidance for preparing a board skills matrix*, Board Composition, Director Tools, AICD.

Things to do:

- Identify desired skills, experience and backgrounds of the board as a whole under relevant headings, and in the form of a matrix, map these against the skills and experience of each individual board member.
- Tie desired board composition to the organisation's strategy and the key issues facing the organisation.
- Differentiate between the skills and experience expected for the board and for the chair.
- Separately prepare a skills/experience/background matrix for each board committee, where they exist.
- Include term expiry dates (where relevant) for each board member in the matrix to assist with succession planning.
- Use a rating scale when assessing the extent to which desired skills, experience and backgrounds exist on the board rather than a simple yes or no response.
- Have the board, or a designated committee (for example, nominations committee) critically examine the matrix at appropriate intervals (for example, annually).

Things not to do:

- Include basic competencies that are expected of all directors (for example, knowledge of director duties).
- Include vague or overly general sets of skills or experience. (Note that while this recommendation is against the inclusion of vague or overly general sets of skills or experience in the matrix itself, it should be acknowledged that a director who has broad, generalist skills and/or expertise is likely to be of significant value to a board, particularly where the board size is small.)

Things to consider:

- Whether changes are likely to occur in the short to medium term (for example, changes to strategy, changes in the external environment) that impact on the desired skills/experience/backgrounds mix of the board.
- The extent to which the board's composition takes account of different scenarios, which might call for a different mix of skills, experience and/or backgrounds.
- How defensible is the board's existing or planned future composition, for example if there are unsolicited approaches for board appointments?
- Whether it is necessary to have specialist skills, experience or backgrounds on the board, or whether it might be better to draw upon these from within management

or from external advisors (this will depend, in large part, on the size of the company and the board).

- When might it be appropriate to engage an external expert to undertake a review of board and board committee compositional attributes and needs?

- The extent to which any gaps identified in the matrix could be addressed through professional development of current board members.

- Whether any self-assessment process by board members adopted ensures a consistent approach and outcome. The company secretary or company representative may wish to audit this component to ensure accuracy and fairness across all directors.

- What is disclosed to external stakeholders, such as a statement of existing skills, experience and backgrounds that reside on the board? The board could consider developing an internal skills matrix that is easy to adapt for regular use and an external matrix that can be communicated to stakeholders.

CHAPTER 2:

Ethical decision making in the boardroom

Common traits found in high-performing organisations

AICD
September 2016, *"Common traits found in high-performing organisations"*, Membership Update, AICD.

How do employees tell the difference between a good and bad decision? Between right and wrong? Do they guess? Do they use their intuition? Or is there a foundation upon which they can make an informed judgement? Three leading experts discuss what it takes for organisations to survive and thrive.

If organisations want their employees to make the right decision, to do right by their customers and to perform well, boards and executives need to lead by example. They need to be able to articulate the standard of behaviour, the organisation's values (by defining what is good) and the organisation's principles (by defining what is right) in a simple, accessible and engaging way.

The issue of ethics and culture in governance and the role they play in organisational performance is one that has evolved significantly over the past 15 years. During this time we have seen organisations move from a governance framework that prefers compliance, to an approach which places increased value in its ethical foundations. In August 2016, the Australian Institute of Company Directors together with The Ethics Centre hosted an event in Sydney – the first of a two-part series – on ethics for directors and senior business leaders.

The evening featured talks from Dr Simon Longstaff AO, executive director of The Ethics Centre, Lisa Claes MAICD, managing director of Core Logic and Dennis Gentilin MAICD, author, speaker and corporate whistleblower.

These experts discussed the common traits found in high-performing organisations, the role and influence of ethics and how organisations can bounce back following an ethical failure.

Strong ethical foundations

"Imagine an organisation is like a building," Longstaff explained. "Its outside features – its windows and spires and towers – are what the public sees and are also what the organisation is known for. But if it is going to

be of any use at all, it has to be built on solid foundations. The core values and principles of an organisation is what lays the foundation and that is what ethics are all about."

Ethics are not the rhetorical flourishes on the wall. They involve thoroughly considered systems, policies and frameworks that embody the purpose of the organisation and help support it. It involves alignment of purpose, values principles and strategy, so that the image the organisation wishes to project is one that is in direct alignment with the actual experience of stakeholders.

When an organisation has strong ethical foundations, it can rely on its employees to make good, responsible decisions using the principles, purpose and values of the organisation as a guide. In turn, this will reduce the over-reliance on compliance and box-checking seen in some organisations. This is restrictive and poses its own systemic risks: where people lose their capacity to make sound and responsible judgements because they have never had to.

High employee engagement

"Engagement matters and is the skeleton of your organisation's culture. High staff engagement leads to higher employee retention, productivity and profitability. Strong engagement is not a result of one thing, but a lot of little things done well, often and shared from top to bottom. That is how the biggest difference is made: through attitude, artefacts, policies and procedures," Claes said.

Achieving high employee engagement is difficult to acquire and then sustain. It requires constant communication and 'pulse checking', the commitment of strong, positive role models and an understanding of the organisation's purpose and desired behaviours across the board.

Superior performance is linked to the discretionary effort of employees: the effort that employees actively choose to put into their jobs that goes above and beyond the minimum required. Nowadays, including and retaining people with an ethical allegiance to the organisation is absolutely critical. If an organisation is not what it professes to be, people will leave.

Transparency

"Transparency is always a good idea, but in the face of an ethical failure, it's absolutely critical to the survival of the organisation," Gentilin said. "How an organisation responds in the immediate aftermath to a crisis is what determines how it bounces back. And failing to act openly, honestly and transparently will only further erode your credibility when the facts finally surface – as they inevitably will."

Acting with honesty and integrity not only applies to how an organisation deals with its shareholders, customers and the media. It also applies to how an organisation functions internally: whether it is in the dynamics of a boardroom debate, the day-to-day dealings of executives or in regular communications to all staff.

Transparency should be a direct result of the alignment of purpose, values and strategy.

If an organisation does go through a tumultuous period, there is a tendency to shroud the crisis in secrecy and to shut down all lines of communication.

However, it is emerging from the crisis by fully acknowledging and learning from mistakes, then sharing these learnings that the ethical foundations of the organisation are strengthened.

Purpose

Dennis Gentilin MAICD
Founding Director of Human Systems Advisory, January 2017.

A global financial crisis, a warming planet, a litany of ethical failures and a host of other factors are driving an increased focus on corporate purpose. This movement has forced boards and executives to reflect, like never before, on the meaning of corporate citizenship. What is their organisation's reason for being? What role, if any, should their organisation play in helping solve some of society's most intractable problems? And perhaps more importantly, is this a passing fad or is this renewed focus on corporate purpose something directors should take seriously?

Suffice to say, the movement has significant momentum and my personal view is that it is more than a passing fad. But cynics still remain and some directors are far from convinced. My goal in this article is not to sway opinion, but rather to outline some of the benefits that can come from giving purpose primacy in your organisations and how one might go about discovering it.

To begin with, it should be noted that the benefits associated with defining and realising a virtuous purpose are broadly shared. It is not an exercise boards should engage in just for the public relation benefits (indeed it will inevitably fail if this is the primary driver). Done properly, it can reduce the likelihood of unethical conduct, elicit discretionary effort amongst an organisation's people, promote greater advocacy and loyalty for an organisation's brand, and ultimately lead to increased shareholder return.

The global financial crisis [of 2007-2008] is arguably the quintessential illustration of the potential ethical consequences associated with lack of purpose. In the years leading up to the crisis, parts of the financial services industry lost sight of their purpose. Money and money making was given precedence over service to customer and community, and the outcomes were catastrophic.

Mark Carney, Governor of the Bank of England, eloquently described the consequences of this orientation in a speech he delivered at the Conference of Inclusive Capitalism in 2014:

"In the run-up to the crisis, banking became about banks not businesses; transactions not relations; counterparties not clients … When bankers become detached from end-users, their only reward becomes money. Purely financial compensation ignores the

nonpecuniary rewards to employment, such as the satisfaction from helping a client or colleague succeed."

By defining and staying true to a virtuous purpose, organisations create a moral guide for their people, thus increasing the organisation's ethical resiliency.

But the benefits do not stop here. Research has shown how purpose can promote increased effort and loyalty amongst an organisation's people, something that pure monetary incentives struggle to do. It can also increase an organisation's appeal to prospective employees, acting as a point of differentiation in the war for talent.

In addition, by successfully prosecuting its purpose in both word and action, organisations can inspire greater brand loyalty and advocacy. Customers and community alike will become promoters, delivering the type of marketing campaign that no money can buy. All of this, ultimately, leads to increased return for shareholders.

Professor Alex Edmans from the London Business School recently undertook a piece of research that compared shareholder returns of companies over a 28 year period. By using employee satisfaction as a proxy for purpose, Edmans found that purposeful companies outperformed comparable peers by 2.3 per cent to 3.8 per cent per year, after controlling for factors like risk, industry performance and other outliers. As Edmans states, "to reach the land of profit, follow the road of purpose".

But how does an organisation go about discovering its purpose?

The process will vary considerably depending on where an organisation finds itself in its evolution. For example at a start-up, the founders and employees are usually brought together by a shared passion, and defining a purpose requires them to translate this passion into something meaningful that illustrates how their venture will contribute to the greater good.

However in large organisations that have rich histories, the process is a bit less straightforward. Whether they are aware of it or not, these organisations already have a purpose, something that their longevity attests to. The challenge is to discover (or perhaps more aptly, rediscover) this purpose. It is so often the case that as successive management regimes introduce new visions, values, processes and procedures, an organisation's true purpose can be lost.

Greg Sutherland, the Chief Innovation Officer at Australia Post, has led the rediscovery of purpose in a number of organisations. He suggests that the process requires the skills of a historian, ethnographer or anthropologist, not a business analyst. "To properly discover purpose, we must go a lot deeper than sitting around a table with the group executive and crafting a slogan. We must explore the organisation and uncover the stories that people tell when they feel the organisation is at its best."

This process of course requires considerable time and effort, but done properly it is very powerful as it engages the entire organisation

in a conversation. This conversation reveals what it is that motivates people in the organisation to come together and not only build something so much bigger than themselves, but contribute to the greater good and pursue meaning. It is in the stories that people tell through this process that an organisation's purpose is discovered.

This approach requires a change in mindset for many directors. To begin with, it suggests that an organisation's purpose is enduring. Absolutely strategy needs to flex and adapt as technology, regulation, the economic outlook or the competitive landscape changes. However, purpose is the foundation upon which the organisation sits – it should survive changes to management and strategy. Successive CEOs may have different strategic intentions but they should all care deeply about the same purpose.

In addition, it fundamentally changes the nature of the discussion with shareholders. It will quite often be the case that in the short term, adhering to purpose may mean that shareholders lose their primacy. This is a conversation that boards should engage in confidently. The concepts of purpose and shareholder value are not mutually exclusive. To be sure there will be times when the concepts are in conflict but boards that consistently place the shareholder first in these scenarios will compromise long term value, and worse still, create fertile ground for unethical conduct.

By discovering, nurturing and living their purpose, organisations will deliver value for all their stakeholders, not least of which the shareholders. In a world where the sources of competitive advantage are dissipating, purpose could be the ultimate driver of long term value.

Interview: Dennis Gentilin

Christopher Niesche
October 2016, "Interview: Dennis Gentilin", *Company Director Magazine*, AICD.

Unethical banking practices and trading loss cover-ups led former National Australia Bank employee, Dennis Gentilin to become a whistleblower.

Dennis Gentilin MAICD was a 29-year-old foreign exchange trader working in the National Australia Bank's (NAB) London dealing room when he learned his colleagues were racking up hundreds of millions in trading losses and covering them up. What he chose to do about this would have profound ramifications for the traders, for NAB and ultimately for himself. Working at NAB was Gentilin's first job. He studied banking and finance at Monash University before joining the bank as a graduate. When he started working in the Melbourne dealing room in 2001, he found an environment where unethical behaviour had become normalised; there was a culture where money and money-making took priority, and a highly hierarchical dynamic made it difficult for a junior employee to voice their own values or opinions.

He struggled with this culture and responded by trying to turn a blind eye. "It's difficult to

admit but you could say that, in some ways, I was complicit for an extended period of time because the way that I chose to deal with it was to try and ignore the poor conduct," he says.

"We fail to recognise, as people, how the environments which we operate and work in can actually shape our character." Gentilin continued to struggle with his colleagues' behaviour to the point where he questioned his own values, wondering if it was actually he who had the problem.

"When you're a young person and you enter the workforce, you really haven't gone through that exercise where you think about what is important to you and what your values are; they tend to be dictated by your workplace, especially by the senior people in your workplace," he says.

What transformed Gentilin from a bystander to a whistleblower after he moved to London was a heated exchange with a colleague, who revealed the full extent of the losses that the foreign exchange team was hiding. His wife urged him to do something about it, as did a trusted colleague, who told him: "You've got no choice."

"It was like a lightbulb moment where I thought: 'What the hell am I thinking?'" he says. "From that point on, I just went into auto-pilot and did what I had to do. I reported what I found to my boss' boss and as they say, the rest is history."

That history ultimately led to four NAB traders being jailed for unauthorised trading, which cost the bank $326 million in 2003–04. In sentencing one of the traders, David Bullen, Judge Geoff Chettle of the Victorian County Court said: "In the corporate culture that existed, you forgot your legal responsibilities to the bank, its management and its shareholders."

He told another, Vince Ficarra: "You became enmeshed in the culture that saw you seeing yourselves as invincible and somewhat arrogant." The scandal also ultimately led to the resignation of NAB CEO Frank Cicutto and chair Charles Allen.

Organisational behaviour

For Gentilin, it led to a deep interest in human and organisational behaviour. "I'm especially fascinated about the why – why do things like this happen? Despite the presence of stringent regulations and compliance frameworks, why do people continually behave in unethical ways?" he says.

The experience led him to complete a psychology degree and after leaving NAB in January this year, Gentilin is now doing public speaking and consulting to help leaders create the conditions within their organisations that promote ethical conduct.

He has also written a book, *The Origins of Ethical Failures*, which captures the lessons that come from his experience and subsequent research.

To this day, Gentilin still isn't sure what it was about his background or makeup that made him blow the whistle while others round him participated in the fraud.

"Even though I consider myself to be a person

of high moral character, I too behaved in ways where I compromised my standards. I learned that when you're in an environment where unethical conduct is so normalised and it's just the way things are done, it is so easy to become involved, especially when you're young," he says.

Gentilin says he didn't think too much about the personal consequences and unlike many whistleblowers, they were not severe. Many whistleblowers, however honourable and well-meaning their actions, are shunned by their colleagues, left unsupported by management and eventually forced out of their jobs.

Unusually, Gentilin was able to stay on at NAB for another 12 years – seven years spent in financial markets, mostly in sales roles and running an institutional foreign exchange desk, then into corporate strategy.

He says he was fortunate to be surrounded by people who instead of regarding him as "used goods", continued to see potential in him and provide him with career opportunities. He suspects there were conversations at senior levels of the bank where it was decided whistleblowers need to be protected.

Gentilin says one of the key lessons from his experience was the realisation of how we, as individuals, fail to recognise how susceptible we are.

"We like to think that our characters are fixed and that if we're placed in an environment where we might be tempted, as long as we're moral people, we'll be able to make the right decisions," he says.

"But there were some really good people who became involved in the incident that came from good families, had great upbringings, were well educated, but just behaved in very uncharacteristic ways."

The conclusion is that we are all susceptible to unethical behaviour, says Gentilin, and it is therefore up to the leaders of organisations to shape workplace environments that foster and promote ethical conduct. In part, this can be done through formal mechanisms: codes of conduct, formal communications handed down from leaders, training programs, and appropriately aligned reward and performance frameworks.

These are all important, but Gentilin says he has learned that the informal mechanisms – the decisions and choices and actions of leaders – send very powerful messages about what's really important in an organisation and what staff need to do to get ahead.

"You can have stated values in your organisation but, when leaders start turning a blind eye to poor behaviour, or rewarding and promoting people who are behaving in ways that are at odds with the organisation's values, the message this sends is so powerful that it shapes the organisation's culture," he says.

Moral stance

Gentilin took what many would consider to be a brave and moral stand when he blew the whistle on the NAB currency traders, but he is careful not to dictate to others who witness unethical or illegal behaviour in their own organisations, saying no two situations are ever the same.

His one piece of advice for those people is to talk about the issue with their "council of advisers" – the people they go to for advice, including family and trusted colleagues. "My experience showed me that when I opened up to someone outside of my immediate team, I got clarity as to what I needed to do," he says.

Once a decision has been made about what to do, they need to think about the approach they take. We tend to view people behaving in an unethical way as "really bad people", but sometimes these people aren't comfortable with their own behaviour either. "In some cases, if these so called 'bad people' are in an environment where the context condones poor behaviour, then they too might be struggling with that situation and need some help," he says.

Whistleblowers also need to think about whom they approach and how they approach them. They should try to put themselves in the other person's position and consider what is at stake for them as well. They need to gather their evidence, think about what they're going to say and the response they want. It is also important to consider what the next step will be if they don't get that response.

Sometimes potential whistleblowers will decide that any action would be futile and will walk away instead. "The two main reasons people don't say anything in organisations is fear and futility – fear that there will be consequences associated with speaking up and futility, that even if they do speak up, nothing is going to get done," he says.

"If someone does walk away, I'm not going to judge them as an individual and think that they're a coward. It's such an extraordinarily difficult thing to do and unfortunately history does show that it doesn't end up well for a lot of people."

Gentilin says he hopes there are many instances where people have raised concerns within organisations and they've been dealt with internally but haven't hit the public spotlight because the story is not newsworthy.

Speaking out

He cites a research project at Queensland's Griffith University, Whistling While They Work, which among other things, aims to collect stories of whistleblowing in the public and private sectors where there was a positive outcome and the reasons for this.

"I think we need more of those stories because unfortunately, the perception of whistleblowers at the moment is someone who has lifted the lid on a big scandal and paid high costs. I'd like to think there are a lot of examples where people have raised concerns internally and they haven't suffered," says Gentilin.

He says that when a whistleblower exposes a big scandal, it usually means the organisation hasn't made the most of whistleblowing opportunities up to that point. Had there been an environment where people felt comfortable about raising concerns earlier, then it is likely the situation would have been dealt with prior to it degrading into a major scandal.

Creating a "speak-up culture" is the key to addressing organisational wrongdoings, says Gentilin, and is the best way to supplement an organisation's "formal" compliance mechanisms. Such cultures typically exist in organisations which value transparency and have nothing to hide – and if there is something being hidden, they want to know about it.

As with all aspects of culture, it starts at the top, says Gentilin. Directors and executives have to set an example that demonstrates that they value openness and transparency, and when things are uncovered, they need to respond in a way that deals with the situation and doesn't result in those who speak up suffering from their actions.

But, of course, it can't just be directors and executives who set the tone, particularly in organisations with thousands of employees. "You need to ensure you have programs in place where leaders across the organisation develop the skills that enable them to create environments in which people feel comfortable challenging and voicing opinions and, when they do so, that they're listened to," he says.

Setting the tone

In small organisations, it is comparatively easy for a director to set the tone from the top, but in large ones, their influence can dilute quickly. Hence, boards and executives need to have a good understanding of what Gentilin calls the "the centres of influence" in their organisation; the leaders who, through their own behaviour and choices, can send a powerful message about what is important.

"Are these leaders, like the directors and the executives, just as committed to the organisation's purpose and values? And do these leaders also create environments where people feel comfortable speaking up and challenging when they see conduct that's not aligned to the organisation's values?"

The reality is that in some cases it is against a leader's interests to have a problem brought to their attention, which they will then have to acknowledge and deal with. Gentilin says this is the leader's problem.

When people perceive hypocrisy in their leaders they disengage and become cynical, and this creates fertile ground for unethical behaviour.

"If you're a leader who struggles with hearing the truth, then you've really got to think about what is it that's causing that – why are you uncomfortable hearing about what's really going on? This type of attitude is going to be detrimental to your leadership, and to the ethics and performance of the organisation," he says.

A recent study into ethical behaviour within Australian society found consumers view big business, banks and politicians as unethical. At the same time, they rated CEOs and directors as the most important "gatekeepers" influencing ethics in organisations. The index also highlighted whistleblowers as having an important role to play in corporate Australia, with 80 per cent of respondents believing they are an essential element in driving ethical behaviour.

Social purpose

Gentilin says business only has itself to blame for the current lack of trust and goodwill. The key challenge for Australian businesses is to articulate their social purpose: how are they making a contribution to the greater good?

"They need to demonstrate, in both their actions and words, that they take their broader social obligations seriously. Over time, this is what will slowly regain the trust of the public.

"When the public begins to see that in addition to generating an appropriate commercial return, business is there to make a contribution to the greater good and to give back to customer and community, then this will rebuild trust," he says.

This can only happen, however, if leaders, and especially directors and executives, are deeply committed to a social purpose. It means taking on roles not for prestige or financial reward, but for the contribution it enables them to make to the greater good.

"When leaders begin placing their privileges ahead of their principles, the message they send, whether they realise it or not, is one of hypocrisy – people see, through their actions and choices, that they're not there to make a contribution to the greater good but they're there to make a contribution to themselves. When people perceive hypocrisy in their leaders they disengage and become cynical, and this creates fertile ground for unethical conduct," says Gentilin.

It is also important to ensure that formal mechanisms such as recruitment, training, compliance frameworks and incentive schemes are fit for purpose. In some cases, previous managers, with the best of intentions, might have put these mechanisms in place, and for a variety of reasons they are no longer aligned to the organisation's values.

In terms of directors' roles in setting an organisation's culture, Gentilin says they have a very important role to play. "Even directors need to ensure that they are heavily invested and committed to the organisation's purpose.

"As much as we like to think that what goes on in the boardroom remains secret, people hear stories," he says. "And if the stories they're hearing paint a picture of a boardroom in which directors lack personal integrity, then people will naturally become cynical."

To promote an ethical culture, directors need to have regular conversations with people outside of the boardroom and the C-suite and listen to them and hear the stories they're telling to learn what's actually happening in the organisation.

Fixing an unethical culture is hard work, but not impossible. At its core, it involves reconnecting people to the organisation's purpose. This can result in staff turnover as management tries to rid the organisation of people who are not committed to its purpose.

"At times, this is absolutely crucial, especially when the people who are responsible are not role models for the organisation's values, yet are the centres of influence," says Gentilin.

CHAPTER 3:

Preparing your response to climate change

The rising tide of directors' responsibilities

John Connor
CEO, The Climate Institute, May 2016, "Opinion: The rising tide of director's responsibilities", *The Boardroom Report*, Volume 14, Issue 4, AICD.

Following the landmark 2015 Paris Agreement and new research into the world's largest investors and climate related risk, John Connor, CEO of The Climate Institute, explores challenges and long-term liability risks facing directors.

At the Australian Institute of Company Directors' [2016] Australian Governance Summit, David Gonski told an audience of 1000 of Australia's senior business leaders that board directors should take a more long-term perspective on their roles. So, how and why does climate change factor in that advice? And is action already under way?

Prior to the Paris Climate Summit last December [2016], Mark Carney, the Governor of the Bank of England, described his concept of the "Tragedy of the Horizon" – the threats that climate change poses to long-term shareholder value and, potentially, financial stability beyond the traditional horizons of the business and political cycles.

Carney outlined the physical risks already impacting property, agricultural and tourism asset classes through the increased frequency and greater intensity of storms, drought and bushfires as well as, for example, the bleaching of the Great Barrier Reef.

Then he talked about transitional risks – changes in policy, technology and physical risks that could prompt a potentially sudden reassessment – a "jump to distress" – of the value of a large range of assets.

Looking into long-term liability

Carney also described liability risks, particularly referring to carbon extractors or emitters, referring to the impacts that could arise up to decades in the future where parties who have suffered loss and damage from the (ignored) effects of climate change seek compensation from those they hold responsible. One example of such litigation is under way in some US states, where it is being investigated whether Exxon misled investors about its knowledge of climate science.

At the Paris Summit, the G20's Financial Stability Board launched a Taskforce on Climate Related Financial Disclosures. It has just released a *Phase One Report* providing an even more detailed typology of physical and non-physical risks and opportunities. Last year, The Climate Institute also examined the issues if Australia's financial system and climate risk.

The Paris agreement was particularly significant because it set goals to keep global warming "well below" 2°C above pre-industrial levels and to "pursue efforts" to keep warming to 1.5°C. With warming already around one degree above, there is mounting urgency. This highlights the importance of the now mainstream understanding that to achieve any of these goals requires economies to sit at net zero emissions or below.

The world's largest institutional investors, like superannuation funds and sovereign wealth funds, are already moving on climate risks. The Asset Owners Disclosure Project's fourth Global Climate 500 Index, released earlier this month, showed around half are now taking action either through assessing portfolio risks, making low-carbon investments or through more direct engagement with corporate governance. In 2016, there has been a 62 per cent jump in support of shareholder resolutions focused on climate change, with 60 investors (12 per cent) surveyed voting in favour of at least one (up from just 7 per cent in 2015).

One way companies are integrating long-term perspectives on climate is by stress testing their business models to see if they can cope in economies avoiding two degrees warming. BHP has already done it. Westpac, AGL and Origin are doing so. This will be an increasingly important approach.

Australia has had a turbulent ten years in climate and clean energy politics; this should provide directors with more, not less, reason to take both long and near-term perspectives on climate change. There is a widening gulf between community, investor and policy-maker perspectives, which is increasing the transitional risks of sudden policy movements. The Climate Institute's A Switch in Time report highlights the looming economic "jump to distress" if we fail to begin effective action to modernise and decarbonise our electricity system now.

The point is that the heat is not just rising on our planet, but on directors to manage climate related risks now to avert worse outcomes in the future.

New legal opinion connects directors' duties and climate change risks

Louise Petschler MAICD
General Manager, Advocacy, AICD, November 2016, "New legal opinion connects directors' duties and climate change risks", *The Boardroom Report*, Volume 14, Issue 10, AICD.

Directors need to be considering how climate change might affect their business or they could be opening themselves up to litigation, a Sydney silk argues in a new legal opinion. Louise Petschler, the AICD's Advocacy General Manager, outlines the key takeaways for directors.

There is little downside, and much potential upside, for directors in properly considering and disclosing climate change risks.

So argues a new legal opinion, *Climate Change and Directors' Duties*, by Sydney barrister Noel Hutley SC. Released by the Centre for Policy Development and co-authored by Sebastian Hartford Davis, the opinion was discussed at a business roundtable on climate risk and sustainability on 21 October and has received recent media attention.

With the commencement of the Paris Agreement on 4 November, the opinion casts a timely eye over the relevance of climate change risks to boards. The Paris Agreement aims to limit global temperature increases to well below 2°C from a pre-industrial baseline.

The agreement also includes a commitment to strengthening nations' ability to deal with the impacts of climate change. The federal government is expected to ratify the Paris Agreement over coming months, and has committed to a review of climate change policies during 2017.

Risky business

Against this backdrop of global and government action, Hutley and Hartford Davis's opinion makes the case that boards of Australian companies would be well-advised to engage with the risks of climate change, including financial and legal risks.

The opinion defines climate change risks as:
- Physical risks associated with rising global temperatures, such as severe weather events and rising sea levels damaging property and disrupting trade; and
- Transition risks, being indirect financial risks that might arise from a transition to a lower carbon economy, including changes in policy, technology or investor preferences that could impact the value of assets and elements of business strategy.

A detailed case is made that a court would be likely to regard climate change risks as 'foreseeable risks', noting that the law views foreseeability differently from probability. Risks will be foreseeable if they are not deemed to be 'far-fetched or fanciful'. The authors argue that with current policy settings, this threshold has likely been reached for many 'climate change risks'.

The authors consider the issue in the context of the duty of care and diligence imposed on directors by s 180(1) of the *Corporations Act*

2001 (Cth), concluding that climate change risks may be relevant to a director's duty of care to the extent that those risks intersect with the interest of the company.

"There is certainly no legal obstacle to Australian directors taking into account climate changes and other sustainability risks, where those risks are, or may be, material to the interests of the company," the authors contend.

"To the contrary, company directors certainly can, and in some cases should be considering the impact on their business of 'climate change risks'." In the authors' view, directors who fail to actively consider climate change risks now could, depending on the circumstances, risk being found liable for breaching their duty of care and diligence in the future.

"It is likely to be only a matter of time before we see litigation against a director who has failed to perceive, disclose or take steps in relation to a foreseeable climate-related risk that can be demonstrated to have caused harm to a company (including, perhaps, reputational harm)", argue Hutley and Hartford Davis.

What can directors take away from this opinion?

The opinion is necessarily general, with the authors noting that the relevance of "climate change risks" to a specific company will be assessed on a case-by-case basis. But in discussing how directors should view their duty of care in light of climate change risks, the opinion states that directors are 'well-advised' to at least consider the impacts of these risks on their business.

Further, the authors argue that:

- Directors' duties oblige directors to obtain knowledge about factors affecting their business, and accordingly directors should consider and take steps to inform themselves about climate-related risks to their business, including obtaining expert advice if appropriate;
- In some cases – such as insurance businesses – the duty of care will likely require a director to go further than merely considering risks. Action may need to be taken in terms of strategy and planning; and
- Directors who are proactive in turning their minds to climate change risks for their business, even if they decide on a properly informed and advised basis not to act, may have the protection of the business judgement rule against claims of breach of duty.

Discussions on climate change often involve strongly held opinions. Other commentators have made the case, however, that it's not individual views on climate change science that matter, but the potential risks and their impacts on a company. Hutley and Hartford Davis share this view:

"It would be difficult for a director to escape liability for a foreseeable risk of harm to the company on the basis that he or she did not believe in the reality of climate change, or indeed that climate change is human-induced. The court will ask whether the director should have known of the danger."

The opinion draws parallels with instances where courts have had to deal with liability for negligence in the context of developing science, such as employee exposure to asbestos or the transmission of the HIV virus through unsafe intravenous blood transitions.

"At a certain point, however, ignorant defendants become liable for those risks on the basis that a reasonable person would have known of them," the authors state. Most importantly, it is a timely reminder for directors to consider whether they are turning their mind appropriately to 'climate change risks' in the exercise of their strategic and risk management roles.

Some directors may be surprised at the authors' conclusion that a court would find 'climate change risks' to be 'foreseeable', and potentially open up exposure for directors to a breach of duty of care.

While the phrase 'climate change risk' may not yet be common parlance in boardrooms, the issues that it encompasses are likely very much on directors' minds. In defining climate change risks the opinion draws together many issues that will already be occupying boards – for example, reputational harm, physical damage from weather events, changing regulatory settings, stranded assets, and disclosure rules – viewing these with a specific climate risk lens.

In a context where current reporting on the issue by boards is variable, the opinion sets out the importance of considering disclosure obligations relating to exposure to climate change risks.

Social value

Mark Rainbird and David Walters,
April 2016, (extract from) *Creating Value: A practical guide for boards and directors*, AICD, pp 70-77.

Traditionally, the societal boundaries around a company's activities were mainly seen as issues of regulation and compliance. This view sees the minimum baseline for how a firm interacts with its customers as being set by Australian consumer law, how it operates in the marketplace by the *Competition and Consumer Act* (2010), and how it treats its employees as being governed by a range of legislation covering occupational health and safety, industrial relations and others.

Increasingly, however, other influences are now infiltrating corporate life though public debate, persuasion and even activism. This spans concerns from fair trade and ethical consumerism to disinvestment movements.

This even extends to the operation of the value chain or network that a company operates in. For example, in late 2015, the sourcing director of the UK supermarket chain Tesco was quoted as saying that "I think all corporations have slavery in their supply chains and some of those instances are absolutely horrific". While there may be some instances of true slavery, which was otherwise abolished in the British

Empire in 1833, in this context what was really being referred to is forced labour of some description in the global agriculture, manufacturing and distribution industries. Nestlé, for example, estimates it has eliminated "less than 1 per cent" of its 30,000 suppliers on this basis, but recognises that "… we do understand we can influence the supply chains we work with, and that's what we have to do".

Traditionally, the response of many companies to these sorts of issues was to passively ignore them. The justification was often built around the concept of shareholder value, namely that advancing the interest of shareholders is the sole purpose of the company and therefore anything else doesn't matter. A more active response may have been to see disruptions to the social context in which the firm operated as simply an additional cost, or at worst a threat.

Obviously, however, not everyone has been passive or even hostile – there is indeed a grand tradition of corporate benevolence and philanthropy. Where, however, it is driven principally by conscience, the outcomes when looked at across the broad corporate landscape have tended to be irregular and uneven.

Increasingly, however, more structured responses are emerging. It is still probably more a loose assembly of sometimes complementary and sometimes competing concepts than a coherent set of overarching principles. However, it is this emerging assembly of ideas that we are trying to capture in the term social value.

Corporate social responsibility

One of the drivers of a more structured approach to social value in a business context has been the emergence in recent years of corporate social responsibility (CSR). While there is an international standard — ISO 2600 — the reality is again a broad clutch of ideas that has begun to take on some organised form.

It is argued that CSR adds value to the businesses that practice it in three principal ways. The first is as a signal that its products or services are of high quality. Second it may be able to command higher prices as consumers see it as an indirect way to support a cause. Finally, there is a halo effect that enhances the general reputation of the company. There is some limited indirect evidence to suggest that the halo effect in particular may have some substance but it is probably fair to say that proving the direct economic benefits of CSR to a company remains tenuous.

How seriously then is CSR taken? A recent report (2015) suggests a steady acceptance and uptake in corporate Australia, but still with a largely compliance focus — "we do this because we have to".

That same report, however, tracks an interesting emerging maturity cycle. This sees companies moving from being initiators focused on mandatory compliance issues, to integrators with strong internal structures and understandings of their responsibilities. The final step is being an innovator who actually uses CSR to gain a competitive advantage.

A new idea — shared value

The last point is important and reflects an emerging change in thinking towards social value, making it an integral part of defining a company's market positioning and therefore a driver of competitive advantage. This is exemplified in the notion of shared value proposed in 2011 by Harvard academics Michael Porter and Mark Kramer. This is not "shared" in the notion of a redistribution of wealth out of the firm to other parties by any form of forced giving. Instead, it focuses on an expansion of the overall economic pie to everyone's benefit.

In Porter and Kramer's view this involves an explicit rejection of classic economic theory that social benefits or issues are both a constraint on the firm's actions and a cost to it. Nor are they suggesting value should be "shared" in a philanthropic sense, but in fact the opposite. Their concept of shared value is based around "self-interested behaviour to create economic value by creating societal value".

The argument is essentially that "societal needs, not just conventional economic needs, define markets" so that competitive advantage is derived from catering to both. It also offers a new perspective on costs, with the recognition that "social harms can create internal costs for firms". This means that the health of the community and that of the company are closely intertwined.

Rather than being in conflict with market forces it is argued that the concept of shared value: "… resets the boundaries of capitalism. By better connecting companies' success with societal improvement, it opens up many ways to serve new needs, gain efficiency, create differentiation, and expand markets."
This is in line with some of the other themes we have seen around value creation, the broader reach of what constitutes a market, and the recognition of the interests of a broader range of stakeholders in increasingly networked markets. That network may well increase not just the range of economic transactions a firm potentially participates in, but the complexity of its social interactions as well.

In many respects, shared value is simply redefining what constitutes a profit pool. In doing so, it potentially brings social value into the corporate mainstream rather than a parallel concern or distraction.

Other emerging ideas around sustainability

The environment is not a new concern for business, but the historical response has been largely regulatory driven based on compliance with legislative requirements, and more lately taxation ones with the introduction of carbon emission taxes and reduction schemes.

The debate is, however, broadening with concerns about an "unsustainable trajectory" in the use of natural resources. This has led to questions being asked whether "prosperity without growth" by decoupling or at least optimising these two drivers is possible.

These arguments are sometimes unfortunately trivialized as implying some economic and social regression back to a pre-Industrial age. Instead, some responses are emerging that are parallel with the notions of shared value that we have already discussed, and are aimed at

enlarging and reshaping the economic pie.

One is what has been termed the circular economy where resources are re-used rather than discarded. This is not simple waste recycling, but includes re-marketing or re-commerce. In the USA around 8 per cent of products by dollar value are returned to physical retailers, with an even high rate for on-line sales. A whole industry is emerging based on extracting value from these returns. The circular economy also involves re-engineering products and services from their beginning so that they are re-usable in some form.

At a higher level, a recent study (2015) has suggested that a circular "growth within" approach across Europe, albeit involving significant transition costs and rapid adoption of new technology, could improve resource productivity by up to 3 per cent annually translating into a GDP increase "of as much as seven percentage points relative to the current development scenario".

A second related concept is that of frugal innovation. This is not just designing low cost, low feature versions of products for third world countries — though that approach has had some conspicuous successes, notably with mobile phones in Africa and elsewhere. It also includes rich world initiatives such as eliminating product features customers are happy to not pay for. This is in effect a reversal of the ever growing consumerism or economic materialism which seemed an irreversible trend in the last half of the twentieth century. Perhaps the best example is the emergence of low cost airlines, with Ryanair now the world's biggest international airline by passenger numbers.

A third concept is what has been termed the shared economy. This is based on optimising existing resources by using them in new ways. There are a number of examples of rapid and successful commercialisation of sharing based services. Uber for example optimises the use of private vehicles for public transport, and Airbnb taps into private homes for public accommodation. It is difficult to judge what cumulative impact these ideas about sustainability are having in more traditional industries, though one study suggests that in Europe firms with explicit and published targets for reducing CO2 emissions are more profitable than those that don't. Why? The argument seems to be that it is just a sign of better management overall and "investors see greenness simply as a proxy for good management".

These are ideas that are unlikely to go away. The significant change is that they are increasingly customer not activist driven.

Issues to consider

- Does the company have policies based on CSR?
- Is there a common view around the board table on whether the company is simply an initiator only meeting compliance requirements, an integrator, or an innovator in terms of CSR?
- What does it aspire to be and how will it get there?
- Is the idea of shared value one recognised around the board table?
- Is sustainability part of the company's market strategy or a basis of its business model?

Climate change and directors' duties

Sarah Barker MAICD
Special Counsel, MinterEllison, December 2016, *Climate Change & Directors' Duties – Legal Opinion*, Governance Leadership Centre, AICD.

A new legal opinion argues that directors should turn their minds to climate change risks as part of their duty of care.

MinterEllison (Sarah Barker, Special Counsel and Maged Girgis, Head of Superannuation) were engaged by the Centre for Policy Development and the Future Business Council to brief Mr Noel Hutley SC to provide his opinion on the extent to which the law permits or requires Australian company directors to respond to climate change risks.

The opinion, provided by Mr Hutley and junior counsel Sebastian Hartford-Davis, was presented at a roundtable of business, regulatory and investment leaders (including from BlackRock, CBA, ANZ, Citigroup, IFM, ACSI, Deutsche Bank, Qantas, ASIC, APRA and several of Australia's largest superannuation funds) on 21 October. Those present heard that, as a matter of Australian law, directors and boards must actively engage with the impacts of climate change-related risks on their operations and strategy in order to satisfy their duty of due care and diligence under s 180 of the *Corporations Act 2001*. That duty of course sets out the core standard of competence to which company directors are held: that of the due care and diligence that would be exercised by a reasonable director in the relevant circumstances.

In particular, the opinion states that:

- 'Climate change risks' represent, or are capable of representing, risks of harm to the interests of, and opportunities for, Australian companies and their business models, which would be regarded by a court as being foreseeable at the present time;

- Such risks are relevant to a director's duty of due care and diligence, and directors can, and in many cases should, be considering the impacts on their business;

- Conversely, the law does not prohibit directors from taking climate change and related economic, environmental and social sustainability risks into account where those risks are, or may be, material to the company's interests; and, critically

- It is conceivable that directors who fail to consider the impacts of climate change risk for their business, now, could be found liable for breaching their statutory duty of due care and diligence going forwards.

In addition, Mr Hutley warned that directors who perceive that climate change does present risks to their business should also assess the adequacy of their disclosure and reporting of those risks.

Implications for company directors

Mr Hutley's opinion clearly confirms that, from an evidentiary perspective, risks associated with climate change have evolved from an 'ethical environmental' to material financial issues, and that directors who fail to

grapple with them are legally exposed. There is simply no substitute for a proactive, robust governance of the impacts of relevant climate risks in the unique circumstances of each business. As a starting point to the exercise of due care and diligence, directors should inform they are adequately formed in relation to the scientific and economic issues, inquire of experts where appropriate, and critically evaluate the impact of these risks and their company's strategic response.

This does not mean that the law now requires directors to prioritise climate risks or sustainability over any other governance matter. However, it must be afforded the same robust consideration as any other issue that may have a material impact on financial performance, risk management and strategy.

Is climate change a governance issue?

Tony Featherstone
Consulting Editor of the AICD Governance Leadership Centre, December 2016, *"Is climate change a governance issue?"*, Governance Leadership Centre, AICD.

Climate change has been described as the greatest challenge of our time. It might also be the great governance challenge for boards in the next 10 years.

That is not to present an alarmist view of climate change or suggest boards take radical action on governance of climate-related risks. Nor is it to downplay the good work of many Australian organisations in the past decade with sustainability reports and other initiatives in this field.

But this view recognises that climate change, from a governance perspective, is moving to a new phase – one where global investment markets progressively factor organisation climate-related risks into company valuations and other investment metrics.

One need only look at trends in Corporate Australia to understand the significance of this change. Several of the country's largest superannuation funds and fund managers now have sophisticated internal Environmental, Social and Governance (ESG) teams that assess ESG risks for corporates and overlay that information into broader portfolio decisions.

On the securities sell side, at least three of Australia's largest investment banks now have specialist ESG analysts who assess corporate performance in this area. Although it is still early days, market scrutiny on corporate ESG performance, including climate risks, is rapidly rising.

Sarah Barker, Special Counsel at MinterEllison, examines the opinion of Noel Hutley, SC, on the extent to which the law permits or requires Australian company directors to respond to climate change risk – a must-read analysis for every director.

Barker says Hutley's opinion confirms that, from an evidentiary perspective, risks associated with climate change have evolved from "ethical environmental" to material financial issues, and that directors who fail to grapple with them are legally exposed.

Hutley warns that directors who perceive that climate change presents risks to their business should assess the adequacy of their disclosure and reporting of them.

Australasian Investor Relations Association CEO, Ian Matheson, makes a similar point from an investor relations perspective. Matheson says ESG data is moving from qualitative to quantitative in the eyes of investors, meaning it is becoming more material.

This trend has significant market disclosure and reporting implications for companies, and by default their boards, on climate-related risks. Boards must be satisfied the organisation's investor relations processes, which often involves the chairman in meetings with key stakeholders, is effectively communicating the ESG strategy to the market.

Ian Dunlop, the former Chair of the Australian Coal Association, writes on this issue that the "implications for boards and directors [from climate change] are profound". He says: "Climate change will be the most important issue of the next few decades for large and small companies alike and, if handled sensibly, the real source of growth. Lack of knowledge of its real risks and opportunities represents a major governance failure."

Dunlop says the business community, and its boards, must show leadership on climate change debate. But he argues there is much "climate denialism" in Australian boardrooms and that "Australian directors have been notable by their absence from this debate".

For boards, the complexity of climate change science is compounded by an issue that cuts across many governance tasks. Boards that pigeonhole climate risks as a "sustainability" issue will need to think broadly about its implications.

Here are 10 to consider:

1. Organisation values and ethics
Climate change responses ultimately require trade-offs. From an environmental perspective, which projects will the board approve and which will it reject, despite their commercial appeal? How does the organisation's climate-change response adhere to its values?

2. Board composition
Nobody expects boards to have directors who are climate specialists or sustainability experts. But boards of organisations that are higher carbon emitters should ensure they have sufficient understanding of climate risks and responses. And every director of every organisation should understand the growing importance of ESG.

3. Board sub-committees
In time, climate change could be as much an issue for the audit and remuneration committees as it is for the sustainability committee. Boards will need to take a multi-dimension approach to an issue that cuts

across a range of governance tasks and influences corporate strategy.

4. Stakeholders
As shareholder representatives, boards need to understand the ESG perspective of their organisation's investors. For example, are their industry superannuation funds or global pension funds on the share register and do they have a strong view on climate risks? What are the shareholder expectations of the organisation's response to climate change?

5. Investor relations
Boards should ensure their organisation has adequate process to report on, and disclose to the market, any climate-related information that could have a material effect on the share price. Understanding the investor relations team's ESG skills and responsibility lines for communication of this information to the market, is a good place to start.

6. Activism
Stakeholder activism towards companies that are higher carbon emitters continues to grow. It started with mining and energy companies, before spreading to financiers that lend capital for these projects. Boards must be prepared for more vocal, public and sophisticated activism campaigns that fuel media stories and risk damaging corporate and board reputations.

7. Impairments
Challenging the assumptions behind valuations could become more complex for boards if climate change affects asset prices. For example, excessive water usage leads to lower land value for an organisation, or climate change affects the values of properties near the sea. Understanding how the external audit firm views climate change risks in asset valuations and potential asset impairments is a worthwhile exercise.

8. Capital management
An organisation's climate performance, in areas such as carbon emissions and water usage, is expected to have a bigger impact on the cost of capital in coming years. Boards will need to understand the linkages between the organisation's environment performance, its market capitalisation and how that affects the rate at which capital is provided for projects.

9. Remuneration
There was heated debate in the latest AGM season about some boards linking executive pay to "soft performance targets", such as customer satisfaction. As climate change becomes a bigger factor in corporate performance (at least for some companies) boards might consider linking environment targets, such as a reduction in the organisation's carbon emissions, to executive short and long-term incentive plans.

10. Director liability
The link between climate change and director liability seems tenuous at face value. But as climate change risks become more material, and disclosure obligations increase over time, some directors may have to demonstrate they exercised a sufficient duty of care in climate-change related risk management and strategy – particularly as shareholder class actions emerge. Noel Hutley's view that directors who fail to grapple with the climate change issue could be "legally exposed" is prescient advice for the governance community.

The role of corporate social responsibility in assessing the duties and responsibilities of directors

Bob Baxt AO FAICDLife
February 2016, (extract from) *Duties and Responsibilities of Directors and Officers*, 21st Edition, AICD, pp 311-312.

There is significant pressure in Australia for a review to be undertaken of the rules that apply to company directors and to evaluate whether a broader range of stakeholder interests should be taken into account as a requirement under the law. The current position is that the duty is owed to the company, and that means the shareholders.

A very important question arises when companies are close to liquidation and facing significant financial circumstances. It is at that point that directors trying to rescue the company and wishing to take into account a range of interests, including the company's direct survival, recognise this may hurt others with a link to the company who are owed money. To accommodate all of these interests may be regarded as unselfish behaviour and appropriate, and indeed very wise in some circumstances. While laudable in the eyes of many, in the eyes of the purists administering the law, such conduct would be considered an inappropriate exercise of power and a breach of the law. The directors would not be acting properly under the rules at both common law and under the statute (namely s 181 of the *Corporations Act 2001*). In such circumstances, the potential for penalties to be imposed by the regulator is significant.

In addition, the law imposes a range of obligations, including the potential impact of the Criminal Code. The reliance by various governments on strict liability legislation over the years, and the reversing of the onus of proof, has not made life any easier for directors. These provisions require the director (or officer) to establish their innocence, rather than for the prosecution or the civil plaintiff to establish that the breach of law has occurred. If something goes wrong in the context of some of this legislation (in a range of corporate activities covered by over 650 pieces of legislation throughout Australia), the director/officer is liable, unless he or she can show that strict liability should not be imposed, or that they can rely on an appropriate defence. The burden on directors in these circumstances is intolerable in my view. Of course, it is also an approach that flies in the face of the fundamental principles of our law: a person is innocent until proven guilty.

The rules of CSR, not backed by specific legislative direction in the appropriate case (for example, the requirement that directors report on the environmental activities of the company), create a burden, but one which the law does not recognise. Although there will be instances when a director will sometimes be seen to be acting shamefully, or against the spirit of community interests, as reflected in the rules of corporate governance, in law the director will face no penalty.
If, for whatever reason, directors favour a particular stakeholder's interests, they may be

applauded by the media and others. However, should ASIC, or certain civil litigants feel the company has been prejudiced as a result of its generous behaviour, they may seek a remedy, which is recognised by law, and results in potential corporate and director liability being incurred. The tension this generates in terms of how companies should be managed, and the way in which directors and officers should conduct their obligations and pursue their duties, adds a significant burden on those who do undertake the responsibility of acting as directors and officers of companies.

In light of Mr Medcraft's recent evidence before the Senate Estimates Committee that the concept of corporate culture and related issues should be addressed more directly in the legislation, and with the government about to consider its reaction to the far-reaching recommendations of the Murray Report into the Australian Financial System (with recommendations that important new powers be vested in ASIC), it will be fascinating to see how the questions of CSR and related matters are addressed. The recent decision to increase the presence of independent directors of superannuation companies in legislation tabled at the end of the 2014–2015 financial year (Superannuation Legislation Amendment (Governance) Bill 2015) indicates the government is very concerned that this is an area of the law that needs to be carefully updated. Whether this is in the best interests of companies and the way in which they are governed, especially if they are not companies operating under special legislation, such as the Superannuation Code and related legislation, is a matter of some debate.

Finally, the recently announced audit of ASIC's operations will no doubt provide some interesting potential opportunities for the government to increase the regulator's efficiency. This may reduce ASIC's over-generous reliance on administrative and related measures when dealing with potential breaches of the law. It may also provide more comfort to company directors and managers that their responsibilities and obligations under the relevant legislation, and its oversight, are reflected by the law and not by wish lists that have no effective legal backing.

CHAPTER 4:

Focus on the long term, deliver for the short term

Why directors should be worried about value

Mark Rainbird and David Walters
April 2016, (extract from) *Creating Value: A practical guide for boards and directors*, AICD, pp 2-7.

It was suggested in a 2014 study by the management consulting firm McKinsey that creating value in a company can be distilled down to a simple proposition:

"The guiding principle of business value creation is a refreshingly simple construct: companies that grow and earn a return on capital that exceeds their cost of capital create value."

Other studies, at least in the US context, have suggested that this "guiding principle" is actually not well understood in the corporate world, let alone followed. Based on the similarities in business structures and practice between the two countries, the same result in the Australian context would hardly be surprising.

At one level, this can be seen as simply a question of financial literacy; that is, being able to understand what "return on capital" actually means. For example, a survey in 2013 by the Australian Financial Reporting Council noted that "almost all respondents acknowledged in their commentary that there were concerns about the level of financial literacy of directors in Australia". Perhaps not surprisingly, finance professionals generally had a lower view of the skills of directors they deal with than the directors did of themselves. The issues were more pronounced in smaller businesses.

Perhaps even more important than just understanding what a set of company accounts says, however, is what is actually done with that information. The answer may be very little.

For instance, in the UK in 2013, a study for the Chartered Institute of Management Accountants found that in the "backbone of the economy" – the small-to-medium enterprise (SME) sector – "… there is a tendency to make decisions without adequate, or indeed any, financial information or analysis".

This suggests that in reality, the problem may be more fundamental than just understanding

and using appropriate financial information. In what was described as a "shocking result", another US based study found that:

"… a mere 34 per cent of the 772 directors surveyed by McKinsey in 2013 agreed that the boards on which they served fully comprehended their companies' strategies. Only 22 per cent said their boards were completely aware of how their firms created value, and just 16 per cent claimed that their boards had a strong understanding of the dynamics of their firms' industries."

In a practical sense, much of the actual day-to-day formulation of strategy and development of business models is a management issue. The problem from a director's perspective, however, is that to review and engage in the necessary debate and discourse on how this is occurring, they are often faced with a myriad of different, sometimes overlapping, sometimes ambiguous, sometimes contradictory concepts of what creating value actually means.

This all points to a broader issue and concern for directors – not just financial literacy, but a more general understanding of what drives business performance. This is what we call value literacy.

Why compliance is not the same as performance

A director of any Australian company should be well aware of their day-to-day legal duties and obligations. These include clear prohibitions on the improper use of their position and improper use of information, as well as obligations to act in good faith and exercise due care and diligence.

This is not unique to Australia and it has been suggested that "most legal codes stress two core elements: loyalty (placing the company's interests ahead of one's own) and prudence (applying proper care, skill, and diligence to business decisions)".

It is not a surprise then that a detailed framework of directors' duties and obligations has built up over time. This focus on good governance is not just a corporate self-protection mechanism, but it is commonly argued "contributes to growth and financial stability by underpinning market confidence, financial market integrity and economic efficiency".

Good governance, however, is not just legal compliance. While that is a key responsibility, so too is stewardship of the organisation's outcomes. In the UK, this has been framed as a responsibility to ensure not only "conformance", but "performance" as well.

In many respects, the compliance or conformance obligations are much more straightforward. Over time, standards have evolved and regimes and mechanisms have developed to allow boards to monitor and ensure that these obligations are met. For example, dedicated board committees with independent non-executive directors are now generally accepted practice.

Performance is, however, far less prescriptive. It does not lend itself as easily to codes, standards and audits, particularly when it involves non-financial, non-quantitative concerns.

This potentially creates a gap in corporate life where it may simply be easier for directors to focus on compliance – where what they have to do is relatively clear – than on the more nebulous but challenging imperatives of value creation and capture. The Chartered Institute of Management Accountants in the UK have referred to this as "an oversight gap in relation to the performance dimension".

Why oversight of performance is more difficult than compliance

The studies noted above suggest some common themes for this apparent gap in corporate life, including a lack of board time dedicated to these issues, a lack of focus on their importance, a lack of accepted frameworks, and the backgrounds and skill sets of the individual directors themselves. To some extent, these are all internal excuses that have a compliance flavour – "we just need to organise the board agenda better".

Really understanding the problem of overseeing performance requires acknowledging fundamental external influences that differentiate all companies – namely the fact that each business has a different market context, a different risk profile and may well have different time horizons.

Different market situations

All companies share the same legal framework and are subject to the same general laws and regulations. What they do not share, however, are the same industries, the same resources and the same competitive environment. These all make a critical difference to performance.

At best then, frameworks for guiding performance can only be general and to some extent abstract. That is inherently more difficult to deal with than ensuring proper compliance processes have been followed.

Different risks and risk appetites

Creating value also implies risk which it is argued is "fundamental to business, however there is a line between taking responsible risks with the aim of increasing the company's value and behaving without due care and diligence". This is enshrined to some degree in the defence offered to directors by the Business Judgment Rule in the *Corporations Act 2001*.

In recent times, there have been moves to systematise the understanding of risk though the development of the discipline of risk management with its own methodologies and standards – ISO 3100. However, since risk is essentially about the likelihood of future events, there must be a high degree of subjectivity. This makes navigating the line between risk and reward a far more difficult decision process than following prescriptive compliance based rules, with risk appetite quite rightly varying depending on a wide range of variables in the company's situation.

Different time frames

Another consistent challenge in arriving at some general formulations around business performance is aligning thinking on the question of developing value over different time frames.

A good example is an ongoing debate over "short-termism" in corporate life. At one

extreme is what has been called the "fail-fast" philosophy that has supposedly become synonymous with start-up culture. A good example is Google X, the research arm of the internet giant, where the explicit objective is to evaluate and if necessary kill projects quickly, learning from the experience. This may be a stark contrast to a private family company where aligning wealth generation and allocation across generations becomes problematic.

One institutional response to short-termism is evident in France where, from 2016, firms must commence granting double voting rights to shareholders who have held shares for more than two years, supposedly as a means of encouraging more loyalty between companies and their shareholders. Shareholders can, however, overturn this requirement themselves by a two-thirds vote, and it seems many companies are.

Is short-termism inherently flawed? The answer is nuanced. As commentators have pointed out:

"Long-termism and short-termism both have their virtues and vices – and these depend on context. Long-termism works well in stable industries that reward incremental innovation. But it is a recipe for failure in such businesses as social media, where firms are constantly forced to abandon their plans and 'pivot' to a new strategy, in markets that can change in the blink of an eye."

A way forward – developing a value literacy

If there are inherent challenges for any board's understanding and oversight of managing value and value creation in the businesses for which they are responsible, what needs to be done?

The answer at one level is obvious. Directors have to devote their time to understanding something about the particular peculiarities of the business for which they are responsible. Rather than just wading through a jungle of detail, however, some frameworks and common understanding to help in that task would obviously be beneficial.

The problem is that, unlike compliance, there are no officially approved frameworks. Indeed, management theorists have thrown up so many competing frameworks over the last fifty years since it became a recognised subject in its own right, that there is an entire other jungle waiting to envelop the unwary.

The reality is that oversight of performance is an interpretative process bringing into play a broad range of ideas, disciplines and perspectives. This is not made any easier by overlapping and potentially confusing terminology.

While it probably sits poorly in an age of specialisation, a modern director needs to be closer to a Renaissance man in a business sense. This requires what we call a broad based value literacy to ensure there is an appropriate balance in corporate life between conformance and performance.

This is not to suggest that the role of the board and management should merge or even blur.

Instead, there must be common ground so that there can be a constructive debate and effective oversight.

Developing this value literacy means traversing quite a wide field and looking at value creation from a number of perspectives. Our intention is to provide some of the basics of that literacy building on contemporary theory and practice. Some of these views are not yet orthodox and some are in their relative infancy, but in a business world where disruption is becoming a common theme a wide perspective is important.

Finally, central to the notion of the original Renaissance was that learning and enquiry were not fixed, but ongoing. So too is developing a robust value literacy.

CHAPTER 5:

Improving board and shareholder engagement

An investor's view on shareholder engagement

AICD
December 2016, *An investor's view on shareholder engagement*, Karin Halliday, Senior Manager, Corporate Governance, AMP Capital Investors, interviewed by the AICD for the Australian Governance Summit 2017.

Directors of listed companies have a critical role to play in communicating with and engaging shareholders. The AICD spoke with AMP Capital's Karin Halliday for an investor's perspective on what makes for a good engagement process and what companies could be doing better.

AICD: What would you like to see companies do more of to engage with shareholders?

Karin Halliday (KH): Companies need to spend more time understanding their shareholders. There are lots of different types of shareholders. Speaking to just your substantial shareholders, or just your domestic shareholders, will give you one view. But shareholders vary – even institutional shareholders are not a homogeneous group.

My views are those of just one of those shareholders. But even then at AMP Capital Investors (AMPCI), we manage a range of equity products that have been established in response to particular client requirements. These include traditional long only funds, long-short funds, yield focused funds and sustainable funds.

All of those funds have specific mandates, risk tolerances, benchmarks and return objectives that have been agreed with the clients and trustees of those funds.

The investment and proxy voting decisions we make must fall within the boundaries of the mandates of each of those funds. For index funds, for example, the clients will expect our portfolio to fairly closely replicate the index. For sustainable funds, clients expect the portfolio to avoid certain companies.

AICD: Is it necessary for boards to be involved in the shareholder engagement process?

KH: Definitely. Boards can't discharge their responsibilities without engaging with shareholders. Boards are accountable to shareholders. Boards are stewards of the company's capital: financial capital, social capital, human capital.

It makes sense to me that boards would want to check in with the suppliers of capital. And seek to understand why, of all the investments we could make, we have chosen to allocate our capital to their company.

AICD: From a shareholder's point of view, is more information always a good thing?

KH: More information is not always necessarily a good thing. Sometimes we're overwhelmed with the amount of information that companies give us. We find that the information we need should be the information that's relevant to the company. It also needs to be material. There's no point just communicating with the shareholders for the sake of communicating. Directors are busy, companies are busy, and shareholders are busy. We don't want all this noise, what we really want is the important issues that companies should be focusing on and that we want them to be focusing on our behalf.

AICD: What trends are you seeing companies using to approach shareholder engagement?

KH: Companies are doing a range of different things. We've got companies that come in to see their large shareholders. We've got companies that use proxy solicitation, then they phone us to ask for our views, and then they consolidate those views.

Something I've appreciated is companies giving us the opportunity to meet with other directors besides the chairman and the chair of the remuneration committee. If they run a forum where they have a few directors in to talk about audit and risk management and those issues, that's quite helpful. We can then get to understand the quality of the board, the quality of their governance and their risk management.

We also find that companies are asking us a lot more about environmental, social and governance issues. The dialogue on those issues has really increased

AICD: How do you see the role of proxy advisers? Are shareholders overly reliant on them?

KH: Proxy advisers are important because proxy voting and shareholder engagement is quite a difficult task and quite a time consuming task. Not all investors have access to have that engagement with companies. It's good for smaller institutions and shareholders to have access to proxy advice. I think they play an important role in the market.

Unfortunately, I think some shareholders are overly reliant because they just don't have the resources to do their own voting and own engagement with companies. To be able to vote, they then rely on proxy advice. At large institutions like AMPCI, we're able to do our own analysis, and even though we use proxy advice and gather information from their research, it's just an input into what we're doing. We don't necessarily rely on it, but some other institutions probably do. You can see that from the way voting results have gone this proxy season.

AICD: Do all companies approach engagement in the right spirit with more than a tick-the-box attitude?

KH: Unfortunately I do get the sense that some companies must have it on their KPIs to engage with shareholders, so they come in and can tick that box. They haven't really come to us with information that they want to share with us, they haven't come to us wanting to listen to our concerns.

I think it really is important for companies to be genuine about the dialogue so that we both benefit from it. We have a lot of insights that we can share with companies, and there's a lot that we can learn. It really needs to be a genuine two way dialogue.

AMPCI tries to work out who has got it right. We try to be pragmatic and constructive. Given the effort we make to understand companies and why they have implemented certain remuneration structures, say, it is disappointing when companies aren't up front with us.

I find now in my meetings with companies, what I tend to do is at the end of the meeting say, "Is there anything that I haven't asked?" I'd hate for companies to leave the meeting thinking, "I'm glad she didn't ask that controversial question." It will come out at some stage, so it's best just to deal with it at the time.

Opening your books to shareholders?

James Morvell
Partner, Hall & Wilcox, May 2016, "Opening your books to shareholders?", *The Boardroom Report*, Volume 14, Issue 4, AICD.

What should you do when a shareholder asks to review the company books? James Morvell considers the risks for company directors and the level of access they are legally required to give.

Boards may face difficult choices when a shareholder requests access to company documents, starting with questions as to what actually constitutes "company books" and how many documents (if any) need to be handed over.

In some cases, a company's constitution or its shareholders' agreement (if one exists) may grant rights to shareholders to inspect the company's books. Shareholders also have a right under section 247A of the *Corporations Act 2001* (Cth) (Act) to make court applications acting in good faith and for a proper purpose to inspect company books.

Company directors need to consider whether disclosure will harm the company and whether to resist when faced with such requests. They also need to discuss the issue with the appropriate executives and legal counsel.

However, if it is inappropriate to voluntarily grant access to the documents requested by a shareholder, it is important to know how

a court is ultimately likely to consider an application (if made by the shareholder).

The Engel case

In the recent case of *Engel v National Biodiesel Limited* [2015] FCA 1114 *(Engel)*, the Federal Court explored the "books of the company" definition, and the orders available regarding a shareholder's s 247A application.

Mr Engel, a shareholder of National Biodiesel Limited (NBL), applied to the court to access certain documents after NBL refused his direct request for documents. Mr Engel wanted to examine what he considered to be a series of alleged related party transactions between NBL, its subsidiary National Biodiesel Distributors Australia Pty Ltd, its major shareholder National Biodiesel Group Pty Ltd and various other related parties.

Mr Engel feared these transactions had resulted in assets being moved out of NBL, thereby diluting the value of his investment.

Establishing "books of the company"

"Books of the company" is not defined (generally or in the context of s 247A). However, the Act does include a wide definition of "books", which includes (without limitation):

- A register
- Any other record of information
- Financial reports/ records
- A document

In *Engel*, the federal court found the phrase "of the company" to mean property of the company. Notably, it also found that where a parent company receives material from its subsidiary for inclusion in board packs, ownership of the materials passes to the parent and becomes part of its records.

How many documents?

Shareholders will rarely be granted unfettered access to all of the books of the company.

In *Engel*, the Court was satisfied the application was in good faith and for a proper purpose, as Engel sought to investigate possible contraventions of the *Corporations Act 2001*.

Nevertheless, the court emphasised that applications under s 247A should only be for documents relevant to the purpose of the application. The court also confirmed its discretion to determine such matters, and held that certain documents sought by Mr Engel were not relevant to the inspection.

What of protection?

The court also explored using legal professional privilege to resist the production of certain documents. It acknowledged the importance of confidentiality in maintaining privilege and ordered Mr Engel not to disclose or copy the documents he obtained other than for analysing the related party transactions.

Who pays the costs?

Cost awards are determined by the court. In this case, NBL was ordered to pay the costs of Mr Engel's application on the basis he had requested access to the documents directly from NBL (which was denied), and was largely successful in his s 247A application.

Engel is a timely reminder that "company books" is a broadly defined term. Companies may benefit from reviewing their contractual obligations to provide access to company books and records, which may allow them to resolve such requests quickly and without going to court – however, there will be situations where court intervention is unavoidable or even necessary to deal with a shareholder who may have malicious or improper intentions.

CHAPTER 6:

Embracing intrapreneurship and innovation

How SMEs can build a culture of innovation

Andrew Klapka GAICD
CEO, Trans Chem, "How SMEs can build a culture of innovation", *The Boardroom Report*, Volume 14, Issue 8, AICD.

A carefully cultivated innovation culture is an essential ingredient for businesses looking to stay current. In part two of his series on innovation, Andrew Klapka GAICD explores key considerations for SMEs looking to innovate.

Many executives and boards will be all too familiar with the phrase "culture eats strategy for breakfast". The best laid plans can falter if a business's culture does not support or align with the business' direction or ambition. Innovation is particularly susceptible to a weak cultural foundation. But it is also the most responsive when the culture is calibrated correctly.

Innovation is a word with a powerful emotional pull that has the potential to inspire teams. Yet how well it is understood by an individual or a function within a business can vary considerably. Even the largest organisations, with sophisticated communications and marketing departments, can be challenged when messaging and setting up an innovative culture. For the SME that may not have a communications function, let alone research or innovation capabilities, the challenge can seem immense.

So what are some of the ways that an SME can build a culture of innovation that captures the hearts and minds of staff and stakeholders?

Create quick wins and tell the stories

There are many steps to embarking on a program of innovation. Executive committees will debate the possible paths of innovation and how these align with core strategy. CEOs will be highly visible in communicating the innovation mission and the key objectives to staff and external stakeholders. Stage-gate review frameworks will be chosen. Management will consider how progress should be measured.

All of these preliminary steps are valid and necessary. But will they inspire enthusiasm alone? Will they give rise to a sense of true innovative ambition throughout the company? Remember that innovation is both an activity of great motivation and one that is often treated with scepticism.

So it is important to capture attention, motivate stakeholders and build business-wide credibility and commitment at an early stage.

This can be best achieved by expeditiously implementing proven practices that will:

- engage people in practical innovation events across the business; and
- have a high chance of delivering early, interesting and visible results.

News about these activities and results can then be shared by way of 'success stories' which describe innovation techniques and milestones from within the business. These messages should be used to engage the collective mindset, resonate with all levels of staff and be talked about in company corridors.

Examples of activities that engage the hearts and minds can include:

- cross-functional workshops to define ideas;
- exploratory 'discovery events' with customer groups to understand possible opportunities for innovation;
- engagement sessions between user-groups and design and production staff; and
- experiential tours 'in-the-customer's-shoes' for senior executives.

All of these activities will generate preliminary findings which are immensely useful. They will help define key innovation directions. Most importantly, they will capture attention and motivate enthusiasm by demonstrating the power and insights of innovation-in-action. Credible practices and outcomes should be publicised across the business to seed and feed the reflection about innovative possibilities.

Get everyone involved – cross-functional engagement

To ensure an enterprise-wide commitment to innovation, it is important to engage people from all corners and functions of the business. Active participants in a healthy innovation culture will not only come from the business' commercial functions, such as sales and customer service, but also from internally-focused functions like HR and finance.

Management should seek to select innovation "champions" from within each function. This serves as an excellent cultural-enabler since it ensures the inclusion of staff views on innovation for each function.

"Champions" can be made responsible for reinforcing the success stories and progress updates. They can unpack the logic behind particular techniques being applied and the findings that are uncovered. The best innovation champions are often those who volunteer; "true believers" who have a keen interest in developing new products and services.

From small steps to embedded culture

Innovation can be a little like writing. Sometimes you need to get your thoughts on paper so you can see what you want to say. With innovation it helps to jump in and start your innovative processes in order to better understand where you need to focus.

Starting with small and symbolic milestones and then sharing their success with staff is a great first step. It allows you to engage with everyone in the business, gauge appetite and bring the whole team with you. By doing this, the right culture becomes embedded and the chances of success in locating and developing valuable innovative opportunities are greatly improved.

CHAPTER 7:

Setting up your board for long-term financial strength

Profit is not a dirty word

Phil Butler
NFP Sector Leader, AICD, September 2016, "Profit is not a dirty word", *The Boardroom Report*, Volume 14, Issue 8, AICD.

The idea that not-for-profits [NFPs] cannot make a profit is damaging the sector. The AICD's NFP sector leader Phil Butler explains why NFPs must make a profit if they are to keep delivering on their vital missions.

There is a long-standing perception that the NFP sector is in a constant state of financial distress. This is not just a view that's held by outsiders, but by members of the NFP community themselves. The AICD's annual *Governance and Performance Study*, now in its seventh year, has consistently found that directors in the sector perceive financial sustainability, diversifying income source and managing expenses as among their biggest challenges.

The recently released 2016 AICD study, entitled *Raising the Bar*, found that there is considerable misunderstanding among NFP directors about the part that profit plays in strengthening organisations so that they can deliver on their mission well into the future.

"If we made a profit, we would have to give the money back," said one director in the focus groups that the AICD held with NFP directors. "It is my understanding that it's illegal to make a profit," said another.

There is an idea that if NFPs do make a profit they are somehow shifting resources away from their mission. The reality is the opposite: profit is essential if NFPs are to keep delivering on their goals over the long-term. It is a view that is also held by one of the most important regulators for the sector.

"Profit is not a dirty word. Robust charities need to make a profit and re-invest for sustainability," Susan Pascoe, head of the Australian Charities and Not-for-Profits Commission, told an audience of sector leaders at the launch of this year's study.

NFPs can and do make profits. But an NFP's profit is retained by the organisation and applied to achieving its mission, rather than distributed to individuals for their private benefit. In some sectors, such as childcare, NFPs are able to, and do make significant profits, sometimes exceeding 25 per cent.

What's the right level of profit?

Admittedly the appropriate level of profit for any particular NFP can be hard to determine. And in fields such as human services it can be wrenching to see beneficiaries miss out on services in the short-term to enable the long-term survival of the service provider. But it is a question that it is vital for responsibly NFP boards to address.

The right profit margin for an organisation will depend on a range of factors such as stage of development, operating environment and the organisation's specific goals. NFPs working in complex and uncertain environments will require more profit to offset risk, as will those with ambition to grow.

In the life of an NFP, there will also be times when things are good, times of stability, and for some, the time may come when it is best to wind up. NFPs can survive a loss in a single year, or even for a few years, but unless they have a reliable benefactor, over the long-term they must make a profit to survive.

Of the directors that the AICD surveyed for the report, about two-thirds (64 per cent) reported that, on average, their organisation made a profit in the last three years, one in five (20 per cent) reported breaking even and 14 per cent reported making a loss. Of the 64 per cent of directors that reported making a profit, a quarter reported profits of less than three per cent – an amount that would barely cover inflation.

What this data indicates is that although some NFPs are making a profit, the profit is often insufficient for long-term survival. If the trend continues, some organisations (at least a third) may soon be in financial distress.

NFPs are critically important for Australian society. They deliver services to some of the most vulnerable members of our community. They repair tears in the social fabric. They bind together diverse groups of people around good causes. But to continue play this vital role, they need to be financially strong. Ultimately profit in the NFP sector should not be a dirty word because when NFPs profit, all of society benefits.

Are there too many charities in Australia?

Lucas Ryan
NFP Policy Advisor, AICD, April 2016, "Are there too many charities in Australia?", *The Boardroom Report*, Volume 14, Issue 3, AICD.

Amidst widespread debate about the number of charities in Australia, Lucas Ryan GAICD explores the underlying causes behind the concern.

"There are too many charities."

It's a popular catchcry about the charity sector, but the facts and underlying causes behind this issue are not generally in focus. They should be.

Australia has approximately 53,000 registered charities: one for every 444 Australians.

This sounds like a significant number, but it is relatively small compared with similar jurisdictions around the world (418 head per charity in Canada, 340 in England and Wales, 274 in the USA and 174 in New Zealand) according to the Australian Charities and Not-for-profits Commission (ACNC).

This number still seems large, leading some, such as wealth management firm JBWere, to call for charities to consolidate in order to become more efficient and effective. Through their latest *Cause Report*, JBWere observed that roughly 10 new charities are registered every day, but statements from ACNC Commissioner Susan Pascoe indicate that a similar number that cease operating, suggesting a slower rate in growth.

So why are we so concerned about the number of charities? The real question is not whether there are too many charities (how long is a piece of string?), but what the drivers behind consolidation in the sector really are.

There's a myth that government funding of charities is constricting. This is mostly untrue. The 2010 Productivity Commission report *Contribution of the Not-for-profit Sector* recorded government funding in excess of $25 billion. Not four years later, the ACNC's *2014 Australian Charities Report* recorded $42 billion in government grants. Clearly, government expenditure on the sector is growing.

But there's a catch. The way that government structures funding is changing. Government is outsourcing more of its functions to charities and, in so doing, reducing the cost allocated for these services. Larger grants are being shared among fewer recipients and government is seeking to realise the benefits of economies of scale. As a result, charities are expected to do more with less.

Make no mistake, the primary driver for mergers in the charity sector is government funding. It hasn't been stated explicitly, but the policy lever has been pulled and the effects are already flowing. For a long time, many charities have not operated in a competitive marketplace and as such have not been subject to market rationalisation. This is changing fast and, as a result, the question is being asked: are there too many charities in Australia?

I want to make a bold assertion. Every charity board needs to ask "are we still relevant and should we still be here?" More challenging still will be having the courage to face the hard truth if the answer is no. The AICD's *2015 NFP Governance and Performance Study* found that one third of charities had discussed mergers at the board table. This suggests that many are recognising the need to change in order to remain relevant and competitive.

A clear example of this new funding approach emerged in the results of the Australian Government's 2015 employment services grants scheme. The new program saw the number of provider organisations reduce from 79 under the previous scheme ('Job Services Australia') to 44 (under 'job active') and the service regions more than halved from 110 areas to only 51. Unsurprisingly, some charities in the employment services space flickered out of existence.

The risk of these changes is that the value provided by specialised local services may be lost, but some charities have responded innovatively to this challenge. CoAct, established as early as 1997, unites a network of localised services under one banner to tender competitively for government funding in employment and training. Together, their 22 member organisations have the ability to compete with larger players (including private providers) without eroding the integrity of their community-based approach.

Government has a responsibility to ensure that its funding practices do not negatively impact the charity sector or, by extension, its clients. Having charities deliver services might be cost-efficient, but pulling these levers too hard merely moves financial distress from the government to charities.

For charity boards, negotiating these changes will continue to be a challenge. Strategic boards will be thinking about how their organisation will fit in the new landscape and how they can demonstrate their value and relevance to government and to the community. Those who are unable to do this may be at risk of being lost to the tide.

CHAPTER 8:

Governing within the constraints of the public sector

Inside government boards

AICD
May 2016, "Inside government boards", Elizabeth Montano FAICD interviewed by the AICD, *The Boardroom Report*, Volume 14, Issue 4, AICD.

After making the jump from a career as a corporate lawyer in the early 1990s, Elizabeth Montano FAICD has gone on to carve a long and successful career in the Australian Public Service.

In 1996, Montano became CEO of AUSTRAC and the most senior woman in Commonwealth law enforcement and regulatory agencies at that time. Later she became chair of Centrelink, and has since sat on a number of other government boards and committees. Today she advises and consults to government departments and agencies on strategy, business planning, governance, compliance, assurance and risk.

Elizabeth Montano spoke with the AICD to share the lessons she has learnt over her career inside and outside the boardroom.

AICD: In your opinion, what makes a good government board?

Elizabeth Montano (EM): A good government board is one which can think commercially but still remember it's operating within a government context. A mix of people with strong commercial, financial and public sector experience who all understand the core motivators and contexts of stakeholders will always produce a better and more innovative result.

AICD: Are there any specific skills you think need to be injected into government boards and committees?

EM: The key skill set is extensive experience in governance and risk with the ability to adapt and apply that in varying contexts. Some government boards and committees require members with specific skill sets and relevant industry expertise.

However, there is great merit in appointing fresh eyes without industry baggage. "I appreciate we've been doing things this way for 50 years, but can someone tell me why?" can be the most valuable question a new board or committee member asks. Often they'll be the catalyst for innovation. You need all these skills in a collegiate group of

people who respect and appreciate what each brings to the table. And when you get on a board like that, it's the most exhilarating place to be.

A good government board is one which can think commercially but still remember it's operating within a government context.

AICD: You have served on a number of audit and risk committees and now provide advice on public sector assurance and risk. Has the way the sector deals with audit and risk changed over the years?

EM: There is a strong emphasis on governance in the public sector. So much so, that audit committees are now mandatory and, at the federal level, have much broader functions and responsibilities than the name suggests. They have evolved to advise on assurance, risk and performance frameworks tailored to suit the organisation and to monitor and evaluate their effectiveness. This reflects the strong connection made in the public sector between governance and superior performance. Audit and risk committees are now recognised as key contributors to public sector outcomes.

Smart boards and CEOs know that active and focused audit committees are a big part of their personal risk management strategies. You can't always ask the probing questions yourself – so you need someone with a different perspective who can ask those questions.

AICD: As former chair of Centrelink, do you have any advice for managing competing political, social and community pressures for directors in similar positions?

EM: Directors on government boards have largely the same obligations as directors in the private sector- you are not appointed a director to represent any particular interest group. I've found that the best way to deal with competing pressures is to overtly recognise them and work to find common ground. That may sound a little "Pollyanna-ish" but it's amazing how the elephant in the room becomes a mouse once you've shone the spotlight on it. Strong conflict of interest protocols support this.

Smart boards and CEOs know that active and focused audit committees are a big part of their personal risk management strategies.

AICD: What are some examples of innovation that you have seen in the public sector? How can the public sector encourage innovation?

EM: There are many examples of innovation in the public sector and I have been fortunate to contribute to a number of them.

In the mid-1990s, AUSTRAC as one of the world's first financial intelligence agencies and anti-money laundering/ anti-terrorist financing regulators, developed innovative information technology including cheap and fast electronic data exchanges between government and industry involving leveraging off institutions' back offices (a world first). We data mined before it became fashionable and we identified intelligence needs of front line agencies. The recently announced Fintech sandbox should provide an environment for industry and regulators to deepen their interactions.

Centrelink focussed on delivering public policy on the ground leading to a closer and more responsive relationship between the public sector and the community.

The Australian Institute of Marine Sciences is another example of a leading innovator. It has an international reputation as a collaborative creator of “public good” and industry relevant science. It has built this over decades by matching strategic direction and capabilities.

The common thread between all of these is a clear understanding of your objectives combined with an unfettered view of how to do it. Of course, when you’re delivering essential public services you can’t throw everything up in the air and wait to see how the experiment goes. You need to operate on two planes of thought - business continuity and business transformation. Boards, CEOs and audit committees who understand this will succeed.

CHAPTER 9:

Tales from the corporate battlefield

Leading over the cliff

Theodora Antonopoulos
September 2016, "Leading over the cliff",
The Boardroom Report, Volume 14, Issue 8, AICD.

A spate of failures in the corporate world and at sporting clubs has highlighted the need for leaders to foster cultures of integrity at their organisations. AICD's Theodora Antonopoulos explains.

For a country which so readily cuts down the tall poppy, it is ironic how much Australian businesses spend on leadership training and development. The estimates exceed $1 billion annually. But leadership on its own does not ensure business success. Indeed, some of the greatest crises in Australian corporate history have occurred under the watch of captains of industry who were adulated for their leadership capacity. Think: Babcock and Brown, Centro and OneTel.

There is no doubt leadership is critical to the success of our organisations. But if we think that improved leadership leads to superior business outcomes, why are all of these crises still happening? What essential ingredient is missing from the leadership equation?

As we find ourselves in hallowed month of September – football finals season – we need only reflect on the governance failures at clubs which are household names. The board of the Parramatta Eels had become so dysfunctional, and had presided over such gross breaches of one of the fundamental tenets of the NRL – the salary cap – that the NSW Government removed the entire board and appointed an administrator. Essendon is still suffering the fallout from its failure to ensure its players complied with the World Anti-Doping Agency code.

Some of the country's largest companies have been the subject of public and political criticism, rightly, for their provision of poor financial advice and inappropriate financial products to their customers. Dick Smith, in an attempt to make a quick return, is now in the throes of insolvency. Another household name gone.

These are not instances of a few bad apples spoiling the cart. For these crises to unfold, they required the cooperation, or at least the acquiescence of a significant number of leaders. They demonstrate to those responsible for governance – our directors

and senior executives – that failures in governance can have catastrophic and possibly terminal consequences for business.

Good governance leads to good performance. And our leaders, while important and accountable, are only as good as the governance frameworks in which they lead.

A positive, performance driven culture is a crucial responsibility for directors and the cornerstone of an effective and sustainable business. The phrase 'setting the tone from the top' says it all. Boards must engage with management to ensure that the organisation's purpose and culture is clear, that it inspires and infiltrates every element of the business.

Good governance is a direct benefit of diversity. The problem with an obsessive focus on individual leadership is that a leader's biases, blind spots and preferences are given undue weight.

Groupthink is a particular vice which diversity combats. Directors are duty-bound to ask the difficult questions in the boardroom even if they go against the majority view. Shareholders can make and unmake directors. Their confidence in the governance of a company is essential to its success. It supports the share price for listed companies, and ultimately those who have the privilege of serving on its board. If directors wish to maintain that confidence – and ultimately their jobs – they should begin with developing good governance practices and communicating this with shareholders – the rest will follow.

Recent corporate failures are a vivid demonstration of what happens when an organisation's leaders neglect to spread a culture of integrity, accountability and diversity. The success of our companies and organisations relies on directors and senior management working together to ensure a focus on governance best practice. Only then is outstanding performance possible.

CHAPTER 10:

Policy making for the long term: one year on

The policy conundrum

Christine Hawkins FAICD
2016, *The policy conundrum*, Mote 3: Board Effectiveness: Challenges for Directors, Cinnabar International Pty Ltd.

Boards are, or should be, dynamic, flexible, adaptive and accountable, bearing the ultimate responsibility for the health and performance of their organisations. Boards rely on the aggregation of skills and experience, the collective wisdom of the group, to make decisions that will drive, or not, their CEOs and staff to deliver a level of performance of which they can be justifiably proud. This is the case whether the board is responsible for a profit-seeking multinational corporation or a volunteer-led, not-for-profit, local community organisation. To do this, boards must focus on the future, looking outside of their organisation, constantly challenging the existing paradigms on which their strategy is based.

One of the inescapable impacts on board and organisational performance is government policy. During the last decade, Australian industry has lived in a policy environment that most would agree has been less than conducive to the effective conduct of business generally. Uncertainty over policy objectives, conflicting and fluctuating proposals, policy that is reactive to vocal pressure groups and with fanciful consideration of the real impact on the people of this nation, has been the norm. We acknowledge the difficulties that successive governments have faced with a divided electorate but anecdotally, there appears to be a view across the electorate generally that none of our political parties has a view for the future of Australia, or, if they do, it is not one that is shared by a majority of the voting population.

The obsessive focus on the budget deficit, at commonwealth level, while a serious issue, will pale in comparison to the devastation that will result if the government fails to consider some of the issues affecting the performance of organisations now and in the near future. We have endured an array of climate responses, with no broad agreement on how this should proceed, and we are now facing the potentially catastrophic economic and social consequences that will result from the failure to develop a domestic energy policy. Those consequences are already playing out in South Australia. Someone once said that Nero fiddled while Rome burned….

For the boards of organisations, this is a nightmare scenario, outside their control. What will your board do about this? Is it even identified as a strategic risk in your risk management system? Boards must lift their game and understand the significant threats to business that arise from absent or ineffectual government policy. Lobbying is an old trade, but there are scientific and technical institutes that are at the forefront of these issues and always in need of support. Does your board look for these external sources of information or does your annual strategy retreat resound with the usual vested interests? The future of this country might well depend on enlightened directors looking beyond their immediate corporate boundaries at the long-term sustainability of their organisations.

Good debt versus bad debt: Investing in Australia's future

Stephen Walters MAICD
Chief Economist, AICD, September 2016, "Good debt vs bad debt: Investing in Australia's future", *The Boardroom Report*, Volume 14, Issue 8, AICD.

The AICD's chief economist makes the case for why governments should borrow to invest in Australia's creaking infrastructure.

After years of lightweight public debate on the issue, the discussion over the size of public debt and what government borrowing should fund is sharpening up, thanks to recent contributions from the Reserve Bank and the Treasurer. Australia sorely needed a better-informed discussion on the merits of government borrowing for nation-building purposes, given the enormous strain on the nation's creaking infrastructure and the fact it never has been cheaper for governments to borrow.

A recent survey of the Australian Institute of Company Director's members taken after the federal election revealed that nearly one quarter of directors saw inadequate infrastructure spending as a major challenge for the economy. An overwhelming 85 per cent considered the current level of government spending on infrastructure to be too low.

Outgoing RBA Governor Glenn Stevens, in his recent speech to the Anika Foundation event in Sydney, made the distinction between "good" and "bad" public debt. Stevens emphasised that government borrowing for much needed infrastructure that adds to the economy's productive capacity is superior to borrowing for recurrent purposes. The government did the latter during the darkest days of the financial crisis, when borrowed cash was distributed to households to help keep consumer spending buoyant.

Scott Morrison joined his voice to Stevens' soon afterwards in his own set piece speech at the Bloomberg Sydney offices. The Treasurer argued that public debt is a "nuanced" issue and that government borrowing to fund investment in public infrastructure can have significant public benefits. The contributions from our chief monetary and fiscal policymakers were refreshing and ran

contrary to what had become, particularly among economic conservatives, conventional wisdom: that higher public debt is undesirable in any circumstances.

The "more government debt is bad" mantra has dominated the debate for too long. This accepted public policy orthodoxy ignores the fact that government actually has significant capacity to borrow right now, unlike the household sector. Increased public borrowing would not necessarily threaten Australia's coveted AAA credit rating, either, because it would add to our productive capacity, lifting future growth and government revenue, and thus aiding budget repair.

As Governor Stevens pointed out, the government is the one sector of the economy where debt levels are still low relative to history, at about 40 per cent of GDP. This is despite a sharp rise in government debt in recent years caused by successive federal governments running budget deficits year after year, partly to fund the largely unproductive payments to households. Gross household debt at 125 per cent of GDP is three times higher than the ratio for the combined public sector.

The benefits of appropriately scrutinised public investment in infrastructure are obvious, particularly in so-called "greenfields" projects where private sector operators are reluctant to assume the associated construction risk. Many of these "riskier" early-phase projects would never be undertaken without government involvement.

Construction of long-lived assets that generate a positive economic return over time allows government to service the additional debt, and the consistent revenue stream later makes the asset attractive to private sector investors. International pension funds, for example, have a great appetite for investment in long-lived infrastructure assets, allowing government to recycle the sale proceeds into other productive assets, creating a virtuous cycle.

The provision of public assets – be they toll roads, ports, rail links, power generators, airports or roads – prudently assessed and constructed, can lift productivity and add to the economy's capacity to produce more, lifting potential growth. The construction phase also has clear benefits for national economic activity and employment.

There is a separate debate to be had about which infrastructure assets are funded by additional government borrowing, and the appropriate governance arrangements. Careful assessment of the costs and benefits associated with each prospective investment needs to be undertaken, with projects not chosen based on political expediency and opportunism, which has been the case too often in the past.

Australia's track record here is patchy at best. We as a nation need to do much better, but as an urgent priority government should not miss the rolled-gold opportunity presented by record low borrowing costs to invest in the nation's productive capacity and future prosperity.

Beating infrastructure gridlock

AICD
May 2016, "Beating infrastructure gridlock", *The Boardroom Report*, Volume 14, Issue 3, AICD.

Effective infrastructure is essential to support our nation's productivity and growth. But big questions have been raised about the efficiency and governance of infrastructure planning and investment.

Improving Australia's infrastructure should be a key priority for our nation, according to Dr Nora Scheinkestel FAICD, director of Stockland, Telstra Corporation and chair of Macquarie Atlas Roads.

This view is shared by a majority of Australian directors who consistently rank infrastructure as the most important long-term issue for government. Ninety per cent of the Australian Institute of Company Directors (AICD) members consider the current level of national infrastructure investment to be too low, according to AICD's most recent *Director Sentiment Index*.

"We need to take a broad view of infrastructure. Making Australia an efficiently connected, networked country – physically and technologically – will deliver enormous benefits," says Scheinkestel.

"It will facilitate mobility and agility, delivering economic improvements by way of productivity but, in addition, well-thought-through infrastructure initiatives will also bring social, environmental and even intellectual benefits."

Barriers to productivity

As the Australian Infrastructure Audit (2015) highlights, without action on infrastructure, increasing congestion and bottlenecks will test Australia's productivity and quality of life.

Infrastructure Australia forecasts that by 2031:

- Road travel times in capital cities are expected to increase by at least 20 per cent, more than doubling transit times on more congested routes.
- Demand for public transport in cities is expected to double.
- The national freight network will have exceeded capacity.
- Regional roads, town water and rail infrastructure will have deteriorated to service standards that the Australian community will be unlikely to accept.

Infrastructure Australia chairman, the Hon Mark Birrell FAICD, says Australia needs to plan and invest better in economic infrastructure.

"We're lucky to live in a nation that has got positive economic growth and positive population growth, which many other countries can't claim. But we're also a nation which has been constrained by the inefficiency of some existing infrastructure assets or the absence of new projects that would make it easier to sell services and products into international markets," he says.

According to Birrell, one of the key issues is the need to increase overall funding of well-selected projects and simultaneously increase maintenance funding of existing assets.

The Grattan Institute's transport program director Marion Terrill agrees that governments should not overlook the benefits available from smarter use of the infrastructure we already have. However, "plenty in the industry are quite concerned at how poor the commitment to maintenance is," she says.

"Certainly by international standards our spending on maintenance is low. Australia spent 15 per cent of transport infrastructure funds on maintenance in 2013 compared to 25 per cent a decade ago," says Terrill.

She highlights that the lack of data, and also government transparency in infrastructure spending, are two big roadblocks.

"More often than not, governments are making really substantial investment decisions on transport infrastructure without any line of sight to the public as to what's motivating those decisions – what's the business case for the investment? [Grattan] has found that a lot of the time the business case in investment either doesn't exist or is quite weak," she says.

"The data is also not very good. Looking specifically at transport infrastructure, there is very poor data available on the conditions of roads, so it's not comparable across different states.

The way forward

In the recently released policy paper, *Governance of a Nation: A Blueprint for Growth*, the AICD encourages Australian governments to develop consistent and strong governance standards for nationally significant infrastructure projects, increase the transparency of forecasts of the costs and benefits of infrastructure investments, and develop nationally consistent measures of infrastructure performance to aid benchmarking and review.

The AICD urges strong COAG engagement with the findings and recommendations of *Infrastructure Australia's Australian Infrastructure Plan*, released in February 2016.

"There's an emerging consensus on how we can improve the delivery of major projects in our cities and regions but also how we can reform the way infrastructure is financed and operated," says Infrastructure Australia's Birrell.

"We need to prioritise federal and state funding into projects that improve connectivity and boost our opportunities for trade. Let's collectively focus on ways to steer the growth we're having in a positive direction by getting transformative infrastructure projects underway and always putting the needs of customers, consumers and users first."

Dr Scheinkestel adds: "While some projects may be more local, many will be national and so require co-ordinated collaborative effort at the government level and far-sighted investment by the various stakeholders."

AICD's Blueprint emphasises that greater coordination between governments is needed to deliver a strong pipeline of productive infrastructure that aligns with the nation's longer-term capacity and growth needs.

Furthermore, Australia's infrastructure needs cannot be funded by public investment alone. Expanding private sector engagement in infrastructure delivery and operation is critical if we are to avoid the forecast shortfall in capacity and service levels.

"There's good signs of business and governments getting their act together on improving infrastructure, but the immense demands that will be placed on our nation are an indication that there's a need for even greater partnerships as well as federal and state co-operation," says Birrell.

CHAPTER 11:

How to foster a culture of innovation

Boards, innovation and disruption

James Mabbott,
Partner at KPMG, January 2017.

In recent years, due to lower barriers to entry, increased customer mobility, pervasive technology platforms and globalisation of business, we are seeing innovation and disruption featuring at the top of strategic priorities for boards and executives alike. Yet most boards are ill-equipped to deal with a world in which the new normal appears to be one of no normal, where industries and long-held business paradigms face rapidly changing landscapes, where today's weak signals of change are tomorrow's industry giants and where competition comes from both within and outside an industry.

This increases the pressure on boards to move quickly to ensure they provide appropriate challenge, direction and governance to executive teams. And they need to do so whilst managing potentially complex commercial, financial and reputational risk issues against long term shareholder interests – something that upstart challengers don't have to contend with. Existing companies have customers, revenue and profit; they also have legacy systems, processes and cost structures: so the modern director faces a particularly challenging landscape.

In order to make sure the board is best equipped to support an organisation to understand and respond to disruption, and build innovation into its core, there are a number steps directors and executive teams can undertake.

Get educated

Understanding disruption and innovation is two-fold. Firstly, they must develop a familiarity with the tools, techniques and methodologies of innovators whether from within or outside their industry, so as to understand how their own approaches measure up. Secondly, they must seek to identify and understand the emergent players in their industry that aim to disrupt their business model, so as identify new business models, acquisition opportunities or threats to be managed.

Make a commitment

The board with the executive needs to define and set the agenda in terms of what

innovation means to the organisation (for example, improving business efficiencies, upgrading or developing new products/ services, developing new approaches to market or even new markets) and why the organisation needs to innovate (for example, to increase revenue, minimise cost, adapt to change in market conditions, keeping up with competitors/taking marketing share from competitors). Clear direction and commitment from the board creates permission and opportunity for innovation.

Examine culture

Innovation, at its heart in an organisation, is about culture. And culture in simple terms is the sum of the behaviours in an organisation: the way an organisation treats its people, the way its people treat each other and the way the organisation interacts with customers. To build an innovation culture requires looking across and within key organisational structures: strategy, risk appetite, remuneration, and investment. A board needs to ask: How does innovation and disruption align to these key organisational structures? Is our operating model conducive to, or does it prohibit, our ability to innovate? How have we defined innovation for our business?

Be transparent

Innovation requires transparency. The board should have visibility of the innovation pipeline and processes should exist within the organisation to allow the sharing, development and investment in innovative and creative ideas.

For each of these areas the board should be asking key questions:

Strategy
- Does innovation and disruption feature in our business strategy?
- What time horizon does our strategy cover?
- How have we defined innovation? And where do we want to innovate?

Remuneration
- How are executives rewarded for taking risk? Are outcomes and consequences in line with the strategic agenda?
- Over what time horizon are incentives paid?
- Have we set explicit innovation goals and do we reward them?

Risk appetite
- Does our risk appetite support innovation activities?
- What risk behaviours do we want and how do these align with our desired culture?

Investment
- Have we allocated funding to innovation projects?
- Do we have an innovation investment pipeline that is reviewed at board level?
- What expectations have been set with shareholders on the balance between returns and investment in future growth and innovation?

Transparency
- Have we communicated our innovation agenda? Are our expectations clear?
- Do we have processes, tools and systems in place to allow for the transparent and easy sharing of ideas?

Processes
- Do we have an innovation process?

- Do our processes allow for easy engagement with innovative businesses? Could we procure from a start-up?

In addition to the above questions, boards need to also consider the make-up and composition of committees and board members: Are the right skills present at the board table? Do advisors and management teams have the right experience and capability? Are adequate time, energy and attention allocated to discussing and acting on the challenges and opportunities that innovation and disruption present?

Ultimately the role of the board and executive is to provide leadership, set the tone, give permission to the broader organisation and create space within boundaries for innovation to occur, because so much of the innovation that is sought will come up from below and it is the board and executive's duty to provide the opportunity for this to happen.

Three signs your organisation is not innovative

Amantha Imber MAICD
Founder of Inventium, November 2016,
"Three signs your organisation is not innovative", *Financial Review.*

Innovation is a word at the tip of almost every CEO's lips. However, despite the best of intentions, many organisations are killing innovation. There are several issues that these organisations have in common.

Leaders don't walk the talk

While the majority of CEOs and their leadership teams talk about innovation, many unfortunately don't do anything about it. Resources such as people, time and money continue to be allocated to "business as usual" projects, rather than put towards riskier but potentially highly rewarding innovation projects.

Senior leaders working in organisations that say they value innovation need to look objectively at how they are resourcing it and review whether what they say reflects what they are actually doing.

At this year's top ranking organisations in the AFR's Most Innovative Companies list, senior leaders really walked the talk of innovation. Many senior leaders took an active role in supporting their employees' innovation activities. This support took a number of forms from open door policies through to mentoring innovation projects.

At Mirvac (who debuted at #3 in the 2015 Most Innovative Companies list), all members of the executive leadership team have the KPI of enabling their team to contribute to innovation at Mirvac. The KPI is measured by people providing examples of supporting or enabling their team to achieve innovation objectives.

Innovation starts with idea generation

People mistakenly think that innovation starts with an idea. As such, organisations trying to innovate will often start by running lots of blue sky workshops (where any idea is a so-called "good idea") and where an online

suggestion box is launched calling for all staff to submit ideas. However, this is a very damaging approach to innovation as it leads to a lot of ideas that are completely off strategy.

Instead, leaders need to focus their staff's innovation efforts around solving challenges that actually matter and that are based on what the customer values.

At Australian Unity, senior leaders set "innovation missions" once a year, which are areas where the business deliberately wants to focus its innovation efforts. After identifying these missions, exploratory customer research is conducted into where specifically the greatest opportunity for innovation lies. And only after these stages do employees commence idea generation.

Ideas are taken straight to implementation

When a good idea is born, many organisations move straight to implementation – or at best, a large scale pilot. However, this can prove to be a very costly mistake. Organisations need to ensure that rather than moving straight to implementation, a stage called Experimentation needs to come first.

Experimentation involves setting hypotheses as to why an idea will add value to the customer and creating a minimum viable product (MVP) - the most basic version of the idea that will still allow for learnings. Experiments can then be set up to test hypotheses using the MVP and based on the results, iterate or change course accordingly. Experimentation is a very effective way to de-risk innovation. Companies from Google, through to Lendlease, through to Commonwealth Bank all embrace experimentation as a key stage in their innovation process.

Through identifying and rectifying these three innovation killers, leaders can make significant inroads into turning their organisation into one where innovation thrives.

Empowering female entrepreneurship for future prosperity

Fiona Boyd
CEO, Head over Heels, October 2016, "Empowering female entrepreneurship for future prosperity", *Membership Update*, AICD.

Research shows that startups led by women deliver outstanding returns but still too little capital is flowing to female led businesses. Fiona Boyd, CEO of Heads over Heels, a not-for-profit supporting high-potential women-owned businesses, explains why it's vital for Australia's future prosperity to empower more female entrepreneurs.

Significant progress has been achieved towards increased diversity and representation of women on boards, and at executive level. Until recently however, there has been less attention given to the promotion and support of female entrepreneurs.

Just as it makes economic sense for the diversity of the global marketplace to be reflected in those who lead companies, it also holds that if women can fully participate as entrepreneurs, the economic benefits should follow.

Entrepreneurs create jobs and enrich societies by creating solutions to social problems. They also introduce innovations, launch new industries and revive mature ones. With the looming global employment challenge, women need to fully participate in these economic activities.

The local economic imperative is equally as confronting when we consider the disruption that is occurring across every industry sector in Australia. The Committee for Economic Development of Australia has reported that over 5 million jobs, almost 40 per cent of Australian jobs that exist today, have a high likelihood of disappearing in the next 10-15 years due to technology advancements.

It will be the current small start-ups – the businesses of the future, that will help create new employment opportunities and potentially replace some of the existing jobs lost through industry change and disruption.

[A] study conducted by Harvard Business School, found that when men and women pitched the same idea, investors were 60 per cent more likely to invest when a man proposed it.

There is evidence that startups led by or co-founded by women generate significantly higher returns. A recent article in *The Australian Financial Review* highlighted a venture capital group which examined 300 start-up organisations over a 10-year period, and concluded that those companies with either a female leader or co-founder performed 63 per cent better than companies founded only by men.

Other research conducted by Dow Jones, Kauffman Foundation, and the SBA Office of Advocacy, have reported similarly high levels of return from female-led companies, including those in technology sectors. Another study analysing a dataset from 350 micro finance institutions across 70 countries indicated lending to more women was

associated with lower write-offs and lower portfolio-at-risk.

And yet, as the article noted, when it comes to achieving the critical support and financing needed to grow their businesses, it appears that women are not being given a 'fair go'. Babson College in the USA discovered that over a two-year period, companies with a female Chief Executive received $US1.5 billion in venture capital, while companies led by men received $US49.3 billion. Another study conducted by Harvard Business School, found that when men and women pitched the same idea, investors were 60 per cent more likely to invest when a man proposed it.

One of the most important determinants of entrepreneurial success is access to business networks, however women are much less likely than men to have access to a broad network of financiers, mentors, advisors, clients and suppliers – all connections which they need to grow their businesses.

This may be changing as women seek to build and leverage their own entrepreneurial ecosystem, with more women moving into angel investment activities in addition to investment banking and venture capital. According to the Centre for Venture Research, as at 2014, 26 per cent of all angels were women, and 36 per cent of all companies seeking funding were women, both of which had increased substantially from previous years.

Women angels also sometimes sit on the boards of the companies they invest in. As these companies grow larger, women will get the experience needed to also sit on larger company boards, which should in turn help create a virtuous circle to further increase diversity. As Geri Stengel notes, women angel investors can do more than simply crack the 'glass ceiling' that prevents women from getting the capital they need, "women angels fly right through it".

For smart investors and business people willing to back women entrepreneurs, there are significant untapped opportunities.

This is an edited extract from the AICD's latest quarterly *Gender diversity progress report*.

CHAPTER 12:

The impact of recent global events on governance

Boards must heed global political shift

Tony Featherstone
Consulting Editor of the AICD Governance Leadership Centre, July 2016, *Boards must heed global political shift*, Governance Leadership Centre, AICD.

Recent Australian and overseas political events should compel boards to reassess their governance capacities in an increasingly regulated, volatile and uncertain market.

A possible hung parliament in Australia, Britain's decision to leave the European Union (Brexit) and Donald Trump's success so far in the US presidential campaign, reinforce the danger. Boards that lack understanding of public policy formation and government have a problem.

Taken together, these events suggest a global shift towards populist politics and a gradual move by electorates to the Left. Support for economic rationalist policies is weakening as voters seek greater government intervention and push back against decades of deregulation and globalisation.

If this trend continues, the inevitable conclusion is higher industry regulation and compliance, public-policy indecision and economic stagnation. The trend adds to expectations of constrained investment returns continuing this decade.

Sovereign risk in developed nations, not only emerging ones, will become a bigger board consideration. The Brexit vote initially crunched the share prices of Australian companies with significant UK operations. A Trump presidency would have significant implications for the US economy, global trade and emerging markets.

In Australia, a Coalition government with minority party support, and a volatile Senate, could spark another round of leadership changes, an early election and a possible change of government. It is too soon to know how events will play out (as this column was being written) but Australia's sovereign risk is rising.

AMP chief economist, Dr Shane Oliver, said: "In Australia, it is arguable that we are seeing the greatest Left/Right divide in any election since the 1970s, with the ALP being a long way from the economic rationalist policies of Hawke and Keating."

The threat of growing global regulation and a possible push by governments could force boards into a quasi-regulatory role.

Earlier this year, I interviewed several of the world's leading governance thinkers about the evolution of governance over 10 years. The report appeared in the February issue of the AICD's *Company Director Magazine* and is available on the AICD website for members.

Philip Armstrong, director of governance at Gavi in Switzerland, said: "Governance will move towards a much more regulated environment over the next decade. Financial crises will continue to be seen as much of a political as an economic issue, and governments will need to be seen to respond with tougher laws. The big challenge for boards over 10 to 15 years is that governance will be seen as a parallel form of regulation."

Dr Roger Barker, director of corporate governance at the Institute of Directors (UK), said: "There is a real danger that governments push boards towards much more of a mandated, supervisory role for corporations … the trend is heading towards boards becoming quasi corporate policeman."

The AICD Director Sentiment Index has regularly identified director concerns about excessive regulation. In the latest survey, more than 60 per cent of directors perceived governance regulations as onerous. Three-quarters said regulation and the risk of personal liability had led to a risk-averse decision-making culture on Australian boards.

Business concerns about excessive regulation and public policy uncertainty will surely intensify in the next few years, given unfolding political trends.

Electorates in developed countries are reacting to growing inequality, stagnant wages growth and higher unemployment – conditions that have characterised the global economy since the 2008/09 GFC. A potential move towards more isolationist economic policies and greater government intervention in the global economy cannot be ruled out – particularly if societal, technology and demographic trends add to rising inequality.

Greater need for government skills on boards

Boards must be prepared for this climate of greater political uncertainty and electorate unrest. The starting point is ensuring the board has at least some directors with deep understanding of public policy formation, regulatory settings and government, and relationships in federal and state politics.

This is, arguably, a skill in short supply on many listed-company boards. Unlike the US, Australia does not have a tradition of senior business people moving between industry and politics – and the divide between business and Canberra, sadly, is widening.

Directors who bring strong public policy skills and can govern across a range of areas will be in stronger demand on listed-company and not-for-profit boards.

Boards, generally, have been reluctant to recruit politicians for fear of being seen to favour a political party (although several

former politicians are on listed-company boards). There have also been concerns that former public servants lack commerciality or cannot govern beyond their core competency – unfounded, given the success of former senior public servants who have transitioned to corporate governance in the past decade.

More regulated industries, such as financial services, understand the benefits of recruiting former public servants to boards.

Expect a continuation of this trend as boards recognise the need to improve their skills diversity in public policy and government analysis. And for more industries to recruit government experts to their boards as higher regulation spreads across other sectors.

In such uncertain times, governing for performance will require deeper understanding of politics, regulation and the electorate. Boards that outsource these skills to external advisers, or do not understand the threats and opportunities of higher regulation in Australian and overseas markets, will be found wanting.

International initiatives will strengthen investor confidence

AICD

April 2016, *International initiatives will strengthen investor confidence*, Governance Leadership Centre, AICD.

The Hong Kong Securities and Futures Commission (SFC) in March [2016] released its conclusions regarding the widely anticipated *Principles for Responsible Ownership* after years of public consultation. The Principles are Hong Kong's first step towards a stewardship code and are intended to apply to investors who invest money or hold shares on behalf of clients or stakeholders to whom they are accountable.

The new code is an important development. Hong Kong consistently ranks highly in Asia for its relatively stronger governance and regulatory oversight and there is a perception that Hong Kong-listed equities are a safer way to gain exposure to China's economy than investing in the more volatile, unpredictably governed Shanghai Stock Exchange.

But proxy adviser Glass Lewis says Hong Kong has "lost some ground due to the lack of general best practice standards in investor engagement initiatives".

Glass Lewis says Hong Kong, one of the world's most business-friendly jurisdictions, will benefit from the code's seven core principles, which follow global norms. The voluntary Principles, based on an "apply or explain model", suggest investors:

1. Establish and report on their responsible investment (RI) policies;
2. Monitor and engage investee companies;
3. Establish clear policies on escalation of engagement;
4. Have clear policies on voting;
5. Be willing to act collectively;
6. Report to stakeholders on RI activities; and

7. When investing, have policies to manage conflicts of interest.

Jamie Allen, Secretary General of the Asian Corporate Governance Association, and Melissa Brown, a leading Asian RI analyst and partner at China-focused adviser Daobridge Capital, say the Hong Kong stewardship code "marks only a first step in a gradual journey towards stronger investor commitment to corporate governance".

They wrote in March [2016]: "The good news is that the SFC has held the line on the spirit of the initiative and will proceed with the Principles largely intact, despite robust lobbying against from some of Hong Kong's more traditional business associations... The SFC largely dismissed complaints about higher costs and the inconvenience of more investor engagement, and countered with a firm statement of principle about its goals, saying it 'believes strong corporate governance requires listed companies and their directors to be proactive, as well as shareholders to be both reactive and proactive'."

South African governance changes

The release of the draft *King IV Report on Corporate Governance* in South Africa in mid-March [2016] is another key governance development. The King Report is considered among the more authoritative, influential governance codes by global standards.

Deloitte describes King IV as "bolder than ever". It says the new version of the King Report provides an even more practical, principles-based approach to good governance and global public sentiment and international regulatory change than King III, which was released in 2009.

Deloitte says King IV aims to establish a better balance between conformance and performance – an issue on the minds of Australian boards that believe excessive regulation is forcing them to spend more time on compliance issues and less on strategy etc.

Key changes in King IV include the application of a principle-and-outcome approach instead of a tick-the-box approach. Seventy-five King IV Principles have been consolidated into sixteen, each linked to distinct outcomes. As in Australia, King IV Principles are designed to lead to identified outcomes and each Principle is supported by recommended practices.

Executive pay is emphasised in King IV. The Principles recommend a remuneration policy and an implementation plan, which links pay to performance, be tabled for a non-binding advisory vote. If at least 75 per cent of shareholders do not approve the remuneration policy or implementation plan, the remuneration committee must consult shareholders and disclose the nature and outcomes of those consultations.

King IV also builds on King III's good work to introduce IT governance to corporate governance in South Africa. It separates technology and information and requires directors to have greater IT risk awareness. "King IV recognises information … as a corporate asset and confirms the need for governance structures to protect and enhance this asset," says Deloitte. That is a relevant

development for Australian boards given their growing focus on cybersecurity and other technology risks and opportunities.

King IV also recommends that listed South African companies establish social and ethics committees to consider issues relating to ethical behaviour and ethics management. The Principles suggest greater integration between this committee and other board sub-committees to ensure ethics are considered more widely in boardroom deliberations.

Formal recognition of the role of stakeholders is another important addition in King IV. It says active stakeholders are required to hold the Board and company accountable for their actions and disclosures – an interesting development as shareholder activism worldwide grows. King IV appears to go further than other governance codes, including the *ASX Corporate Governance Principles and Recommendations*, in emphasising the critical role of stakeholders in the governance process.

King IV's changes around technology, ethics and on the disclosure of investor consultations when executive remuneration proposals do not meet sufficient hurdles, provide food for thought in the next iteration of the *ASX Corporate Governance Principles and Recommendations*.

CHAPTER 13:

Making the most of your data

The man in charge of building Australia's future

Domini Stuart
December 2016, "Increasing global competitiveness", Adrian Turner MAICD, CEO, Data61, interviewed by Domini Stuart, *Company Director Magazine*, December 2016 - January 2017, AICD.

Adrian Turner, CEO of CSIRO's Data61, speaks to Domini Stuart about the research organisation's drive for greater ambition and innovative thinking in Australia.

After 18 years in Silicon Valley, Adrian Turner MAICD felt it was time to make the US his permanent home. But an invitation to head the Commonwealth Scientific and Industrial Research Organisation's (CSIRO) new data innovation group, Data61, changed his mind. "I accepted the job because I believe this is the one group in the country that can change Australia's innovation trajectory from within," he says. "It's an incredible asset – a team of 1,100 people including 680 PhD and doctoral students, all focused on every aspect of data science."

Turner graduated from the University of Technology Sydney and worked in product management before switching to technology in the late 1990s. He moved to Silicon Valley where he co-founded software security firm, Mocana Corporation. He also co-founded holding company, Borondi Group, which is building a portfolio of operating assets with the aim of disrupting traditionally conservative industries such as agriculture, mining and healthcare.

Turner's time as chairman of Advance, a not-for-profit network which connects 20,000 expatriate Australians in 90 countries, made him more aware of the deficiencies in culture, finance and infrastructure that were driving Australian entrepreneurs to take their nascent businesses elsewhere. This awareness was behind his eBook, Blue Sky Mining: Building Australia's Next Billion Dollar Industries, which compares Australia with Silicon Valley and sets out changes necessary to ensure Australia's global competitiveness over the long term.

Building new industries

As industries become data driven, the world is undergoing massive economic change, which Turner compares with the move from agriculture to manufacturing. "New economic structures like Facebook, Google and Uber tend to be naturally monopolistic and are scaling three times faster than any other cohort of company in history," he says. "As we move to a world where everything connects to the network, these structures will be applied across all industries, including

the most conservative. In Australia, we need to figure out how to develop and build these new industries and how to help the 97 per cent of our businesses that are small businesses to succeed in a global digital environment."

The best place to focus is on our strengths, he says. "One obvious example is food provenance," says Turner. "Australia has a huge opportunity to sell premium and value-added agricultural products overseas, but at the moment, we value add to just one per cent of our agricultural exports and there are already examples of inferior, local produce being passed off as quality Australian exports. If we have any ambition to fulfil our potential in this area we must ensure that the litre bottle of milk being sold for $9 in other countries is, in fact, Australian milk and that we as a country are reaping the benefits. Genetics, smart packaging and blockchain could all be combined to guarantee provenance."

Another example is geospatial intelligence. "About 70 per cent of government data sets have a geospatial dimension and this will become even more prevalent as we move to a world of precision agriculture, robotics and autonomous systems such as driverless cars," he says.

Picking up the pace

One of Turner's major concerns is Australia's attitude to collaboration. "In Silicon Valley, deep collaboration and almost perfect information sharing is the norm," he says. "As a result, everything moves much faster because people don't waste time on problems that someone else has already solved. In Australia, a lot of lip service is paid to collaboration but, overall, we still have an "I win, you lose" mentality rather than a growth mindset of doing things together. I do sense a bit of a shift but we're still moving too slowly." Another concern is the culture surrounding risk. "In general, Australians have been comparatively risk averse and afraid of failure but I don't think this will inhibit the next generation," Turner says. "The school students I talk to, and the students working in our organisation, all seem to be fearless, which is very encouraging."

What it means to be human

In April 2016 Turner was appointed co-chair of the industry-led Cyber Security Growth Centre. "For me this role has brought into sharper focus what it will mean to be human in the emerging digital world," he says. "The technologies are going to be extremely powerful in terms of quality of life as well as life extension and wealth creation so there are many societal implications. It's vital that we don't allow a divergence between people who have access to technologies and people who do not."

There will also be fundamental questions about data, including who should own it, who should have access to it and under what circumstances. "As more of the systems that influence our lives are automated, there needs to be transparency and there must be mechanisms in place that allow people to challenge the decisions the systems are making that affect them," he says. "That's profound. And these are all things that business leaders should be thinking about right now."

Protecting privacy: What consumers expect

Marta Ganko
Risk Advisory, Deloitte Australia, June 2016,
"Protecting privacy: what consumers expect", *The Boardroom Report*, Volume 14, Issue 5, AICD.

Consumers are increasingly demanding that organisations take preventive measures against breaches of personal data. Marta Ganko, Client Manager in Risk Advisory at Deloitte Australia, walks through the key findings from the firm's Australian Privacy Index survey, which sounds a warning to organisations that neglect consumer privacy.

Privacy is hitting board agendas at the moment. Consumers are becoming more aware of the privacy risks associated with their information. A perception that an organisation will protect user's privacy and use data appropriately is now essential to the integrity of a brand.

A data breach can be devastating to an organisation's reputation and take years to repair. Boards need to put in place appropriate protections to guard against this risk to the business.

Last year Deloitte launched the Australian Privacy Index to give organisations an idea of what consumers expect of organisations and what the state of play is across industries in regard to privacy.

In the second year of Deloitte's assessment of the privacy practices of more than 100 leading consumer brands operating in the Australian market, a picture emerges of a sophisticated consumer - one that sees privacy as a function of both data protection and transparency around how their data is being used.

A telling finding in this year's survey is that more than 90 per cent of the 1,000 Australian consumers rating the brands value trust over convenience, when using the organisation's website or app.

There is an imperative for organisations to safeguard the data that is entrusted to them, no matter to whom it is delivered, or in which country they reside. Organisations that do so have a real opportunity to proactively build trust with customers, positioning themselves as safe and reliable when it comes to customer data.

Main findings

The Deloitte Australian Privacy Index 2016 analysed the state of privacy of 116 of Australia's leading consumer brands in 13 sectors – government, banking and finance, insurance, telecommunications, technology, media, retail, health and fitness, travel and transport, social media, energy, and for the first time, real estate and higher education

These are the three key expectations that consumers have of companies when it comes to their privacy:

- It will use information reliably and respectfully
- It will implement adequate security measures when information is submitted publicly
- It will inform consumers how their information is to be used.

There are particular practices that consumers rate highly when it comes to meeting these objectives. Organisations that did well in the survey had mobile apps that advised the user what they did with their collected data. They had security protocols on their website to protect personal information when capturing it. They were transparent and actively communicated with the consumer how data would be used. The cookies on their website had shorter expiry timeframes than companies that did badly — the average time across all organisations surveyed was 657 days, but some companies stored cookies for more than three years.

Organisations that do not pay heed to the privacy expectations of their customers risk a public relations disaster. Poor practices can expose their customers to embarrassment and sometimes criminality. Boards need to make sure that they are up to date on what best practices and how their organisation can implement them.

Big data and the use of analytics

Nicholas Tate and Alexander Tate
September 2016, (extract from) *A Director's Guide to Governing Information Technology and Cybersecurity*, AICD, pp 34-36.

In February 2012, *The New York Times* reported on a widely publicised use of big data at a store of the Target chain in the US. Apparently a man walked into one of the stores, asked to see the manager, and then proceeded to complain about a letter and some coupons that his teenage daughter had received. The coupons were for maternity clothing, nursery furniture and cribs and the man was asking if the store was trying to encourage his school age daughter to get pregnant. The manager offered to investigate and when he called back a few days later to apologise, the father disclosed that after speaking with his daughter, she was indeed pregnant.

According to the paper, Target collected substantial amounts of data about purchases from its stores and by analysing this "big data", it was able to identify 25 "markers" in the data which allowed it to predict whether a shopper was pregnant and roughly when the baby was due. It appears that sharing these insights with shoppers may actually be a cause for concern sparking debates about the ethical use of big data and the analysis of it.

This is a useful example of the power of big data. If the data samples are big enough, then it is possible to derive insights from them that were not previously possible to identify. The data held by transformational businesses such as Facebook, Google, Amazon, Uber, Airbnb and many others are already disclosing deeper insights into the preferences and behaviours of their users and these insights are being used to develop new business opportunities. The advent of cloud computing platforms is allowing many more traditional businesses to develop their own capability in this area in very cost effective ways.

Analytics and big data are now in use in many areas of the economy where it is possible to acquire sufficiently large datasets. These include retail, health services, transport, financial services and others. As will be discussed in the next section, the internet of things is a prime source of big data for analysis. A question that is often asked is, "how big is big data?" There is no particularly easy answer to this; insights might be drawn from relatively small sets of previously unavailable data but in many cases, it is the intersection of many datasets which could not previously be correlated, that drives new insight and discovery. It is a sober thought but it is likely that we are today generating as much data in two days as existed in total from the start of history until 2003. It is the volume and diversity of this data, coupled with the computational power to analyse which gives rise to the term, big data.

As illustrated earlier, big data is now being effectively used to enable organisations to understand their customers better and, therefore, more effectively target their marketing efforts. Although still an emerging area, the increasing use of big data in the health industry is one of the most exciting examples.

The goal of a more automated approach to the diagnosis of patient complaints is now looking achievable. After all, this is an activity which compares symptoms to a range of likely causes. What is perhaps even more interesting is that the use of big data could lead to a more personalised approach to medicine in which the treatment offered is specifically tailored by the individual data available about the patient. Quite apart from the increased healthcare outcomes, estimates of cost savings in the US health care system exceed US$300 billion.

As these examples illustrate, the application of big data is disrupting traditional approaches and business models in industries such as retail, transportation and healthcare. For those organisations that are involved in these industries, understanding the likely impacts of this disruption will be crucial.

As is so often the case, potential benefits bring with them attendant risks. For big data, this has involved an active ethical discussion around some aspects and the inevitable increase in the risk of a cybersecurity attack on concentrations of data, which may be either confidential or private. Any board considering a big data project should enquire about the nature of the proposed controls for it, ensuring that the necessary controls are in place to protect both confidentiality and privacy.

How big data will affect boards

AICD
July 2016, *How big data will affect boards*, Governance Leadership Centre, AICD.

Megatrends broadly fall into two categories: those that unfold over several decades in relatively predictable fashion, such as the ageing population, and those that are so disruptive and far-reaching that they can barely be imagined, let alone forecast.

Data could be the new river of gold for organisations that harness its power.

Consider some claims about big data, which refer to enormous data or information sets that are almost impossible to process with conventional technologies:

- More than 90 per cent of global data was created in the past two years, says IBM.
- The volume of business data worldwide is expected to double every 1.2 years, according to eBay.
- Data production will be 44 times greater in 2020 than in 2009, says Wikibon.
- Annual spending on big data services will reach US$48.6 billion in 2019, predicts International Data Corporation (IDC)
- By 2020, half of all business analytic software will incorporate predictive analytics, says IDC.
- The amount of high-value data worth analysing will double by 2020 and 60 per cent of information delivered to decision makers will be actionable, predicts IDC.
- Big data will be the next trillion-dollar industry, says Dell.

These are just some of the many big data predictions. Technology trends, of course, are prone to hyperbole and nobody knows for sure how big data will play out. But it certainly has the potential to be transformative and the epicentre of so many other emerging technology trends.

In time, big data might be considered the fuel for the fourth industrial revolution.

Big data is inextricably linked to the internet of things (IoT), which refers to objects that have embedded technology that allows them to send and receive data via the internet and connect with other devices. The Governance Leadership Centre examined the IoT megatrend in June 2016.

Cisco Systems estimates 50 billion hardware devices on the planet by 2020 – a trend that will drive almost unimaginable growth in the creation of big data as more devices talk to each other via the internet and data is captured and analysed.

Big data is also closely linked to cloud computing. Organisations are increasingly storing and managing vast data banks offsite through cloud-computing – another booming IT trend. Cloud computing is a general internet-based technology that allows companies to store information in services and access it on-demand as a software service.

As companies capture more data through the IoT, and manage it via cloud-computing, powerful software algorithms are being developed to analyse this information. These

algorithms will transform decision-making in many industries, quicken the development of robots and machine learning, and boost demand for workers with data-analytic skills.

These combined trends could redefine labour markets as technology does higher-level tasks and replaces more white-collar workers across industry.

Organisations investing in big data

More companies are investing heavily in big data and analytics. After initially experiencing modest returns on investments, firms are now deriving substantial benefits for big-data investment, according to a recent McKinsey survey.

The firm's survey of 714 companies worldwide found the profitability and productivity-enhancing effects of big-data were similar to those experienced in the earlier period of intense information technology investment. Big data, it seems, is following the pattern of other major technology trends, which disappointed at first, before stronger gains.

Tech researcher Gartner says investment in big data is starting to slow as the technology becomes the 'new normal' in business. Nevertheless, about three quarters of companies are investing in or planning to invest in big data in the next two years, according to Gartner's June 2015 survey of 437 clients. IBM says companies are extracting more value from big data in five ways. First, they are using big data to visualise information, share it across the organisation, and improve decision making. Second, big data is providing organisations with an enhanced 360-degree view of the customer: why they buy, what they buy and when, and what makes them tick.

Third, big data is helping organisations lower risk, detect fraud and monitor cyber-security threats in real-time. That has been an important focus of boards that are ensuring their organisation uses big data to help mitigate risks.

Operations analysis is the fourth focus for big data. Companies are analysing machine and other operational data to improve transparency and productivity. Big data's fifth high-value use is helping firms modernise warehouses and create other efficiencies.

Big data and boards

Governing through this new era of big data is a huge board challenge. The concept of 'information governance' – how information is managed to support the organisation's obligations and meet its outcomes – is deservedly gaining more traction in board circles.

But big data extends well beyond information. It will affect everything from the organisation's strategy, skills and capabilities to its culture and values. Boards must ensure that structures and frameworks are in place for the organisation to take advantage of the opportunities that big data presents, and manage through its many threats.

Here are eight considerations for directors with big data (the role of big data in organisation strategy and business models is a separate topic in its own right).

1. Does the board have sufficient skill to understand big data issues? Australian boards continue to upgrade their technology skills by recruiting technology executives, visiting overseas technology clusters and forming advisory panels or technology committees. They need structures to ensure that the right information on the organisation's big data capabilities, and the capabilities of others in its industry, are presented and considered.

2. Can the board use big data in its decision making? Most commentary has focused on executive teams using big data to make decisions. Less considered is whether the board can use big-data visualisation technologies to make key governance decisions, for example, whether to approve management's proposal to invest in a new project.

3. Does the executive team have sufficient big data skills? An essential board responsibility is to recruit, incentivise and monitor the right CEO. Increasingly, CEOs and their direct reports will need strong data-analytic skills, or an ability to manage those who have them. Boards need to know that the organisation's executives are capable of adapting to big data and working with data scientists who will help shape decisions.

4. Will the organisation's skill and capabilities accommodate big data? Predictions abound of a coming shortage of data scientists and managers with deep data analytic capabilities. Demand for data scientists will be 60 per cent greater than supply, estimates McKinsey. Accenture also found that 90 per cent of its clients intended to hire data scientists, but 40 per cent said a lack of talent in this area was a key concern. Boards will need to spend more time with the human resources executives to understand how the organisation is developing its data analytics capabilities and its ability to recruit more people in this field.

5. Can the organisation's culture facilitate big data? Boards must understand whether their organisation's culture is sufficiently flexible and adaptive to respond to big data trends. A culture that encourages lifelong learning and embraces rapid change will be even more valuable as big data redefines business models and reshapes global industry.

6. What is the framework to assess return on big data investments? Many boards will be asked to approve larger investments in big data projects in coming years. They will need to understand and measure the return on this investment – arguably a more challenging task compared to traditional investments in physical assets.

7. How is the organisation managing security risks from big data? Big data potentially creates as many threats for organisations as it does opportunities. Organisations that capture more data on customers, store it offsite, and allow more employees to access it, have a delicate task to safeguard this information and ensure they meet their ethical, social, regulatory, legal,

environmental and governance obligations.

8. Does big data meet the organisation's values test? More organisations could find themselves conflicted as big data provides unprecedented customer insights and technological advances. Boards must know that their organisation has appropriate policies and reporting systems that provide checks and balances on how big data is being used, so that the right decisions are being made.

CHAPTER 14:

Preparing for the fourth industrial revolution

Facing the fourth industrial revolution

Tony Featherstone
Consulting editor of the AICD Governance Leadership Centre, April 2016, *Facing the fourth industrial revolution*, Governance Leadership Centre, AICD.

Boards should ensure their organisation is preparing for the fourth industrial revolution as emerging technologies reshape the global economy, a leading innovation expert says.

Nicholas Davis, head of society and innovation at the World Economic Forum, says industry is on the cusp of its next revolution as artificial intelligence, 3D printing, precision genome editing (using super-computing), new materials and neurotechnology develop at a faster pace.

Davis leads the Swiss-based forum's work on the fourth industrial revolution and is a member of its executive committee. He gave insights from the 2016 World Economic Forum annual meeting in Davos in January for an AICD Governance Leadership Centre briefing this week in Sydney.

Davis says the fourth industrial revolution will build on the unfolding digital revolution that began in the 1970s. "The development of a new set of technological capabilities will fundamentally change how we create, store and distribute value, and relate to each other."

He says the development of machines that think, in areas such as self-driving cars, will transform transport systems; 3D printing will become a new form of manufacturing; genome editing will drive medical breakthroughs; new materials, such as graphene, could revolutionise the computer-chip industry; and advances in our understanding of the brain could alter decision-making systems and information processing.

"A lot of these technologies are still sitting in university labs or being discussed in the media, but have not yet been commercialised in any meaningful way," Davis says. "But these changes are coming and their impact is now a bigger part of CEO agendas."

What boards need to consider

In understanding the potential impact of these technologies, boards should consider four key gaps between business today and that of the fourth industrial revolution.

1. The gap between the digital and fourth industrial revolutions
   "History shows that industrial revolutions are not distributed evenly," Davis says. "Organisations that do not get their digital infrastructure right will find it very hard to play in the fourth industrial revolution."

2. Hype and fear
   "People seem to be either huge technology optimists or very concerned about the impact of technology on global inequality," he says. For boards, that means understanding the opportunities and threats from the fourth industrial revolution and developing different scenarios of what could emerge.

3. Technology and values
   Boards must consider how the development of new technologies, particularly in areas such as neurotechnology and genome sequencing, relate to the organisation's values and ethics. "The link between values and technology and the purpose of new information systems is hugely important, but we don't have a clear narrative yet for that discussion," Davis says.

4. Partnerships
   The implications of these technologies are potentially so profound that no company on its own can have the answers. Ensuring the organisation collaborates with government, academia and start-up enterprises, as part of a broader innovation ecosystem, is critical, Davis says. "Building partnerships that align with the different strategies of organisations in different sectors is a huge challenge. In my experience, Australia is further behind in this regard compared to the US and UK or the Netherlands."

Davis's view on the four key gaps between the digital revolution and fourth industrial revolution provides a useful framework for boardroom discussions. Company directors who can consider the long-term impacts of technology, and how their organisation can bridge the digital and fourth industrial revolution gaps, will have a valuable knowledge advantage.

We are on the cusp of an artificial intelligence revolution

Marc R Benioff
Chair and CEO, Salesforce, September 2016, *Marc Benioff: We're on the cusp of an AI revolution*, World Economic Forum.

Over the last thirty years, consumers have reaped the benefits of dramatic technological advances. In many countries, most people now have in their pockets a personal computer more powerful than the mainframes of the 1980s. The Atari 800XL computer that I developed games on when I was in high school was powered by a microprocessor with 3,500 transistors; the computer running on my iPhone today has two billion transistors. Back then, a gigabyte of storage cost $100,000 and was the size of a refrigerator; today it's basically free and is measured in millimetres.

Even with these massive gains, we can expect still faster progress as the entire planet – people and things – becomes connected. Already, 5 billion people have access to a mobile device, and more than 3 billion people can access the Internet. In the coming years, fifty billion things – from light bulbs to refrigerators, roads, clothing, and more – will be connected to the internet as well.

Every generation or so, emerging technologies converge, and something revolutionary occurs. For example, a maturing internet, affordable bandwidth and file-compression, and Apple's iconic iPhone enabled companies such as Uber, Airbnb, YouTube, Facebook, and Twitter to redefine the mobile-customer experience.

Now we are on the cusp of another major convergence: big data, machine learning, and increased computing power will soon make artificial intelligence, or AI, ubiquitous.

AI follows Albert Einstein's dictum that genius renders simplicity from complexity. So, as the world itself becomes more complex, AI will become the defining technology of the twenty-first century, just as the microprocessor was in the twentieth century.

Consumers already encounter AI on a daily basis. Google uses machine learning to autocomplete search queries and often accurately predicts what someone is looking for. Facebook and Amazon use predictive algorithms to make recommendations based on a user's reading or purchasing history. AI is the central component in self-driving cars – which can now avoid collisions and traffic congestion – and in game-playing systems like Google DeepMind's AlphaGo, a computer that beat South Korean Go master Lee Sedol in a five-game match earlier this year.

Given AI's wide applications, all companies today face an imperative to integrate it into their products and services; otherwise, they will not be able to compete with companies that are using data-collection networks to improve customer experiences and inform business decisions. The next generation of consumers will have grown up with digital technologies and will expect companies to anticipate their needs and provide instant, personalized responses to any query.

So far, AI has been too costly or complex for many businesses to make optimal use of it. It can be difficult to integrate into a business's existing operations, and historically it has required highly skilled data scientists. As a result, many businesses still make important decisions based on instinct instead of information.

This will change in the next few years, as AI becomes more pervasive, potentially making every company and every employee smarter, faster, and more productive. Machine learning algorithms can analyse billions of signals to route customer service calls automatically to the most appropriate agent or determine which customers are most likely to purchase a particular product.

And AI's applications extend beyond online retail. Brick-and-mortar stores still account for 90 per cent of retail sales, according to the consultancy A.T. Kearney. Soon, when customers enter a physical store, they will be greeted by interactive chat-bots that can recommend products based on shopping history, offer special discounts, and handle customer-service issues.

Advances in so-called "deep learning", a branch of AI modelled after the brain's neural network, could enable intelligent digital assistants to help plan vacations with the acumen of a human assistant, or determine consumer sentiments toward a particular brand, based on millions of signals from social networks and other data sources. In health care, deep-learning algorithms could help doctors identify cancer-cell types or intracranial abnormalities from anywhere in the world in real time.

To deploy AI effectively, companies will need to keep privacy and security in mind. Because AI is fuelled by data, the more data the machine gains about an individual, the better it can predict their needs and act on their behalf. But, of course, that massive flow of personal data could be appropriated in ways that breach trust. Companies will have to be transparent about how they use people's personal data. AI can also detect and defend against digital security breaches, and will play a critical role in protecting user privacy and building trust.

As in past periods of economic transformation, AI will unleash new levels of productivity, augment our personal and professional lives, and pose existential questions about the age-old relationship between man and machine. It will disrupt industries and dislocate workers as it automates more tasks. But just as the internet did twenty years ago, AI will also improve existing jobs and spawn new ones. We should expect this and adapt accordingly by providing training for the jobs of tomorrow, as well as safety nets for those who fall behind.

AI is still a long way from surpassing human intelligence. It has been sixty years since John McCarthy, a computer scientist and nominal father of AI, first introduced the term during a conference at Dartmouth College, and computers have only recently been able to detect cats in YouTube videos or determine the best route to the airport.

We can count on technological innovation to continue at an even more rapid pace than in previous generations. AI will become like electrical current – invisible and augmenting almost every part of our lives. Thirty years from now, we will wonder how we ever got along without our seemingly telepathic digital assistants, just as today it's already hard to imagine going more than a few minutes without checking the 1980s mainframe in one's pocket.

Technology and the boardroom

Nicholas Tate and Alexander Tate

September 2016, (extract from) *A Director's Guide to Governing Information Technology and Cybersecurity*, AICD, pp 11-25.

Why should a director be interested in IT?

According to recent estimates, the worldwide cost of IT project failure ranges from US$3 trillion to US$6.2 trillion per year.

Increasingly, IT is an essential enabler for new product initiatives, product delivery and innovation in companies to the extent that many organisations are now dependent on IT, not just for business as usual but also for the ability to bring new products to market and to transform their business models. This has accelerated a trend to larger and more expensive IT projects, whose implementation is critical to the success of the business. With this increased dependence comes increased risk, together with the potential for very significant rewards if the right choices are made.

As IT assumes a greater role in not only supporting the business but in underpinning and enabling all aspects of the business, it also becomes an essential critical infrastructure without which the business cannot run. This presents further risk that a board of directors should be confident is being adequately addressed.

Finally, cybersecurity, which is addressed later in this chapter, provides a growing risk to business not least through the often disastrous public release of private and personal information through the activities of cybercriminals.

There are six significant risks for directors to consider:

1. Critical IT projects may fail through poor governance and oversight;
2. Failure to invest in the right IT projects at the right time will leave a business exposed to competitors who make better choices;
3. An increased use of IT provides a greater target from cybersecurity attacks;
4. An increased dependence on IT leaves businesses significantly exposed to loss or damage through the failure of IT production services;
5. Inadvertent breaches of legislative requirements for IT and cybersecurity through poor levels of oversight of these activities; and
6. Civil or criminal liability for directors if boards do not exercise appropriate governance and oversight of IT and cybersecurity.

This book addresses these risks by identifying what every director needs to know about establishing the appropriate board level governance of both IT and cybersecurity for an organisation as well as providing practical examples and templates for establishing the mechanisms of governance. The book is written in plain English, without resorting to jargon, and explains those technological and legal concepts that board members need to be familiar with. It is designed to meet the needs of, and be accessible to, every company director in discharging their duties in relation to IT and cybersecurity.

Why care about IT?

- IT is driving the digital economy and underpinning both the emergence of new organisations and the substantial disruption of long-established organisations, through digital transformation.
- The worldwide cost of failed IT projects is estimated at over US$3 trillion per year.
- The benefits of success are huge, the cost of failure is high and few organisations have the luxury of standing still.
- The oversight of IT, and the digital transformation that IT should be driving, must now migrate from the backroom to the boardroom.

What is cybersecurity and why should a director care?

Cybersecurity, also referred to as information technology security, is a set of processes, practices and technology solutions that are designed to protect IT infrastructure (such as computers, smartphones, networks and communication links) together with software programs and confidential or personal data, from unauthorised access, use or destruction. According to a recent report by the Centre for Strategic and International Studies (CSIS), which was funded by Intel, the likely annual cost to the global economy from cybercrime is more than US$400 billion to a possible maximum of US$575 billion.

Cybercrime is now big business

Although there has been a traditional view of computer hackers as lone activists, the reality is that hacking has given way to cybercrime. Malicious activity is now targeted at generating financial returns for criminals. A good illustration of this is the black market price list for stolen information which was reported recently by the Symantec Internet Security Threat Report from April 2015. A sample of quoted prices is:

- 1,000 stolen email addresses $0.50 to $10;
- credit card details $0.50 to $20;
- scans of real passports $1 to $2;
- custom malware $12 to $3,500;
- stolen cloud accounts $7 to $8; and
- one million verified email spam mail-outs $70 to $150.

All prices are US dollars. Custom malware includes the outsourcing of cybercrime attacks using what has been described as “Malware as a Service” or sometimes “Hacking as a Service”. This has lowered the technical barriers for cybercriminals to carry out attacks by outsourcing their attack using specialised threat kit brokers and attack service providers.

Although organised crime is the most likely motivation for cybersecurity attacks, other motives can include IP theft by competitors,

political activism, social activism (for example, defacing a website to draw attention to a particular social cause), thrill seeking and state-sponsored activity. An example of activist attacks occurred in June 2015, when a group known as "Anonymous" attacked the websites of several Canadian Government agencies, in protest at the Canadian Government's proposed C51 Security Bill. The attacks made several websites inaccessible.

The high costs of remediation

A security incident can take significant time and money to deal with effectively while also posing a substantial reputational risk to a company. One of the biggest contributors to this cost is the time taken by staff to remediate an incident, but loss of business is also a significant contributor. According to a survey of organisations in seven countries in Europe, Asia and North America by the Ponemon Institute, the average time taken for remediation varies by incident type from 2.6 days for viruses, worms and trojans to 58.5 days for malicious insiders. Each incident can require multiple staff members to resolve or manage and this rapidly escalates to a large cost. This does not count the cost of reputational damage which is difficult to quantify or the potential cost of criminal or civil action, resulting from the theft of personal information.

Cybercrime

- Cybercrime costs the global economy more than US$400 billion a year.
- Security incidents can take over 50 days to fix and tie up multiple staff members at significant cost.
- A successful attack on an organisation's systems can involve substantial reputational damage and leave it exposed to civil action.

Typical cybersecurity threats

Typical cybersecurity threats facing any organisation can be divided into two categories: internal and external.

Turning to internal threats first, all the available evidence may suggest that there is a significant cybersecurity threat from inside an organisation. If there is no security policy (or a poorly considered policy) and staff are not aware of what they should or should not do to work securely, then it is quite possible that their actions may lead to an unintended security incident. Rogue staff, who intentionally sabotage a system, are by no means unknown and a common problem is theft of data. If sensitive data is not encrypted or managed, then the loss of memory sticks and laptops, or the deliberate removal of data via a memory stick, can compromise confidential or private data. For example, it was reported that a security company purchased three bags of lost USB memory sticks at a railway auction in Sydney and many internal files, documents, drawings and videos were discovered on the sticks. A common example of employees inadvertently putting sensitive data at risk is the use of login credentials for internal systems that are then also used on social media sites.

Turning to external threats, these may typically include the following.

Viruses, worms and trojans

These attack a computer and are usually designed to steal data from the computer, gain

an insight into the activities of the computer user or simply take over a computer for the attacker's use. This threat is usually mitigated by the use of anti-virus software. See the Glossary of Terms for a more detailed definition.

Zero day attacks
If there is a vulnerability or weakness in computer software, which is unknown to the developer of that software but known to an attacker, then the software is at particular risk from what is known as a zero day attack. By their nature, these can be hard to detect and mitigate against. See the Glossary of Terms for a more detailed definition.

Phishing
Phishing is an attempt to trick recipients of a message into revealing sensitive, confidential or private information, such as passwords. Deceptive emails are often used for this purpose. Raising awareness of security for all stakeholders will help to alert people not to be deceived by this type of attack. See the Glossary of Terms for a more detailed definition.

DoS attacks
A Denial of Service (DoS) attack is an attack on a computer or network which attempts to make them unavailable to the legitimate users. It is usually mitigated through collaborative action between an organisation's network administrators and its Internet Service Provider (ISP). See the Glossary of Terms for a more detailed definition.

Social engineering
Social engineering tricks victims into divulging confidential information, or access to sensitive computer systems, through psychological means such as impersonating legitimate users of the computer system. It is a common means of gaining unauthorised access. These attacks bypass many of the technical and policy defences for the target organisation. As with phishing, which is a particular variant of social engineering, raising awareness of security for all stakeholders will help to alert people not to be deceived by this type of attack. See the Glossary of Terms for a more detailed definition.

Hacking
This exploits weaknesses in computer systems' security arrangements to gain unauthorised access to that system or to confidential or private data on the system. See the Glossary of Terms for a more detailed definition.

Security awareness training for all stakeholders is an excellent way to mitigate both internal and external threats.

An increasing threat
According to a *Worldwide Threat Assessment of the US Intelligence Community* presented to the Senate Armed Services Committee in February 2015 by James R Clapper, the US Director of National Intelligence, "cyber threats to US national and economic security are increasing in frequency, scale, sophistication and severity of impact." The report continues with the observation that: "[T]he ranges of cyber threat actors, methods of attack, targeted systems, and victims are also expanding."

In 2015, the first unclassified Australian Cyber Security Centre (ACSC) *Threat Report* was released. The ACSC brings together input from many agencies of government including the Australian Crime Commission (ACC),

the Australian Federal Police (AFP), the Australian Security Intelligence Organisation (ASIO), the Australian Signals Directorate (ASD), Computer Emergency Response Team (CERT) Australia and the Defence Intelligence Organisation (DIO).

The report provides the following clear guidance: "[T]he cyber threat to Australian organisations is undeniable, unrelenting and continues to grow. If an organisation is connected to the internet, it is vulnerable. The incidents in the public eye are just the tip of the iceberg."

An issue for board consideration

The 2015 US State of Cybercrime Survey published by PwC with the support of the US Secret Service, CSO and the CERT® Division of Carnegie Mellon University's Software Engineering Institute, commences with the statement that: "It's been a watershed year for cybercrime." It goes on to report that, "Almost half of boards still view cybersecurity as an IT matter rather than an enterprise-wide risk issue" before discussing seven reasons why cybersecurity is a board oversight issue. Prominent among these is the potential for significant financial impact "which may reflect on boards' fiduciary responsibility to preserve corporate financial value." Directors' duties, including fiduciary responsibilities, are discussed in more detail in Chapter 7.

The US National Association of Corporate Directors (NACD) noted, in June 2014, that the potential effects of a data breach (a cybersecurity incident in which private or confidential information is lost or stolen) go well beyond the simple loss of information and can have much greater ramifications for the organisation as a whole. It observes, however, that competing pressures to increasingly deploy cost effective technology to support the business can affect investment calculations. It suggests that: "These two competing pressures on corporate staff and business leaders mean that conscientious and comprehensive oversight at the board level is essential."

Board oversight of cybersecurity

Cybersecurity failures have the potential for significant financial impact across the whole organisation, yet many boards still view cybersecurity as an IT matter rather than an enterprise-wide risk issue.

The US National Association of Corporate Directors (NACD) suggests that the competing pressures to deploy technology cost effectively while preventing data breaches mean that conscientious and comprehensive oversight at the board level is essential.

Some examples of the failure in addressing the risks

Almost all of these risks can be illustrated by considering real-world examples, as can many successes in the digital transformation of businesses that have adequately addressed the risks. Issues of governance are significant contributors to many IT project failures.

Failure of critical IT projects

On 22 September 2011, newspapers in Britain reported that the Health Secretary, Andrew Lansley, Cabinet Office Minister, Francis Maude, and the National Health Service (NHS) Chief Executive, Sir David Nicholson had decided to scrap the NHS's £12.7bn national program for

IT. They cited significant delays, while the UK's Public Accounts Committee found that it could identify few benefits despite the substantial expenditure on the project. The following day, the Daily Mail newspaper suggested, after analysis, that this money could have employed 60,000 nurses for a decade.

Reactions to a failure of this scale differ between the public and private sectors. In a company or other non-government organisation, shareholders or stakeholders may well hold directors responsible for such a significant failure, particularly if the board cannot demonstrate that it had established and implemented effective governance arrangements for IT. There are numerous examples of CEOs and directors standing down over significant failures of IT projects.

In March 2010, Queensland Health went live with a new payroll system that proved to be disastrous for both its employees and the state's finances. From an original budget of $120m for a whole-of-government payroll project, the scope was reduced to Queensland Health only, but the cost expanded to $1.2 billion. Along the way, significant numbers of Queensland Health employees were either incorrectly paid or not paid at all on some occasions. According to the report from the subsequent Queensland Health payroll system Commission of Inquiry about the project, "[I]ts failure, attended by enormous cost, damage to government and impact on workforce, may be the most spectacular example of all the unsuccessful attempts to impose a uniform solution on a highly complicated and individualised agency."
In February 2008, British broadcaster the BBC commissioned an £81m project called the Digital Media Initiative (DMI) and outsourced it to Siemens. After five years under development and an expenditure of £98 million, the project was abandoned in May 2013. After an inquiry undertaken by the House of Commons Committee of Public Accounts, the chair, the Rt Hon Margaret Hodge MP, issued a statement saying, "The BBC's Digital Media Initiative was a complete failure. Licence fee payers paid nearly £100 million for this supposedly essential system but got virtually nothing in return" and added "the BBC Trust failed to exercise sufficient oversight of the Executive Board's delivery of the DMI, despite assuring us that it would." On 24 January 2014, the BBC reported that its former technology chief, John Linwood, had been sacked over the failed project. It went on to say that: "[A] failure of governance and management oversight was to blame, noting senior executives did not have a 'sufficient grasp' of the technology to sufficiently monitor its progress."

The governance arrangements that the board might consider to provide appropriate levels of oversight for IT will be explored in Chapter 4. For more information about the level of knowledge about a company's activities that directors must possess to comply with Australian law, see Chapter 7.

Competitive risk

The examples of IT disrupting business are numerous and, in some cases, stretch back over many years. For example, in 1975, a 24-year-old engineer, Steven Sasson, invented the digital camera while working for Eastman Kodak. There was little interest from the company in such an early prototype with the prevailing technology, film, providing

significantly greater resolution and quality. By 1989, Sasson and a colleague had developed a digital version of the Single Lens Reflex (SLR) camera. However, James Estrin writing in the *New York Times* reports that the marketing department at Kodak did not take it up as a product because of the potential to disrupt its existing film business. On 19 January 2012, Kodak filed for Chapter 11 bankruptcy protection in the United States. Despite being the company that invented the digital camera, it didn't exploit its technology effectively or select the correct strategy for its technology assets. When Kodak emerged from Chapter 11 on 3 September 2013, it was a very different company and moved its focus to commercial customers. In 2003, Kodak reported that it had 63,900 employees. In March 2015, it was reported that Kodak has 8,000 employees worldwide. A new board of directors was appointed in 2013.

Cybersecurity failures

Few will have missed the publicity surrounding the exposure of personal information from the Ashley Maddison online dating service that marketed to people who were married or in a committed relationship. In July 2015, hackers, known as the impact team, stole all the personal data of the service's users. This included names, addresses, email addresses and credit card information of the service's customers. The hackers threatened to publish all this data unless the company shut down both this website and an associated service. In August 2015, all the data was published. The situation was exacerbated by the revelation that although the company charged a $19 fee to "permanently" remove data about an individual (even if this has been setup by a third party without the individual's knowledge) that the data was not actually deleted. According to a BBC report, Ashley Madison is facing a C$760 million class action lawsuit. On 28 August 2015, it was announced that the founder and CEO of Ashley Madison, Noel Biderman, was stepping down. In September 2015, it was reported that a pastor in New Orleans had committed suicide after he was revealed as one of the estimated 37 million users of the service.

This incident is by no means unique. In late 2013, news emerged that the credit card details of 40 million customers of the US retailer, Target Corporation, had been stolen by hackers. Target later revised this to indicate that private data of 70 million customers had been stolen. By mid-2014, both the Chief Executive Officer (CEO) and the Chief Information Officer (CIO) has been replaced as part of the fallout from the data breach. Aside from reputational damage, it is reported that the breach cost Target US$162 million excluding any expenses relating to a pending class action. It has been reported that more than 90 lawsuits have been filed against Target by customers and banks for negligence and compensatory damages and that Target had been alerted to the breach some time before action was taken.

On 4 February 2015, Anthem Inc, the second biggest health insurer in the US, disclosed that hackers had broken into its systems and stolen 37.5 million records of personal data. On 24 February, it revised this number upwards to 78.8 million records. The data contained names, addresses, email addresses, birthdays, social security numbers, medical information, employment and income data. A report on security breaches in the health industry, by

a Unites States cybersecurity company, has suggested that the cost to Anthem may be over US$1 billion.

In Europe, on 2 October 2015, Experian, the world's largest credit checking company, revealed that personal data of up to 15 million US users of T-Mobile had been stolen by hackers. Experian shares dropped 3.8 per cent on that day and T-Mobile indicated that it would be reviewing its relationship with Experian.

Australian companies have also been affected. In September 2015, both Kmart Australia and David Jones had their websites hacked with significant amounts of personal data apparently being stolen. Both companies have indicated that credit card details were not among the data known to be stolen. The data did, however, include names, addresses, email addresses and other personal data. Both companies have reported that they are investigating the breach and the Office of the Australian Information Commissioner (OAIC) has indicated that they have been notified of the breaches.

These are by no means the only Australian breaches and not all affected organisations are as fast to report an incident. In July 2014, the Australian retailer, CatchoftheDay reported to OAIC that it had suffered a data breach in 2011. It took three years to report.

Data breaches

- A data breach (or loss of data) can result in criminals gaining access to both confidential company data and the sensitive private data of individual customers.
- Customers whose data is compromised are being subjected to identity theft and some are seeking significant financial redress.
- Organisations suffering data breaches are exposed to significant reputational risk.
- Directors and senior executives are being held accountable and some are being replaced.
- See Chapter 8 for further discussion about Australian legal requirements regarding data breaches.

The governance arrangements that the board might consider to provide appropriate levels of oversight for cybersecurity will be explored in Chapter 4.

Success through digital transformation

IT is not only an enabler of new products and initiatives, it is increasingly being used as a means of disrupting existing business models, often over a relatively short period. Three very different examples are given below.

In July 1994, Jeff Bezos initiated a small startup called Amazon as an electronic bookstore.
In July 2015, it was reported that Amazon was valued at approximately US$270 billion.
It now dominates the bookselling business having completely disrupted bricks and mortar bookshops to the extent that they are a shadow of their former major presence in our shopping malls. Amazon has also diversified into the sale of Blu-rays, DVDs, CDs, electronics and many other products and now cloud services. It is the largest internet-based retailer in the US and by 2015, it had surpassed Walmart as the most valuable retailer in the US using the metric of market capitalisation.
It is hard to escape the impact of Uber on the taxi industry. Uber runs a smartphone app

which provides an on-demand taxi service by connecting potential passengers with available taxi drivers. Uber does not employ any taxi drivers or run any taxis. It connects passenger and provider and takes a fee. This effective use of technology to disrupt a very traditional industry has led to Uber growing from a startup in 2009 to a valuation of over US$50 billion in August 2015, with a service that is available in 58 countries worldwide. It reached this valuation two years before Facebook reached a similar valuation. In December 2014, it was reported that Uber was more valuable than at least 72 per cent of the Fortune 500 companies.

On 11 August 2008, Airbnb officially launched its website. Airbnb provides a service which lists, finds and rents private accommodation. It started as a service for shared accommodation such as bed and breakfast rooms, but has now expanded to most types of accommodation including private islands, castles and igloos. From its start in 2008, Airbnb now operates in 34,000 cities across 190 countries and apparently has over 1,400 castles on its books. In March 2016, Airbnb claimed over 2,000,000 listings and over 60,000,000 guests. Despite its recent beginnings, the company is now reported to be worth more than some global hotel chains such as Hyatt. In June 2015, seven years after it started, Airbnb was valued at US$25.5 billion and in June 2014, it was reported that Airbnb had just 600 employees.

Each of these disruptive businesses is absolutely dependent on IT and they could never have grown as fast as they did without technology. An interesting characteristic of these organisations is that they employ far fewer people than equivalently-sized more traditional businesses.

A more local example is Xero. In 2006, Rod Drury and Hamish Edwards founded Xero, the cloud-enabled accounting software company, based in Wellington, New Zealand. In February 2016, it had a market value of over A$2 billion with a presence in New Zealand, Australia, the US and the UK. Xero now has over 600,000 users and 1,300 staff.

Xero took advantage of the emerging cloud computing platforms at a time when many others were still targeting the desktop computer. This allowed it to offer its clients, particularly small businesses, the opportunity for the business and the accountant to view the accounts simultaneously, rather than having to send each other reports. This advantage was conferred by using cloud computing. Further advantages included the ability to have just one codebase or version of the software, and that the data was securely stored and backed up in the cloud.

Once again, Xero would not exist without IT, but not traditional IT. It was an early user of one of the disruptive technologies that will be discussed in the next chapter, namely cloud computing.

Digital disruption and the fourth industrial revolution

Nicholas Davis
Head of Society and Innovation, Member of the Executive Committee, World Economic Forum,
September 2016, "Digital disruption and the 'fourth industrial revolution'", *Essential Director Update 2016 Handbook*, AICD, pp 9-10.

Taking a futurist perspective, today's rapid convergence of digital, biological and physical technologies heralds the beginning of an economic and social revolution, which will fundamentally alter the way we live, work, and relate to one another.

This transformation is just starting to emerge, and there is strong evidence that it will alter the way that we create, exchange and distribute value on a scale comparable to previous three major industrial revolutions: the first factories, automated machinery, widespread use of fossil fuels between 1750-1950; the rise of electrical systems, the telephone, mass manufacturing, the automobile and much more between 1870-1914; and the advent of digital computing, mobile digital communications, space-based technologies and so on since 1960.

The emerging transformation is labelled the fourth industrial revolution, and it is being driven by emerging technologies which treat digital connectivity and processing capabilities as an essential infrastructure, in the same way that the digital revolution relies on pre-existing electricity and telecommunication systems. Examples include neuro-technologies, additive manufacturing, artificial intelligence, cryptography, advanced materials, and biotechnologies.

The revolutionary aspect of these technologies exceeds their new, powerful capabilities – such as the ability to interpret brain signals, create rapid prototypes or edit genomes. It is the expected speed, scale and influence of their diffusion across industries and social groups that will disrupt existing systems of transport, communication, agriculture, production, security and governance. This will impact our social and economic relationships and even our sense of what it means to be human.

Much of the discussion to date has been polarised around fears related to employment or promises that new technologies represent a panacea for current economic woes. We should be optimistic that new technologies will provide new opportunities, however this optimism must be matched with thoughtful action by directors – indeed by all stakeholders – to embed positive values in technological systems, support innovative regulatory systems and ensure both the benefits and costs of the fourth industrial revolution are shared fairly.

How the internet of things could reshape industry

AICD
June 2016, *How the 'Internet of Things' could reshape industry*, Governance Leadership Centre, AICD.

Megatrends broadly fall into two categories: those that unfold over several decades in relatively predictable fashion, such as the ageing population, and those that are so disruptive and far-reaching that they can barely be imagined, let alone forecast.

The so-called internet of things (IoT) typifies the latter. It refers to objects that have embedded technology that allows them to send and receive data via the internet and connect with other devices. That data is used to optimise products, services and operations.

The impact of the IoT could be phenomenal. McKinsey & Co last year estimated the IoT would have a potential economic impact of US$3.9 trillion to US$11.1 trillion a year in 2025. The wide divergence in McKinsey's low and high estimates shows the trend's unpredictability.

For context, the IoT's economic impact will be more than three times the size of Australia's economy in a single year by 2025 (using McKinsey's low estimate); or worth around 11 per cent of the global economy within a decade (using the high estimate).

This trend is snowballing. Ten million hardware devices in 1980 grew to 100 million in 1990 as people bought a personal computer, and a billion in 2000 as the internet took off. By 2010, there were an estimated 10 billion, as mobile devices mushroomed.

Cisco estimates 50 billion hardware devices across personal and industrial applications by 2020 as the IoT takes hold – about 6.5 connected devices per person, on average, on the planet.

Working with advanced technology will be the norm for more employees. Collaborative robots (cobots) that do advanced tasks and interact with human managers in shared workspaces will become prevalent in the workforce. About 85 per cent of managers expect human-machine-centre environments to be commonplace by 2020, according to a recent Accenture survey of 500 executives worldwide.

Many survey respondents saw the "connected industrial workforce" as critical to strategy. They expected their organisation to boost its investment in augmented reality devices, such as helmets and smart glasses, to allow cobots to take on more advanced tasks and boost productivity.

The IoT, of course, is prone to hype and overestimation. Some forecasters have begun to lower their estimated number of connected devices. Technology researcher, Gartner, last year described the IoT as one of the most "overhyped" technologies (along with self-driving cars). It said the IoT would not reach mainstream adoption for at least five to 10 years and described its current position in the technology landscape as at the "peak of inflated expectations".

But even at McKinsey's low estimates, the IoT will reshape much of industry.

IoT's far-reaching effects

The IoT has many applications. More factories, for example, will use connected devices to optimise production, predict maintenance and make greater use of cobots. Retailers will use the IoT to optimise supply chains, store layouts and redefine customer relationships.

The health industry will be transformed as technology is embedded into consumer devices to monitor and manage illness and improve wellness. The boom in fitness trackers, some of which measure steps and heart-rates, is just the start. In time, smartphone devices, smart clothing and other technology will monitor patient health autonomously and alert medical professionals when needed, potentially saving the healthcare system billions of dollars.

Cities will use connected devices to better control traffic, improve public safety and wellbeing, reduce their environment footprint and better manage resources. Smart, connected homes will use the IoT to optimise energy usage, improve security and reduce chores. It is already happening as new home devices, such as heating/cooling systems, are connected via the internet, and accessible via smartphones remotely.

Autonomous cars are another vision of IoT in practice. It is unclear when self-driving cars will go mainstream, particularly if vehicle manufacturers focus more on incorporating technology into existing cars to create a hybrid where people and technology share the driving.

But the prospects of autonomous cars being connected to road technology and other databases could revolutionise energy usage, road safety, car maintenance and insurance. More mining companies are already using remote-controlled, autonomous vehicles to improve productivity.

In terms of IoT penetration, it is likely that manufacturing will generate the biggest economic benefit from connected devices and be an early adopter. The public sector, health and retail industries will be other large beneficiaries of IoT, predicts McKinsey.

Perhaps the biggest winners will be organisations that provide technology and networks to connect devices.

Boards should act now

If Gartner is right, boards have time to act to ensure their organisation is prepared to harness the benefits of a trend that could take up to a decade to go mainstream. Those that have not already should start thinking about the IoT now because it will require vastly different resources and thinking within organisations.

The first priority is ensuring the board has sufficient technology skills to govern through technological change. Some Australian boards have recruited non-executive directors with deep technology management skills; others are forming advisory panels that feature technology experts, to advise the main board on technological trends such as IoT.

More Australian boards, particularly those of large listed companies, are visiting technology clusters such as Silicon Valley, to hear from leading experts. Or they are arranging for experts, local and offshore, to present to them on technology trends. More directors, anecdotally, are taking technology courses as part of their professional development.

Establishing formal technology committees is another option. Accenture late last year said banks, for example, should be considering forming technology committees, after its survey showed only 6 per cent of board directors and 3 per cent of CEOs of leading banks – an industry facing significant disruption from fintech start-ups – have professional technology experience.

A technology committee, alongside audit, remuneration, nomination or risk-management, makes sense for larger organisations more likely to be affected sooner by the IoT and other technological changes. But technology will affect many aspects of governance and cut across so many committees, that limiting its analysis to one committee could be too restrictive.

These initiatives, while important, will not be enough. Nobody knows for sure how the IoT will unfold or how quickly it will go mainstream. One certainty is that boards, and most in business for that matter, will struggle to keep up with IoT adoption rates and lag well behind the trend.

Rather than attempt to predict the future, boards should test whether their organisation can adapt to technological disruption from IoT. They must know the executive team is abreast of IoT trends and has the right people – and the right succession planning – to harness technology.

Information technology systems will need greater capabilities in “big data” as the IoT revolutionises the amount of data captured and analysed from connected industrial and personal devices.

Depending on their industry, boards should test whether their organisation has the right capabilities to analyse big data, incorporate it into more decision-making, and if its recruitment strategies are planning for a future where blue-collar and white-collar staff work closer with technology, such as software algorithms, that guide decisions or make them outright.

Most of all, boards must know that their organisation’s culture is adaptable, capable of continuous change, and encourages innovation and self-learning. A culture that allows people to make mistakes quickly, cheaply and ethically as they try things, and test ideas through experiments in a rapidly evolving IoT space.

It is no hyperbole to suggest that the IoT, when it arrives in full force in the next 10 to 20 years, could spark the fourth industrial revolution. And that boards that are not considering this trend could end up governing organisations that are made redundant by technology.

How the future of work will affect the future of organisations

AICD
April 2016, *How the future of work will affect the future of organisations*, Governance Leadership Centre, AICD.

New research on workplace trends emphasises the need for boards to spend more time with human resource executives to understand if their organisation is prepared for faster labour-market change in the next 5-10 years.

Findings from a recent Chartered Accountants Australia and New Zealand survey, *The Future of Work*, reinforce the need for boards to consider human resources from a risk-management perspective, as labour-market unpredictability rises.

The report was based on a survey of more than 1,400 Australian workers in late 2015, conducted by Deloitte Access Economics. It is among the largest surveys of its kind of early-career, mid-career and developed-career employees.

The findings are stark. Two-thirds of respondents with less than five years' experience (early-career employees) expect their job will not exist or will fundamentally change within 15 years. Many will have to reskill, retrain or change jobs.

Three in five respondents who expect to change jobs in the next 10 years, expect to move to a different industry or role or both. Workers, it seems, will be increasingly willing to move across industries, making it harder for organisations to retain key talent.

Young employees mostly expect an average tenure of five years or less with any given employer through their career, according to the survey.

And about one in five surveyed expect to be workplace "generalists" with a broad skill set rather than deep skills in one or two areas.

Moreover, digital disruption will reduce the shelf-life of university degrees. Just over half of employees with less than five years' experience already see their qualifications as not being "very much" relevant to their work.

How boards should respond

From a governance perspective, directors should ask the following questions:

- Does the organisation have a strategy to combat higher turnover of staff, particularly among younger employees, in the next five years?
- Will our employees' skills remain relevant as more tasks are automated, and technology and traditional white-collar job functions are increasingly blended?
- Is the organisation sufficiently adaptable to deal with labour-market transformations in the next 10 years that are impossible to predict today?
- What is the organisation's learning and development strategy as the world faces a looming step-change in machine-to-machine learning, artificial intelligence and automation?
- What are the potential risks to the organisation from a sharp rise in staff turnover and growing skills gap if the

organisation's talents and capabilities lag behind advances in technology?
- What are the opportunities from workplace transformation?
- Is there sufficient alignment between the organisation's strategy and its people, capabilities and culture over short-, medium- and long-term horizons?
- Does the organisation have the right human resources skills in the executive team and on the board to deal with an increasingly complex labour market?

Technology's disruptive effect on workplace skills could be the biggest risk some organisations face – and potentially cripple those that cannot keep up with workplace change.

Oxford University academics Carl Frey and Michael Osborne predicted in their seminal 2013 paper, *The Future of Employment: How Susceptible are Jobs to Computerisation?*, that almost half of all jobs in the United States were at risk of being displaced by technology. If these and other predictions are even half correct, boards would be wise to consider how the future of work will affect the future of their organisation.

CHAPTER 15:

Strategies for growth and adapting to change

Megatrends, cybersecurity, innovation and failure

AICD
November 2016, "Megatrends, cybersecurity, innovation and failure", *Membership Update*, AICD.

Leading ASX directors, including Kevin McCann AM FAICD, Wendy Stops GAICD and Roger Corbett AO FAICD, shared practical insights on their toughest challenges at the recent AICD ASX Sector Forum

The first AICD Listed Sector Forum was held in Sydney and featured pre-eminent practitioners, including former Macquarie Group Chairman Kevin McCann AM FAICD, Commonwealth Bank director Wendy Stops GAICD and Mayne Pharma Group Chairman Roger Corbett AO FAICD. The speakers discussed megatrends coming down the pipe for listed businesses, how listed directors should approach innovation and how to avoid corporate disasters.

1. What are the key global megatrends impacting listed companies?

Panellists:
Wendy Stops GAICD, Non-Executive Director, Commonwealth Bank of Australia; Jane Eccleston, Senior Executive Leader, ASIC; Tim Trumper MAICD, Advisor, Quantium.

Technology
The significance of technology as a strategic enabler is rapidly increasing. It's no longer something in the background. Boards must consider how they can make 'digital' part of the core DNA of the organisation.

Digital disruption is a key aspect of this. Business models are being turned on their head and companies that traditionally operated in one industry are branching out into others.

Rate of change
In 1960, the average time a company spent in the S&P 500 was 60-70 years. Today it's 18 and is moving very quickly towards 12 or so. By the simple maths, something like 75 per cent of companies that are in the S&P 500 today will fall out by 2030.

Most companies will not make it through this period of change.

Community and investor expectations
We are in a world where expectations are changing for listed companies. The community and investors have expectations of companies' operations that are not just about maximising profit.

This broadening of expectations ties into the risks for listed companies. There are issues like customers boycotting over the ethics of a supply chain.

Long-term investors in particular are also looking for things like reporting of ethical and environmental issues.

2. Cybersecurity: The latest insights for your boardroom

Speaker:
Alastair MacGibbon, Special Adviser to the Prime Minister on Cyber Security.

What can Australian companies do to prepare for future cyber-attacks if and when they occur?
Threat sharing and communication
Maturity on cybersecurity comes through full disclosure and continuous discussion. The wider business community and our customers appreciate a policy of open disclosure – particularly about something that attacks our interconnectedness; because there is no doubt that we are more interconnected than ever before.

Good mechanisms for communication and information sharing about cyber-threats and cyber-incidents are beginning to emerge. Part of the government's cyber security strategy is grounded in increasing the frequency, quality and sophistication of threat sharing between business and government; this has been seen specifically with the publishing of the *Australian Cyber Security Centre Threat Report*.

"Exercising crisis"
Organisations should begin to look at practicing for and simulating a cyber-incident with the same discipline that conducting regular fire drills receives.

Government currently carries out cyber-incident simulations to test its policies and procedures and will need to start to partner with businesses in the future to conduct similar crisis simulations; there is no point in government acting alone in this area.

This can involve simulating 'black swan' cyber-incidents that engage the entire workforce, including board and management to respond to the incident, or red teaming to help detect any network and system vulnerabilities.

3. Achieving innovation in big business

Panellists:
Colette Grgic, General Manager for Innovation, BlueChilli; Kevin McCann AM FAICD, Chairman, Citadel Group; Sandra Hook, Non-Executive Director, RXP Services; Brian Ruddle GAICD, Managing Director, Impact Innovation Group.

How do big companies encourage innovation (in 140 characters or less)?
"If you've got an innovation program without an innovation strategy, be concerned!"

"Don't just invest in the product, invest in the process."

"What can disrupt us? What should we be doing to innovate? That challenges management and challenges the board."

"Ask: what if?"

4. Contemporary governance failures revisited: What can we learn?

Panellists:
Roger Corbett AO FAICD, Chairman, Mayne Pharma Group; Kathryn Greiner AO MAICD, Executive Director, Gabane; Kathy Hirchfeld FAICD, Non-Executive Director, Energy Queensland.

How do directors avoid disasters?

Get out of the boardroom
Directors need to get out of the boardroom, talk to the employees and get a feel for how the business is going. You can't overview safety sitting in the boardroom and that goes for all aspects of the business. Directors have to test what management are telling you in the boardroom.

Directors need to remember why they're there
Directors need to always question what they're doing there in the first place. Is this job just the next stage in your career? That's not enough.

Fundamentally, directors have to represent the interests of the owners of the business. Directors should be asking, "If I owned this business entirely, what would I do?"

Understand the risk profile of the cash flows
To make money, a business needs to take risks. Directors must remember that they can't completely de-risk a business.

But they do have to understand the risk profile of the company's cash flows. Directors have to closely scrutinise the cash flows and understand the assumptions that have been made in making projections.

The influencing and shaping role of leadership groups

Juliet Bourke
February 2016, (extract from) *Which Two Heads Are Better Than One? How diverse teams create breakthrough ideas and make smarter decisions*, AICD, pp 258-263.

Our suggestions in this final chapter will come as no surprise. Indeed, the discussion is more in the nature of consolidation rather than offering new insights about the role to be played by leadership groups in influencing others and shaping culture. We see the opportunity in two ways: firstly in terms of self-reflection and secondly in terms of powerful questions of others.

Seven areas of self-reflection for leadership groups

We expect that what you have read so far would have caused you to reflect upon yourself – your own approach to problem-solving, intellectual style and leadership traits, for example. There's another level of reflection you might have engaged in as well, and it goes to the groups you are a part of. Given that diversity of thinking is a team sport, a leadership group (as a whole) has the capacity to reflect on its own composition, the processes used to debate and decide, and the strategies used to mitigate bias and

cognitive depletion. Quite obviously we are suggesting that groups, and particularly powerful senior groups such as executive teams and board, might ask of themselves:

1. Diversity of perspective: does our composition facilitate diversity of perspective in terms of the demographic profile of our members (paying particular attention to race, gender and role/ education)? If we were to select new members, or create sub-committees, how could we factor in these visible diversity characteristics at the same time we also consider capability?

2. Diversity of approach: do we understand each member's problem-solving approach? Is there a bias in our group to favour just some of the six problem-solving approaches? Should we adopt interim and long-term strategies to build our capability to use all six approaches? Should we adopt group discussion processes or checklists which enable equal and individual consideration of each of the six approaches?

3. Diversity of style: do we understand each member's preferred communication style? Have we adapted our written and verbal communication protocols to cater for these diverse styles? Have we adapted our communication styles to respond to the preferences of our followers and stakeholders?

4. Biases and behaviours: can we adjust our social and information collection/ evaluation processes to mitigate biases? Can we be more diligent in mitigating social biases in key moments, such as stranger-to-stranger interactions with potential new members, new external stakeholders and internal reports? Can we be more diligent in mitigating information biases when we formulate our opinions, seek information and evaluate contradictory information?

5. Cognitive depletion: can we adjust our decision-making processes to take into account the effects of cognitive depletion? Can we reduce the number of trivial decisions required of the group? Can we adjust the timing of decisions, with the more complex earlier in the day? Can we include reminders about the importance of diversity of thinking to motivate us to consider diverse views? Can we attend to our patterns of eating to ensure regular glucose top-ups?

6. Inclusion: do all members feel like they are treated with fairness and respect? Do we recognise each person's unique value? Do we ensure that everyone is connected across the group? Do we have an environment in which people feel psychologically safe? Do we make others we connect with (in our role as board members or executives) feel that they have been treated respectfully and fairly? That their uniqueness is known and appreciated? How do we hold ourselves to account?

7. Inclusive leadership: do we role model inclusive leadership in our interactions with others? Do we select our own leaders (for example, the board chair, committee chairs, the CEO) with an eye to their capacity to role model inclusive leadership

and create an inclusive culture? Do we communicate clearly and regularly the importance we place on diversity of thinking and inclusion to others?

Each of these seven reflections offers much food for thought. If we were to have asked these questions at the beginning of the book, we expect that some readers might have felt overwhelmed, or that the questions were rhetorical and conceptual, rather than leading to actions which are practical and feasible. Hopefully, having read the detail of each chapter, you now know otherwise. Our overarching objective, as we noted in the introduction, is to make the concept of diversity of thinking both accessible and achievable.

These self-reflections are mere thought prompts to stimulate discussion about how a leadership group can improve its own capacity to think more robustly and innovatively. What comes next is the design of a plan to assess the relevance (in your context) of each of the six chapter insights, consideration of how they might be applied in practice, and prioritisation of implementation. This will be of direct benefit to a leadership group itself, and of indirect benefit to the group's influencing role. When followers and other stakeholders observe that a leadership group has engaged in self-reflection, and made appropriate adjustments, it will increase the group's power to authentically ask others about their diversity of thinking strategies.

Seven powerful questions to ask of others

As we noted earlier, one of the most powerful biases is blind spot bias, meaning that it is easier to see the faults in others than to see them in oneself. However, what is a personal weakness can become a strength if this blind-spot is used by boards and executive teams to identify bias in others, for example sub-ordinates and professional organisations. Taking a mindset of both curiosity and respect, leadership groups can ask powerful questions to help other individuals and groups see their biases and take corrective actions.

If the objective is diversity of thinking, then, as you would expect, we suggest that these questions focus on group composition, group processes of debate and decision-making as well as biases and behaviours. In addition, and where appropriate, we suggest that leadership groups can create powerful measures of accountability, for both diversity of thinking as well as inclusive leadership and an inclusive culture, asking others to report back to them on key indicators and strategies for change.

Here are some powerful questions executive teams and boards might ask of their direct followers to create a more diverse thinking organisation:

1. Diversity of perspective: tell us about the demographic composition of your key decision-making teams in terms of race, gender and role/education? What strategies could you implement to ensure greater visible diversity?

2. Diversity of approach: what group discussion process do you use to capture the six approaches to problem-solving? Can you develop a pro-forma document that identifies information relevant to each of the six approaches when presenting a

recommendation to us? What plans do you have to communicate to your reports the value of the six approaches to problem-solving and to build their capability?

3. Diversity of style: do you understand the way we prefer to be communicated with? Do we understand your communication preferences? What could you do to understand and adapt to the communication preference of your followers and other stakeholders?

4. Biases and behaviours: what strategies do you have in place to mitigate biases such as homophily and confirmation bias? Do you need to conduct a review to identify where these biases are influencing decisions in moments that matter (for example, recruitment and performance reviews, product design, responding to customer feedback) and make adjustments?

5. Cognitive depletion: how do you cater for cognitive depletion in the manner and timing of your daily meetings? Strategic planning days? Interactions with key stakeholders?

6. Inclusion: how do you explicitly communicate the importance of inclusive behaviours to your followers? Do you measure perceptions of inclusion amongst your staff and other stakeholders (for example, clients and business partners)? Do you measure whether there are differences in perceptions of inclusion for different demographic groups in terms of the three levels of “fairness and respect”, “value and belonging”, “inspiration and confidence”? What are your plans to address those differences?

7. Inclusive leadership: how do you assess the inclusive leadership capability of your new hires and promotes into people leadership roles? How do you develop inclusive leadership mindsets and skills in your leaders, via both dedicated leadership programs and the integration of these themes into existing programs? How do you communicate the standard you expect of leaders in terms of the six signature traits? How do you recognise and reward those leaders who show exceptional inclusive leadership capability (for example, have led a very diverse team to success)? How do you hold leaders to account for their behaviours in terms of inclusion and leading a diverse team? What actions have you taken when a leader has demonstrably and repeatedly demonstrated a lack of inclusion of diverse others?

Taken as a whole, one can see the power of these seven individual questions in communicating to others the importance that a leadership group places on diversity of thinking, especially if these individual questions are coupled with a statement of explicit intent. Together, the seven questions signal the componentry of diversity of thinking. While we would not suggest that leadership groups ask every sub-question that sits within each of the seven (that would be overwhelming), the judicious selection of a question from the seven topics would help to reinforce the multiple sites of action to drive a diverse thinking organisation.

CHAPTER 16:

Planning for a disrupted future

How boards can meet the long-term challenge of disruptive technologies

AICD
April 2016, *How boards can meet the long-term challenge of disruptive technologies*, Governance Leadership Centre, AICD.

High-performing boards understand the importance of governing strategy over different timeframes. The same is true of technology. Directors must assess how short, medium and long-term technology trends could affect their organisation and its industry.

It is not easy. Boards, in effect, have to think concurrently about multiple streams of innovation. Is technology sufficiently embedded in their organisation to drive performance now? How could the digitisation of business models disrupt the organisation over three years? And which radical innovations could reshape the industry landscape over 5-10 years?

Nicholas Davis, Head of Society and Innovation at the World Economic Forum, has considered several emerging technologies that could reshape the global economy and create unprecedented challenges and opportunities for organisations and their boards.

These combined technologies are so significant that the World Economic Forum describes them as the fourth industrial revolution. They include the rise of artificial intelligence, 3D printing, precision genome editing, new materials and neurotechnology (brain studies).

Davis gave insights from the 2016 World Economic Forum in Davos in January for an AICD Governance Leadership Centre briefing in Sydney in March. Davis leads the Forum's work on the fourth industrial revolution and is a member of its executive committee.

Attendees at the breakfast briefing included: AICD Managing Director, John Brogden AM FAICD; the former New South Wales Premier, The Hon Nick Greiner AC FAICD; University of Sydney Chancellor, Belinda Hutchinson AM FAICD; Professor Guy Ford of the University of Sydney Business School; Terry Moran AC, Chairman of the Barangaroo Delivery Authority; Oil Search director Dr Eileen Doyle FAICD; and Aurizon director Samantha Lewis.

Global trends changing the future

Davis said key topics at this year's Davos summit included: growing global inequality; China; rising geopolitical risks and global security; the migration and refugee crisis in Europe; and the environment and water accessibility.

He said more CEOs were giving greater priority to long-term technology trends as different markets oscillate between the digital revolution, which began in the 1970s and is still unfolding, and the embryonic fourth industrial revolution, where ground-breaking technologies are still being researched and years from being commercialised.

"A lot of these technologies are still sitting in university labs or being discussed in the media, but have not yet been commercialised in any meaningful way," Davis says. "But these changes are coming and their impact is now a bigger part of CEO agendas."

He adds: "The development of a new set of technological capabilities will fundamentally change how we create, store and distribute value, and relate to each other."

The digital and fourth industrial revolutions are inextricably linked, Davis says. Technologies developed in the digital revolution are providing the tools for the next industrial revolution. Advances in supercomputing, for example, are making it faster and cheaper for precise genome editing – a key emerging technology identified by the World Economic Forum.

"Organisations that do not get their digital infrastructure right will find it very hard to play in the fourth industrial revolution," Davis says. Boards, therefore, must ensure their organisations develop a true digital mindset – not only to capitalise on the digital revolution, but to get set for the next great industrial revolution which is just beginning.

Brave new world

Consider the magnitude of what is ahead. Machines that can think, such as self-driving cars, could transform the transport, infrastructure and insurance sectors. Artificial intelligence and robotics in manufacturing, as plant and equipment communicate via the internet of things, could reconfigure supply chains and create unprecedented productivity gains.

Davis likens 3D printing to a new form of manufacturing that in time could fundamentally change construction processes across industry. Genome editing could accelerate the pace of medical breakthroughs, in turn transforming healthcare and adding to the ageing population, which has profound implications for economies, government spending and the environment.

The development of new and advanced materials, such as graphene, could disrupt a range of industries. Lighter, stronger and more energy efficient materials, in theory, mean lighter products and greater scope to use renewable energies rather than fossil fuels to power them.

Advances in neurotechnology and human understanding of brain function could affect everything from medical devices to big data

and information processing.

Gaps between industrial revolutions

Davis says boards should consider the gaps between the digital and fourth industrial revolutions and use them as a framework to guide their thinking. He outlined four key gaps: the uneven distribution of industrial revolutions; technology hype and fear; the relationship between technology, values and ethics; and stakeholder partnerships.

Boards must understand that different markets will be at different stages of industrial revolutions. Multinational organisations, for example, might have operations in developing countries that are still, in some regards, in the second industrial revolution and yet to provide electricity distribution or clean water for all residents.

Other markets, such as in parts of South-East Asia, are starting to fully embrace the digital revolution. Rising internet penetration rates and rapid uptake of mobile telephones are creating opportunities for Western companies in those developing countries.

Davis says boards must also address the gap between technology hype and fear in their thinking on the fourth industrial revolution. "People seem to be either huge technology optimists or very concerned about the impact of technology on global inequality." For boards, that means understanding the opportunities and threats from the fourth industrial revolution and developing different scenarios of what could emerge.

The third gap – between technology and organisation values and ethics – is arguably the most important for boards to consider. As directors think more about the organisation's environmental, social and governance (ESG) standards, they must ask whether new technologies, which, for example, rely on the capture and analysis of vast amounts of personal data, are upholding the organisation's broader corporate social responsibilities.

Boards must also examine the fourth gap: stakeholder partnerships. Davis says the implications of the fourth industrial revolution are so profound that no organisation on its own can hope to have the answers. The key is developing innovation ecosystems where firms complement, rather than only compete with, others to create value.

For boards, this means ensuring the organisation has relationships with government, academia, start-up enterprises and other stakeholders, and is capable of open innovation in a global market. Davis says: "Building partnerships that align with the different strategies of organisations in different sectors is a huge challenge. In my experience, Australia is further behind in this regard compared to the US and UK or the Netherlands."

Implications for boards

The takeout for boards from the AICD Governance Leadership briefing is two-fold.

The first is the importance of boards assessing long-term technology trends, not only those that affect the organisation today and in the next few years. Technology

trends often take years to unfold, are overlooked or underestimated along the way, then can damage industries in a blink. The development of online advertising, for example, took many years. When it arrived in full force it hurt traditional print media companies that underestimated its significance.

The second takeout is the importance of having frameworks to understand how organisations can navigate between the digital and fourth industrial revolutions.

The work of Davis, a leading innovation expert, provides the basis for boardroom discussions about long-term technology trends, particularly in areas such as values, ethics and external partnerships, and scenario planning for the impacts of disruptive technologies over the coming decade.

The end of the tyranny of distance

AICD

July 2016, "The end of the tyranny of distance", *Membership Update*, AICD.

The costs of distance are tumbling due to a range of new technologies, according to research from Bain & Company. The consulting firm's Chief Macroeconomist Karen Harris presented to AICD Fellows earlier this month on how their organisations should respond to this disruptive trend.

The world is shrinking. Due to technological change, the cost of distance is declining. The falling costs of working remotely, of delivering goods and the ability to manufacture at low cost close to consumers will wreak enormous changes to where people decide to live and how businesses operate, according to consulting firm Bain & Company's chief macroeconomist Karen Harris. The changes present challenges for organisations and businesses as they face potential disruption.

At an Australian Institute of Company Directors Fellows' Breakfast earlier this month, Harris, who is the managing director of Bain's Macro Trends Group, presented the findings of the consulting company's research into the costs of distance.

"A confluence of technologies – you don't have to bet on any one of them – is changing the cost of distance," Harris told the audience of AICD fellows. "The cost of moving information is free, the cost of moving people is going down, the cost of moving goods is collapsing," the New York-based Harris said.

Harris highlighted the potential effects of drones, robots and 3-D printing in making it easier for businesses to provide services for people who had made the decision to leave cities for more sparsely populated areas.

Already drone delivery of a package costs 75-80 per cent less than human delivery, according to Bain's research. Wide deployment of drones could drastically

reduce the expense of delivering small packages, particularly for the last mile.

At the same time a combination of robots and 3-D printing could lower the minimum efficient scale of businesses. Harris uses the example of service robots being deployed at casual dining outlets, which by the consulting firm's estimates by 2025 could reduce by 30 per cent the number of households the restaurant would need to service to break even. Meanwhile 3-D printing will allow the local production of standard parts and complex one-off items, reducing reliance on central manufacturing and warehousing. The technology could let companies build manufacturing bases closer to consumers.

The cost reductions of these technologies may allow retailers to service smaller population centres, while remaining profitable. "A much smaller town can have a much more interesting variety of stores," Harris told the audience at the fellows' breakfast.

A wider range of businesses and services would make these less dense areas more attractive. Added to this, the ease with which people can now work from home due to communication technology and skyrocketing property prices in cities mean the exodus already occurring out of developed cities around the globe is likely to continue.

Bain & Company's advice is to prepare for the disruptive decline in distance costs.

Beware stranded assets

The value of fixed assets – including real property, such as apartment buildings, shopping centres, telecom fibre and toll roads – may fall sharply in some locations. The risk: today's investments become tomorrow's write-offs. Companies can seek to minimise the risk of such stranded assets by keeping a sharp eye on population migration patterns and looking beyond cyclical economic swings that can mask migration flows.

Examine supply, distribution and logistics chains

Leadership teams can assess whether supply chains are vulnerable to a sharp decline in the cost of distance and experiment with alternatives that offer a lower net distance cost. They also can review the future need for large-scale production or warehouses vs. multiple smaller locations.

Test and learn

Leadership teams can put themselves on the front lines of the transformation by starting now to incorporate new technologies such as robotics, 3-D printing and drones into their workflows. Not every bet will pay off, but the experience of testing and learning will help position early movers to benefit.

Stay alert to the migration of human capital and talent

Spatial freedom will pool talent in some locations, drain it from others and generally disperse it more widely than in the past. Depending on the specific talent and human capital needs of each business, this shift may require rethinking the core locations for centralised business functions.

Canvass the growing number of investment opportunities

To be among the first to spot trends, stay abreast of enabling technologies. What's important is the pace at which they are adopted and combined, triggering new development.

What boards can learn from the Pokémon Go phenomenon

Lucas Ryan GAICD
NFP Policy Advisor, AICD, July 2016, "What boards can learn from the Pokémon Go phenomenon", *Membership Update*, AICD.

Worldwide phenomenon Pokémon Go has illuminated the potential as well as the risks of augmented reality technology. AICD policy adviser Lucas Ryan GAICD explains how boards can catch all the lessons of the Pokémon craze.

Pokémon Go is the first major augmented reality (AR) game to hit mobile devices, topping the charts of the Apple App Store in its first week and sending part-owner Nintendo's share price soaring nearly 70 per cent since its release. The game is the most downloaded application in the United States, Australia and New Zealand and is rolling out progressively across the globe.

The game's release represents a major step forward in the commercialisation of AR, a burgeoning field of innovation where computer-generated sensory input is integrated with real world environments.

For boards, understanding the impact of disruptive technology such as AR in terms of risk, ethics and strategy can be challenging, especially when a trend can flare and fade in a matter of days.

Pokémon Go has a simple premise. Players are presented with a map of their environment (driven by Google engineering) and must move through the real world to capture Pokémon, fantastical creatures drawn in a Japanese comic book style.

The application uses GPS to display a player's avatar on a map and projects images of Pokémon in the real environment when observed through the lens of a smartphone camera. The game has reached global viral status with millions of players taking to the streets in search of the elusive creatures.

The potential integration of this and similar AR platforms with other commercial activity is enormous. AR applications similar to Pokémon Go are seeing huge investment from Silicon Valley venture capitalists and are gaining the attention of home-grown innovators as well.

Data integration

Pokémon Go users log in to the application using their Google accounts, which gives them access to the maps that power the game. As players use the application, it is possible to collect data about the movement of users through the built environment.

Combining Google data (such as your internet

search history and ecommerce purchasing records) with real-time data about where you are and how you travel presents a real and immediate opportunity for commercial integration.

For example, digital advertisements could be programmed to identify when a user is in proximity and dynamically display content relevant to their interests.

Questions for boards: When making decisions using new data sources such as this, how do boards satisfy themselves as to the validity and reliability of the data? How do boards identify and address the implicit biases of data sourced through AR gaming?

Influencing user behaviours

More intriguing still is the potential for AR gaming to influence consumer behaviours to achieve commercial goals.

Around Australia, thousands of people are walking around today varying their regular routes to optimise their gaming experience.

There is scope for sophisticated commercialisation of this element of augmented reality. The Sydney Opera House has already seized the opportunity, incentivising players to visit the icon by sponsoring neighbouring "Pokéstops", places where players collect items needed to capture Pokémon, for a meagre $3 per hour.

AR game developers have the power to influence the movement of their players in more strategic ways, by positioning in-game activities at locations that present commercial opportunities. A retailer, for example, could pay to have an in-game location positioned at their storefront to generate higher foot traffic for a set period.

Questions for boards: How do boards identify and capitalise on the commercial opportunities that AR presents business, especially if they don't currently have the skills to do so? How do boards support their business to understand new influences on consumer behaviour?

The dark side of Pokémon

There is also potential for more Machiavellian application of this technology. The power to redirect people's movements in such a dynamic way is new for business, and there are risks associated with this influence.

Players whose attention is consumed by their phones are at higher risk of traffic accidents and theft, and the structure of the game may even accidentally incentivise unlawful behaviour. This was the case in New South Wales, where the Department of Justice was prompted to issue a reminder via Facebook that the use of recording devices in court houses is prohibited after players ventured inside in search of Pokémon.

On the other hand, developers may be able to positively influence public health outcomes through rewarding players for incidental or active exercise. This too presents opportunities for the realisation of corporate social responsibility goals or, alternatively, vertical integration.

Questions for boards: What are the ethical considerations for boards in exercising such influence over human behaviour? What level of responsibility does the board have for the behaviours of players influenced by their business's products?

Pokémon Go is the first AR game to have gained the attention of the broader public, but it will not be the last.

Whether technology is the core business of an organisation or not, boards of all kinds will need to consider how the effects of disruptive technology like AR can flow on to influence their regulatory context, operational environment and governance.

CHAPTER 17:

Taking your NFP from good to great

Taking back control: Putting strategy on the NFP agenda

Phil Butler
NFP Sector Leader, AICD, September 2016,
"Taking back control: putting strategy on the NFP agenda", *Membership Update*, AICD, (a version of this article first appeared on the NFP news website *Third Sector*).

The AICD's latest research reveals that NFP boards are spending too much time on operational issues at the expense of the strategic stewardship of their organisations, writes NFP Sector Leader Phil Butler.

There is possibly a stronger propensity for boards of not-for-profits to get involved in operations than there is with other types of organisations. Such is not-for-profit directors' passion for the mission of their organisations, whether that be the local surf club or a world-renowned gallery, that they want to get stuck in and help out. This enthusiasm though comes at a cost. If boards are too involved in the day-to-day operations of an NFP, it can mean they have less time to turn to questions of the wider strategy of the organisation.

Setting strategy for any board is one of its most vital functions. To achieve their missions over the long-term, it is critical our NFP boards feel that they have sufficient time to devote to strategic planning. However, the latest AICD *NFP Governance and Performance Study* paints a worrying picture of the capacity of directors to do the necessary strategic thinking and planning in an environment where NFPs' resources are constrained.

Most directors surveyed for the study recognised the importance of strategy, but many reported their focus was still drawn too much to short-term or operational issues. While nearly all directors (90 per cent) have undertaken some sort of training in the last year, a minority (40 per cent) received training in strategic planning. Many respondents in the study considered a lack of skills and experience in strategy available to boards represented a major challenge for the NFP sector. Strategic planning and oversight of strategy implementation were the two most common areas directors named where their boards could improve.

The attention of directors is taken up by short-term exigencies because many feel that they are constrained by the 'hand to mouth existence' of their organisations. Many of

the directors in the AICD study described their NFP and board as having a culture of 'survival'. The reliance of their organisations on grants and donations leads to planning that is by necessity short-term and risk averse, the NFP directors reported. The feeling that the future of their organisations is outside of their locus of control limits the ability of boards to properly focus on long-term strategy.

Policy changes are also putting a strain on the time and energy of NFP boards. The introduction of National Disability Insurance Scheme and Client Directed Care should both ultimately be of great benefit to beneficiaries of services, but adapting to the changes is a major drain on the resources of many NFPs and their boards. For a large number of NFPs it is the first time they will have needed to think about the marketing of their services. It will involve a complete re-think of many NFPs' business models with the need to understand cash flow implications and have a much better knowledge of their unit costs. These are obviously key questions for boards of those NFPs, but again take time away from other important strategic issues that they could be addressing.

The way forward

There is no magic wand that will give NFP boards the capacity they need to address strategic issues. But there are steps the sector can take to correct the gap in strategic thinking. NFPs must be proactive in making sure in their succession planning they are bringing in directors with strategic planning experience. It is important directors also take personal responsibility for raising the standard of their board's skills by extending their own abilities.

The sector as a whole needs to advocate for effective policy with more certain funding so that boards are freed up to concentrate on strategy. The AICD has called for five year funding cycles from government for the NFP sector with a twelve month notice period of the termination of a contract. This would alleviate the anxiety many directors of NFPs feel about the financial sustainability and very solvency of their organisations. Under the conditions that exist now with much funding being short-term, it is understandable that directors feel frustrated they can't turn their attention to long-term strategy.

The most effective boards control their organisation's future through strong and thorough strategic planning. Given how important NFPs are to the health of our communities, it is unacceptable that so many directors feel at the moment that they can't give the time and attention they need to strategy. The first step to this changing is for the sector to face up to the problem and for boards to explicitly discuss how they can make strategy one of their main priorities.

Interview: Lisa Chung

Christopher Niesche
August 2016, "An interview with Lisa Chung", *Company Director Magazine*, AICD.

When Lisa Chung FAICD left school, she was planning a career in international relations or foreign affairs, perhaps triggered by a high school study tour to China just as it was opening up to the West.

She was lined up to study law and Asian studies at the Australian National University, but for reasons she can't remember decided to stay at home and study law at the University of Tasmania.

"That's one of those decisions that you don't realise when you're making it, particularly when you're 17 or 18 years old, that changed the course of my life," says Chung, who had studied French, German and Japanese at school and wanted to learn about other cultures.

As it happened, Chung pursued a successful legal career in Tasmania, then in Sydney and went on to take a range of non-executive directorships at organisations including APN Outdoor Group and urban planning and design company URBIS. She is deputy president of trustees of the Museum of Applied Arts and Sciences, which runs Sydney's Powerhouse Museum, and chairman of The Benevolent Society, Australia's oldest charity.

Growing up in Tasmania, Chung spoke English and Cantonese at home. Although she is a fourth-generation Australian, she is the first born in Australia, because like so many other Chinese families, her family moved back and forth between Australia and China for many years. "That's no longer home now for my family, so that shifted in my generation."

Her great-grandfather came to northern Tasmania as a tin miner, then moved to Hobart to start a market garden after the mines closed. The business closed about a decade ago and the family has also diversified into owning property.

After her degree, Chung joined a local firm in Hobart and after five or so years at the firm she decided it was time for a change. "I'd become a partner there quite young and I got to a point where I thought 'That's it now for the next 30 years'," she says. "I was married by then so my husband and I both moved to Sydney – really in pursuit of different job opportunities."

She had ideas of making a career swap that would allow her to pursue her interest in other cultures and international relations, but joined Blake Dawson Waldron (now Ashurst) as a commercial property lawyer at the start of the 1990s and kept on with the law. It's not a decision she regrets.

"It is a very enjoyable profession. It's quite fulfilling. It's intellectually very stimulating. I think people do get into it and then they find a niche and they find a path. It's rewarding in many ways," she says.

She became a partner at the firm – unusually while she was on maternity leave – and enjoyed 20 years there, as a practising lawyer

and in senior management roles. She then moved to Maddocks after receiving an offer to establish a property practice and although she no longer practises law at the firm, she remains a consultant.

"The thing about the law – and practising law in a law firm in particular – is you are working with very like-minded professional people. They're usually people who are highly intelligent and who are very committed to what they do in terms of their expertise, the intellectual engagement and working with clients. That collegiate common endeavour is quite a powerful thing in law firms."

Chung says that when lawyers join a board, they shouldn't be doing so as a lawyer – if the organisation needs a lawyer it can hire one. Instead, she says, there are many skills that lawyers can bring, but they can only make a contribution as a director if they can combine those skills with the core attributes needed to be on a board.

"Lawyers are quite analytical; they are good at understanding and assessing risk in quite complex scenarios; and where there are a lot of facets around a factual situation or circumstances or context, lawyers are good at unpacking those quite complex fact scenarios," she says.

In particular, directors need an understanding of the organisation's business and the sector in which it operates, and these are skills which lawyers have acquired in recent years. "In order to be an effective and a sought-after lawyer in the market these days, you really have to be able to understand your client's business, you need to be able to translate the law into the context for the client," she says.

The Benevolent Society

Chung joined The Benevolent Society board in 2011 when a colleague was approached to join. The colleague didn't want to take on any further not-for-profit (NFP) boards so suggested Chung.

"Strangely enough they were looking for a lawyer with some property background because of a particular project that we had on at the time. I met with the chairman and one of the other board members and it went from there," she says. Egon Zehnder conducted the search, as it continues to do for The Benevolent Society today. Chung had experience on other NFP boards and was serving on the Australian Institute of Management board at the time.

The Benevolent Society is one of those names that many people are familiar with without necessarily knowing exactly what it does.

Founded in 1813 by leading business people who saw a need among destitute women and children, The Benevolent Society essentially became the country's welfare system, which wasn't provided by government at the time.

Its work was pioneering, such as running institutions that provided accommodation and support for unmarried mothers and enabled them to keep their babies with them; advocating for the old age pension which was the first of its kind in the world; and setting up the first maternity hospital and baby health centres.

The Benevolent Society's vision is for "a just society where all Australians can live their best lives", and it aims "to empower and educate for personal and societal change".

Its day-to-day work has a two-pronged focus. The first is on-the-ground support services for children and families in aged care, respite care and in educational support.

It is also one of the four founding NFP organisations that anchored the buyout of ABC Learning Centres, now renamed Goodstart Early Learning.

The Benevolent Society is the issuer of one of only two social benefit bonds that the NSW government has sponsored. These bonds are a relatively new and innovative way of raising capital for programs which address important social needs.

Private investors provide capital to a service provider to achieve improved social outcomes. If these outcomes are achieved, the cost savings to governments are then used to repay the upfront investment plus a dividend.

The Society's second focus is on advocating for changes that will benefit its clients and broader society. The Benevolent Society follows a broad governance model rooted in the ASX standards, although not all listing rules are relevant to NFPs. Chung says the Society was ahead of many listed companies in recognising the need for a skills matrix when determining board composition.

Chung says the matrix addresses the strategic and financial skills that many other boards also seek, and also requires directors who have a strong background in the sector. The board always has two or three directors with expertise or experience in the community and charity sector, perhaps from academia or with long-term service delivery experience, for instance in children's services or in-home ageing.

Line of distinction

There are three key issues that distinguish the governance of an NFP such as The Benevolent Society from that in a commercial company, Chung says.

While all companies are concerned with the issue of reputational risk, the nature of The Benevolent Society's work with the most vulnerable in society and its impact on the community put it in a particular position of trust and responsibility. "If we fail in discharging that responsibility or breach that trust, quite rightly the consequences would be extremely serious for the organisation," she says.

Secondly, because it is a mission- and purpose-driven organisation, the Society must always behave to the highest ethical standards, not simply comply with a legal standard.

Finally, it has a broad range of stakeholders, including the clients and communities it serves; the government both as a funder and as a policy maker; donors, sponsors, members and other supporters; staff; volunteers; partner organisations and philanthropic foundations; colleagues in the sector; and society more generally. "We have inherited

a legacy built up over more than 200 years and we are responsible to those who have gone before us to continue to deliver on our purpose," Chung says.

Funding aged care and disability care is progressively changing, from one of block funding providers to funding the individual users of the services, who can then allocate the funds to where they need them most. This moves the care system from being supply-led to demand-led and will also give users of the system more say over their care. Chung says organisations are preparing for the transition, but they also have to help their clients prepare.

"That is a real game-changer and has opened up the sector to for-profit organisations entering. With that comes challenge and competition around bigger cheque books, more resources and more sophisticated infrastructure," she says.

"Our focus is on the disadvantaged and marginalised. So, it's a question of how do we maintain those services appropriately for people in that stratum of society if the more profitable sector of the market is getting picked up by for-profit organisations?

"There's complexity in how that's all going to play out and how ultimately the new funding model will enable us to continue to serve those in greatest need. We have just signed on to a new strategic plan and undertaken a major organisational restructure in preparation for the changes."

Fundraising challenges

Fundraising from the public is always a challenge, with the large number of organisations seeking the charity dollar and the need to be constantly coming up with new fundraising ideas adding to costs.

Historically, most of The Benevolent Society's funding has come from government and from philanthropists and private foundations. For instance, the Society's research, evaluation and service development arm might devise a particular program, which it believes can be effective, often around early intervention to try to head off a problem.

"We might go to one of our major philanthropic partners and say that we would like to run a pilot on a certain program. 'This is what the research is telling us. This is the evidence. We'd like to run a trial on it to build more of an evidence base'," says Chung. In terms of funding its advocacy work and innovation, The Benevolent Society is in the fortunate position of having a significant endowment fund, which was started with the proceeds of the sale of the Royal Hospital for Women site in Sydney's Paddington.

A few years ago it was topped up with the sale to Mirvac of a site in Bondi after planning authorities quashed the Society's plans for an innovative residential aged care facility there.

Variety matters

Chung's other NFP board position is as a trustee of the Museum of Applied Arts and Sciences, which runs Sydney's Powerhouse Museum, and she says she enjoys the contrast

with her work at The Benevolent Society.

"It's quite a different remit. It's really at the other extreme. Its focus is on the arts, science and human ingenuity," she says.

The opportunity to work in a creative space is very attractive, says Chung. The museum has recently established the Centre for Fashion which she chairs and which draws on its 30,000 historical fashion items.

"Apart from being exhibited to the public, it serves as inspiration and engagement for people working in that industry now. You'll often have designers or fashion students come in for research purposes or to use the collection as a source of inspiration for a new collection that they might be designing," she says.

She has been on the board of APN Outdoor since it listed in November 2014, and that provides a whole other set of challenges and interests, not the least of which is the way in which technology is changing out-of-home advertising.

The digitisation of outdoor advertising has helped the company outstrip the growth of the overall advertising sector. "You don't necessarily have guys up on ladders putting up the billboards anymore," says Chung.

"The content can be quite different. It can be put up and changed at short notice. It can tell a story. It can be time-based. It can accommodate quite a different level of creative. We also have digital innovation around smaller screens in railway stations and, at the same time, other forms of media advertising have lost market share."

The Society's share price has surged from $2.55 at the initial public offering to as high as $7.30 in June this year.

Chung says that outside of her board work and work at Maddocks she enjoys spending time with her husband and children aged 19 and 21.

Broader family is also important, which Chung says comes from her cultural background. Her three sisters also live in Sydney, so every Sunday night the family gathers at one of the sisters' houses for dinner.

"We all descend on the house of whoever's turn it is to host. It's a bit of an eat-and-run. Dinner's on and then we have a good chat and we usually leave two-and-a-half hours after that. That's a ritual that the whole family enjoys."

She is also an enthusiastic traveller, describing herself as a Francophile. "They're quite formal, the French. I like that – knowing what the rules are and knowing what's expected and so on. I love their pursuit of excellence when it comes to their cultural activities – whether it's food or wine or art or design or fashion," she says. "I love their general philosophy of life. They pursue excellence but they also understand the broader context of life and the importance of how you live your life. I think that's what attracts me to it."

Chung started out wanting to learn about diverse cultures and instead ended up enjoying a three-decade legal career. But the story doesn't end there.

“I’ve come full circle now. I think the issue of cultural diversity has finally come on to the agenda this year,” she says, adding that she is often asked to speak on cultural diversity at various events. She highlights Australian of the Year David Morrison’s acceptance speech on gender equality, diversity and inclusion as an example of how the issue is being talked about.

“I’ve been thinking about diversity at so many different levels. The diversity of sectors in which I work and which I absolutely love; I’ve learnt so much from having been exposed to that.

“Diversity in whatever guise is, I think, quite empowering and energising, partly because what you learn in one sphere you can apply in another.

“The fact that I have the benefit of diverse experiences – whether it’s by reason of sector, gender, or culture – is more powerful to my thinking today than the 30 years that I spent in the law,” Chung says.

CHAPTER 18:

Embracing an environment for public sector innovation

Study finds public sector more innovative than private sector

AICD
June 2016, "Study finds public sector more innovative than private sector", *The Boardroom Report*, Volume 14, Issue 5, AICD.

There is a common view in Australia that the public sector is sclerotic, slow moving and conservative. However, findings from a new study show that the public sector is more radically innovative than the private sector.

The Centre for Workplace Leadership at the University of Melbourne has released the *Study of Australian Leadership* – a new report which paints a dark picture for innovation and leadership in Australia.

The study, the largest of its kind in Australia, interviewed 8000 people, including CEOs and senior executives, 'frontline leaders', and employees of over 2700 organisations across the public and private sectors.

"We have modelled the linkages between leadership, performance and innovation in Australian business, and our findings reveal a pattern of mediocrity," said Professor Peter Gahan, Director of the Centre for Workplace Leadership.

According to the report, *Leadership At Work: Do Australian leaders have what it takes?* productivity across the economy is low and examples of radical innovation are few. A significant number of businesses underperform against their own targets for return on investment and profitability. There is chronic underinvestment in the development of leaders and managers. There is a lack of focus on fundamentals such as performance monitoring and target setting. And there is a noticeable gap between managers' perception of their own skills and how their own employees view them.

Key findings:

- Innovation
  Only 18 per cent of private sector organisations reported high levels of radical innovation.

- Performance
  40 per cent of workplaces are not meeting their performance targets for return on investment and profitability.

- Leadership quality
  There is a significant gap between managers' perceptions of their leadership skills and the

way they are viewed by employees.

- Leadership development
  For every $10 spent on senior leaders, only $1 is spent on developing frontline leaders.

- Diversity
  There is a systematic failure of leadership to reflect wider social diversity, particularly in relation to gender.

The study also found public sector organisations are more likely to have reported higher levels of radical innovation than the private sector.

Here radical innovation involves experimentation and a focus on new opportunities, new markets, or new ways of bringing products and services to the market. Whereas incremental innovation focuses almost solely on improving efficiency, expanding existing markets and reducing costs.

Accountability and risk: barriers to innovation?

According to Susan Wilson GAICD, non-executive director of Innovation Australia, the results on innovation are hardly surprising. But she says that when examining the results, the difference in orientation of the sectors needs to be considered.

"Essentially it comes down to the element of risk. Each sector needs to manage their unique set of risks in their own way. To say one sector outshines another's innovation efforts is just one side of the story," Wilson said.

"The public sector is not beholden to shareholders or market capitalisation. They have longer timeframes to roll out different levels of innovation. Their purpose is not intrinsically linked to shareholders and so they can be more innovative. Their challenges, however, lie in their accountability to the public to deliver successful programs and services, and the tumultuous periods that come with changes in government and government policy."

"The private sector, on the other hand, can be far more risk averse. They are accountable to their shareholders; any poor decisions they make can be immediately detrimental to their existence. This is directly felt in their readiness and willingness to innovate on a radical scale," she said.

Give innovation a seat at the board table

The results of this study present a range of issues for our organisations' leaders.

And for boards in particular, it's clear more work needs to be done to unpack the reasons for shortfalls in innovation and leadership, especially if organisations need to navigate a new set of challenges and an uncertain future.

"Forget the 'lucky country'. If we want to become the 'innovation nation', Australian organisations need a reality check. We need to take urgent action using leadership skills and innovation capabilities as the levers for responding to these challenges," said Gahan.

Wilson advises it is imperative that any boards that aren't including innovation as a formal agenda item in meetings where

strategy and risk are discussed should do so immediately.

"At the board and senior executive level, we are at an important nexus. It is critically important that we put a lot of thought into positioning the organisation for the future. And, if we need to, we must change our mindset in order to ensure our organisations are thriving in a self-determining, innovative and leadership-driven culture."

Australia Post's transformation challenge

AICD
November 2016, "Australia Post's transformation challenge", *Membership Update*, AICD.

Speaking to an audience of some of Australia's senior business leaders yesterday, Australia Post's John Stanhope and Ahmed Fahour shared the story of the business's large-scale transformation program that aims to bring the struggling letter service into the 21st century.

When Ahmed Fahour FAICD joined Australia Post in 2010 he inherited a business – and one of the country's most iconic and beloved brands – under great threat.

At its peak around the year 2008, Australia Post delivered approximately 5 billion letters each year. Its core letter service has since halved. Fahour entered the business when there was a near halving of its profits from the year before. Unions were on strike, the ACCC had rejected a proposal for a five cent increase for the letters business and the morale of the organisation's staff was at an all-time low. Australia Post was in serious need of transformation.

"When you think about it, it took 200 years for us to reach our peak and only eight years for it to be wiped out," said Fahour.

"And it is not like the communications market was shrinking – not at all. 40 billion SMS messages and 400 emails were sent at this time. The market was exploding with growth but not in a way that was aligned with our core business."

The business needed to transform, not only the products and services it was offering customers and the community, but also its process for adapting, changing and creating new business models quickly. The "how" as Fahour described it is by far the most important factor:

"The most powerful tool of the how is in the cultural settings in the organisation."

Under the leadership of Fahour, who was later joined by John Stanhope FAICD as chairman in 2012, Australia Post has changed tack. In the past year its letters business has undergone significant reform with the introduction of the two-tiered letter service – and now only makes up 28 per cent of the business's revenue.

Today, Australia Post is by and large an e-commerce company dominated by parcel delivery that has grown to meet

the increasing demand made by online transactions. Its parcel business now contributes $300 million in profit. For financial year 2016 Australia Post registered a profit, turning around the previous year's $222 million loss, with the added bonus of being able to pay a dividend to its sole shareholder – the federal government. On Tuesday this week [14 November 2016], Standard & Poor's upgraded Australia Post's official credit rating from negative to stable.

"One of the most satisfying things for a CEO is when you identify an opportunity and the team sits around and lays out a strategy and you work with your management team, the board and the organisation to reach an outcome," Fahour said.

Joining the AICD's Victorian Division President, David Bayes FAICD, on stage at the Trans-Tasman Business Circle event, Fahour and Stanhope shared their insights on the importance of culture, agility, strategy and the significance of the chair/CEO relationship.

On workplace culture

"One of the greatest and most important assets that our organisation has is, we have been living this adage that happy staff lead to happy customers and then they in turn will lead to happy shareholders and a happy community.

"We start with our people. If you want the customer to be happy and for your shareholder to see returns, who is going to be able to make that happen?" Fahour said.

On business agility

"We have learnt over the past four years together, there is no question that a culture of agility is very important. You have got to be able to turn one way or another very quickly," Stanhope said.

"I've noticed that our customer's behaviour has changed at least four or five times in the four years that I have been here. Growing the agility to meet these behaviour changes has been part of our transformation."

On responding to digital disruption

"The source of revenue we make today is so rapidly changed even compared to what it was six years ago," Fahour explained.

"In terms of our retail business, today 60 per cent of the profit we make is from sources of business we didn't have in 2010. We have to replace $200 million to $300 million of profit with business initiatives every year…But the culture of the organisation that we have set up is allowing us to keep reinventing this thing every day."

On strategies for success

"There are three strategic questions that as a business we must answer in order to succeed," said Fahour.

"Number one is how do we manage for the decline in the mail business? Number two is how do we grow the commercially attractive businesses in front of us, like online shopping and e-commerce? Number three is how do we go about this transformation? How do we bring our people and our stakeholders along on the journey?

"Too many times organisations and executives focus on the 'what' – but the how is important and the how determines the outcome."

On the chair/CEO dynamic

"One of the main reasons I have stayed in this job is the relationship. It is authentic and genuine, it is based on trust and…we are able to have difficult conversations," said Fahour.

"In the first instance, it was important we understood each other and each other's background…to ease into the relationship. And there's a level of mutual respect and friendliness," Stanhope added.

"Though I must say that we still keep an appropriate level of chair/CEO objectivity. It is balanced."

"Boards are there to govern and management are there to lead the operation…and the day that becomes confused…is the day that you lose your authority as a CEO," Fahour said.

CHAPTER 19:

Directing in a complex environment

Simon says: The former Australian of the Year on innovation and why he left AMP

AICD
August 2016, "Simon says: The former Australian of the Year on innovation and why he left AMP", Simon McKeon AO FAICD in conversation with Alan Kohler, *Membership Update*, AICD.

Simon McKeon AO FAICD, in conversation with Alan Kohler at a recent AICD Leaders' Lunch, shared his views on innovation, boardroom diversity and the energy of millennials. He also finally broke his silence on why he recently stepped down as chair of AMP.

On resigning as chair of AMP

The reason, just for all of you, was we said private and changed circumstances. And read into that, if you like, the fact that I have a constant set of opportunities and things that come my way and don't come my way. And at that particular point in time I said, "No, I would rather do some other things. Not this thing."

That is important because for everyone in the room, I'm just like one of you, we get choices. And if there's only one thing that I say today that you remember, let's try very, very hard to do the things we actually think we ought to be doing that actually give something back to us, that get the best out of us.

On innovation

In this country we do struggle having the right approach to innovation. We don't have enough PhDs or properly qualified people on boards that can actually say, "I've been there": spending money not on bricks and mortar but on something else; to share their risk/return, their journeys, all this sort of stuff. We actually, compared to other boards in other parts of the world, we just have to acknowledge that we don't have enough of that competency on the board.

We are replete in this country with a terrific education system, churning out gifted, young, technically-oriented people all the time and I guess my main point is those people shouldn't be just fodder for startups. Startups are great, wonderful things, happening in parents' garages all around the country, all around the world. That's terrific. But actually that innovation mentality should be just as alive and well in big corporate Australia. Big corporate Australia has the

client lists. It has the funding. It has all sorts of things that actually ought to mean that it gets more than its fair share of innovation. But too often we actually just find it too hard. We're too cautious.

The way I'd express it is we don't have enough experience in the senior management ranks and the boards who say, no, let's have a proper and good look at what the innovation possibilities are in our particular industry.

On diversity

I think [quotas] demean the issue, and they demean women. On the board of CSIRO, for most of the time I was there, we had a majority of females. At AMP, we had more females on that board than any other top ASX-listed board. I don't like – and I know I've got many enemies in making this statement, and I apologise to those that see it differently – but I really think the best way to promote diversity, including gender but actually a lot, lot more, is to focus on what we can gain by simply getting the best of the best whoever they are sitting around the table, as opposed to saying we'll have a certain number of this and a certain number of that.

On millennials

I can't recall really the impact I had when I was a twenty-something on the world. I think it was a pretty pathetic impact, if it was anything at all. But at Macquarie I choose to be surrounded by 28 year olds and I always have.

And all I'm saying is that at this point I get out of bed with a real spring in my step if I'm actually spending any time at Macquarie here. Because these people just tell me heaps. I mean sometimes I think they're wrong but the point is that they're a different breed. They're exciting. They're not perfect. But what I am saying is somehow whether it's our education system, whatever it is, we've bred at this point in time, I actually think, a very exciting human being, full of potential.

And I'm just not talking about the technical things at their disposal, which they just take to like ducks to water. There's something more again. And all I'm saying is that it behoves business to take an extra minute or two and take a look at the extraordinary and increasingly wise resource that we have in our young people."

On getting out of the boardroom

As a chairman I subscribe to two things: firstly it is important, without being silly about it, to get the board out of the boardroom and into the places where things are happening, and secondly for it not to be a royal tour. Obviously the CEO's first thought is, "well we'll take it to a part of the organisation that's just starring". And I say well that's all very interesting but I want to go somewhere else.

I want to go to where it's hard. I want to go to where the opportunity is but for some reason we're not really exploiting it. I want to go to a place where we know the management isn't as good as it might be. Every now and then there's a need for boards to get a bit of dirt under the fingernail. Why? Because when we come back into the boardroom, the discussion is simply more informed.

On corporate culture

Corporate culture is not an add-on. It's not something that you get to at the end of the day if you've got a spare five minutes. It is the bedrock of outperformance. And why do I say that? Well it's interesting going back to the swimming team. That's where they started.

You know 2012 was a disaster in London, they would say, because of an inappropriate team culture. And John Bertrand and the others went to work three or so years ago to ensure that the culture of that team was demonstrably better. Now they're only part way through a plan, and they'll have a big review, and perhaps they'll be better again in Tokyo.

But I have to say they are very pleased today, a few days after the swimming finished, because they would say as well as everyone trying harder and better diets and everything else that goes into sport, the culture itself played a tangible part in improved performance.

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