AUSTRALIAN INSTITUTE of COMPANY DIRECTORS

Australian Governance Summit 2019 Reader

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Introduction

There is little doubt that the role of corporate governance in Australia, particularly in relation to the duties and responsibilities of directors, is under intense scrutiny. Organisational culture, trust, fairness and accountability have become part of the national conversation, across both business and the broader community, and we can expect the discussion around board obligations and performance to continue for some time.

In 2019, the Australian Governance Summit focuses on rising to the moment, delivering a program designed to broaden the conversation, reassure and challenge, and assist with the fundamental question: What does good governance look like today?

The event features the latest governance, business and technology trends, robust discussions and exclusive networking opportunities for experienced directors and executives from across Australia. Attendees will explore current and emerging organisational, technological and social issues and ways in which they can respond to these complicated and often interconnected challenges.

This *Australian Governance Summit 2019 Reader* follows the summit program and provides a selection of expert presenter submissions and recently published articles and extracts from the Australian Institute of Company Directors. The purpose of this collection is to enhance attendees' participation by providing contextual background to the current director and governance landscape as it relates to the themes explored in this year's summit.

CHAPTER 1

The future of corporate governance in Australia

The future of corporate governance in Australia

Penny Bingham-Hall FAICD
Non-Executive Director of BlueScope, Dexus and Fortescue

2018 was probably the *annus horribilis* of corporate governance in Australia. Management and boards were found to be lacking in their oversight in the financial services sector with findings from the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Hayne Royal Commission) and the Australian Prudential Regulation Authority's Final Report of the Prudential Inquiry into the Commonwealth Bank of Australia (APRA's CBA Report) sending shockwaves through the non-executive director community at large. Combined with a general lack of trust in our institutions, politicians and big business it has left the Australian community wishing for a happier, healthier and better governed new year.

So, what does all this mean for corporate governance in Australia in 2019? Undoubtedly a heightened focus on a number of issues called out over the past year and probably a level of unease about what the year ahead will bring. Not the least of which is a looming federal election, NSW state election and various criminal court cases being brought forward by regulators for alleged 'white collar' crimes.

At the Australian Governance Summit, there will be plenty of debate about the fallout from the final report from the Hayne Royal Commission. However, it will also be a good opportunity to step back and ask what has really changed and what should non-executive directors continue to do regardless of the impact of the financial services sector inquiries and the reinvigorated role of regulators.

Doing what is right seems to be the new catchcry. But this has always been, and should always be, a core value of leaders and those with a governance role. For directors, assuring yourself that what your company is doing is in the best interests of all its stakeholders is not only common sense but in the best interests of shareholders in the long run. Community, customer and employee expectations may have changed but it is a director's role to be in touch with these expectations. This role hasn't really changed in recent years although some directors have been held to account for unacceptable behaviour towards customers in their businesses and the *#metoo* movement has called out behaviour towards women that was never okay. And the concern about the sheer quantum of executive pay and board discretion over incentives will continue to create tension between directors, management, investors and the community at large.

Directors must have the courage to not only call out bad behaviour when they see it but increasingly must assure themselves that they will see it if it happens. One of the real debates facing directors is the level of their responsibilities regarding corporate culture. Not only because culture is hard to measure and quantify, especially in very large organisations, but it also raises the question of where non-executive responsibilities start and end — and where they overlap with management. In response to APRA's CBA Report, most boards are re-thinking what information pieces they get from management that are good indicators of corporate culture and also how they supplement these with direct interactions with employees. There is no substitute for getting out amongst the operations and meeting people to take the pulse of an organisation. It is also essential to understanding the risks and safety hazards in the workplace. Directors doing safety walks sends a strong message to employees about the importance of keeping them safe and the board's level of interest in the actual operations of the company. The days of just reading board papers and turning up to board meetings are long gone. To be an effective director you need to build a strong base of knowledge about the organisation's operations, markets, customers and its people. Investor and community expectations around environmental and social issues will continue to be top governance agenda items in 2019. Global and local investors have been asking companies to demonstrate how they are addressing climate change risks and social risks such as modern slavery for some years. And we are now seeing increasing pressure on politicians in Australia to up their game on these issues.

Most public companies have risen to the challenge of reporting against TCFD (Taskforce for Climate-related Financial Disclosures) and looking at the impact of long-term investments in a carbon constrained world. The passing of the Modern Slavery Bill in the Australian Parliament in late 2018 will require all companies with an annual consolidated revenue of more than $100 million to report annually on the risks of modern slavery in their operations and supply chain, and their actions taken to address those risks. For some companies and directors this is an evolving journey whilst for others it is yet another area of responsibility which will require time, resources and good governance.

The other governance issue that continues to challenge directors is balancing expectations around executive remuneration. Whilst there is now greater acceptance that one model doesn't necessarily fit all, the jury is out on a range of new remuneration structures that have been adopted. Time will tell how these play out but the issue that all directors are juggling with is how to apply discretion to incentive outcomes. No remuneration structure is perfect and whilst balanced scorecards provide a score, that score needs to be weighed up against community and shareholder expectations, and then balanced by the board's view on how well the CEO and management team have performed.

Some pretty dramatic votes against remuneration reports during the 2018 AGM season says that directors are not always getting this right. And when companies haven't performed to expectation, not just in a financial sense, then shareholders are saying they don't expect executives to receive large bonuses, if any at all. Directors need to balance the performance of individuals with the overall performance of the company and be able to clearly articulate decisions around remuneration.

A key skill of any non-executive director is judgement and the ability to balance external perspectives and insights with an inquiring mind about the company that they serve. This skill will continue be tested in the year ahead as directors balance increasing governance and compliance requirements with the need for strong strategic leadership and oversight of performance and corporate culture.

Reset for the future

Angus Armour FAICD
1 December 2018, "Reset for the future", *Company Director*, December 2018, AICD.

2018 will be remembered as a pivotal time for governance in Australia. Governance and organisational culture have been part of the national conversation, not just among directors, but in the community at large.

While Australian businesses, not-for-profits and government agencies generally continue to serve their customers and communities well, the outcomes and testimony of the Royal Commission into Institutional Responses to Child Sexual Abuse and the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry have shone a spotlight on appalling and unethical behaviour. Recent shake-ups at the ABC and Cricket Australia have also focused public attention.

This year's events have posed fundamental questions around the role of the board, remuneration policies, the approach of regulators and the organisation's relationships with key stakeholders. As we look to 2019, we can expect the debate and discussion around governance issues to continue and broaden. Commissioner Kenneth Hayne AC QC will deliver his final report in February. This is soon to be followed by a federal election. Both will fuel the conversation around obligations to the community and general governance standards.

It is important directors do not sit back and take a reactive approach when positions or proposals are put forward on these issues. It would be naive to think Australia is immune to the type of populist wave we have seen across the world over the past few years. Directors must engage early on questions of fairness and accountability, which speak to the community's concerns.

If we do not, the discussion on these issues will quickly move away from us.

Some proposals that emerge will achieve broad consensus quickly. For instance, stronger penalties for corporate and financial sector misconduct have already been announced and the AICD has supported these moves. Some ideas will require more careful consideration. We may see calls for reform of the *Corporations Act 2001* (Cth) around directors' duties along the lines of s 172 of the UK Companies Act, which sets out a number of stakeholder groups whose interests directors must have regard to when acting to promote the success of a company. Or there may be a push to professionalise directorship, at least for the largest companies, requiring directors to meet certain training requirements. These policies and others like them are being evaluated by the AICD, working closely with our members.

It will also be important for the AICD to continue to advocate in an election year for policies that promote growth, including comprehensive tax reform and infrastructure spending. Our vision commits us to strengthening society through world-class governance — and that vision extends to national governance.

At an organisational level, directors are aware they need to future-proof their organisations to prepare for technological and social change. The governance framework (legislation, principles and policy settings) also must be in place to help them in building strong organisations that serve their stakeholders.

Is your organisation ready for the future?

AICD
1 December 2018, "Is your organisation ready for the future?", *Company Director*, December 2018, AICD.

With rapid technological, social and environmental change, boards should be preparing for the future. We outline the major issues directors need to consider.

One of the most significant changes directors need to prepare for concerns the future of work. Which tasks will still be required? Who will carry them out, and what skills will they need? What environments will people work in?

The impact of these changes on governance is profound. The way organisations are governed must adapt and directors will need to take informed and considered steps to take advantage of the opportunities presented. Governance must be flexible in its response to the changing nature of work as well as providing oversight and strategic direction for new ways of working.

The impact of the future of work varies across industries, geographies and business models. To give structure to this complex topic, this guide considers the future of work from three perspectives — the nature and type of work being done, workforce capabilities and composition and the physical, digital, cultural and structural environments required to carry out the work.

The impact of these changes for directors needs to be examined through six lenses based on the key roles of the board:

- strategy development;
- allocation of resources required to achieve the strategy;
- monitoring organisation performance against strategies and targets;
- legal and regulatory compliance;
- risk management framework; and
- accountability reporting of progress and aligning the collective interests of stakeholders.

The work

New technologies and shifting consumer behaviours are redefining what work tasks are required to create value. Manual or physical tasks are still necessary in many industries, but these no longer require as much human input. Instead, employment is more concentrated in service-based tasks. As a result, tasks and roles are less focused on technical and mechanical requirements. Work tasks increasingly require a combination of technical and soft skills to create value.

Evidence (or data) is becoming the basis of more tasks, particularly those that include elements of decision making or judgement. This evidence is complemented by a growing recognition of the need to look beyond the balance sheet to longer-term value generation. Many businesses now look to align work tasks to an overarching 'purpose' and demand is growing for companies to operate in a socially and environmentally responsible way.

Five questions to consider:

1. Have we quantified what work is being done and how it might be affected by developments in technology?
2. How is our data protected against misuse, damage, loss or theft?
3. How do we incorporate considerations of purpose into decision making?
4. How do we develop the existing workforce to build capacity in alignment with skills needs?
5. Do we recognise development and use of soft skills in our incentive and reward frameworks?

The worker

The new workforce includes human and mechanical workers, varying qualifications and skills, and new models of working.

Automation is one of the most commonly discussed topics in the future of work, but augmentation better describes the reality. With technology increasingly able to do manual, repetitive tasks more efficiently, new jobs will be created.

Human workers will focus on higher-value-add roles reliant on skills such as emotional intelligence, judgement and empathy — and their ability to do so will be enhanced through augmentation. Individuals and workplaces will need to invest in continuous learning, rather than 'set and forget' qualifications and ad hoc training.

Contingent work, in particular, has become more popular. Simultaneously, workplaces are becoming more diverse across gender, age, ethnicity and sexuality.

Five questions to consider:

1. Are frameworks in place to support workers as more machines come into the workplace?
2. What external education/technology/advisory partners can help support the transition and sustainability of this new workforce?
3. How will we maintain workforce culture as more independent contractors begin to replace the traditional full-time workforce?
4. Do we need a workforce advisory panel or other mechanism to give insight to the board?
5. Have we defined our current skills needs and forecast how these might change?

The workplace

The physical, digital and organisational context of work occurs includes facilities, infrastructure and technologies, as well as components such as culture and structure. Several of the trends influencing the form of workplaces have been evolving for some time. For example, most large organisations already recognise the costs of silo structures, and remote working has been on the rise for over a decade. It's also now widely accepted that leaders who display personal power rather than just 'pulling rank' are more effective in their roles.

Other trends, however, are still emerging. With consumer preferences evolving rapidly, there is a new focus on organisational agility, and the ability to react quickly to external change. Many of these trends pose challenges for business. Boards are typically not designed for rapid response and remote workforces can make it more difficult to monitor performance, security and health and safety.

However, directors who successfully embrace future workplaces can foster more innovation and informed risk-taking. It can mean better staff engagement and a stronger pipeline of future leaders.

Five questions to consider:

1. How do our policies, processes and systems encourage or discourage silos in the business?
2. Are our high-level strategic goals distributed across the performance framework in a way that incentivises collaboration?
3. Is innovation on our board agenda and do we have the data we need to discuss it?
4. How do we measure innovation and is it incentivised and rewarded?
5. What is our attitude to failure as a business?

Trends for the board agenda

AI and outsourcing

The current trend of outsourcing labour to other parts of the world may reverse. With new AI developing each day, demand for cost-effective labour may fall. Freight costs and proximity to other parts of the supply chain may drive decisions about where to locate workforces.

These technologies are most effective when they complement, not replace, humans.

Human capital

Human capital is a core asset for businesses and boards will need to recognise its value. Only one in 10 businesses nominate staff as a top priority for future planning.

Retraining enhances a company's public reputation and makes economic sense. At the 2017 World Economic Forum, 80 per cent of CEOs investing in AI pledged to retrain existing staff.

Purpose

Purpose-led businesses are more successful, more likely to grow in revenue and expand into new markets. Directors should seek to define, codify and monitor the impact of business purpose.

In 2017, 88 per cent of Australasian businesses said practising social responsibility helped them build their reputation; 78 per cent said it helped brand positioning. Institutional investors expect companies to have a solid long-term vision. Businesses that don't pay attention to community expectations may be penalised by investors, consumers and governments.

Wellbeing at work

Boards must consider how their decisions impact employee wellbeing, position it as a performance issue and make resources available to managers. Businesses with the best wellbeing programs see fewer sick days per year and higher productivity.

Move the metrics

Directors should consider new ways to align the organisation to its purpose and social and economic impact and check whether traditional metrics impede innovative approaches.

What's keeping ASX 200 directors awake? The three Rs: risk, relationships and remuneration

Dr Saranne Cooke GAICD
Director of Racing NSW, Fisheries Research and Development Corporation and Western NSW Primary Health Network, Council Member Charles Sturt University and Chair of the AICD's Western Region Committee.

ASX 200 directors are arguably under more pressure and scrutiny that ever before, so how do they govern the biggest listed companies in Australia? How do they perceive their governance responsibilities and enact them?

41 ASX 200 directors, who between them held 70 ASX 200 current board roles, were interviewed about governing under the current ASX corporate governance principles. The research found three key themes: risk, relationships and the process of establishing executive remuneration.

Risk

Risk is at the forefront of ASX 200 directors' minds, and was prominent in their reflections on governing their companies. The third edition of the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations* (Principles) enhanced the number of recommendations concerning risk. It is clear that this, combined with other external pressures and corporate collapses, has resulted in a significant increase in the focus on risk by ASX 200 directors. It is at the forefront of their thinking and invariably what keeps many directors awake at night.

Risk from internal factors

Directors interviewed focused on various risks stemming from breakdowns in internal controls when they reflected on their governance practices in relation to the Principles. These risks included incidences of unethical behaviour within the organisation, a failure to disclose appropriately to the market and inaccurate corporate reporting.

ASX 200 directors reported being very focused on the culture of the organisation in their efforts to eliminate unethical behaviour. They are equally aware of the potential for reputational damage from unethical practices in the company — acutely conscious that it takes a long time to build the reputation of the organisation and that reputation can be destroyed quickly if the organisation is found to be acting unethically.

Directors take maintaining the integrity of corporate reporting seriously. They are focused on having extensive and varied levels of assurance and, in their interviews, they reflected on the potential for severe ramifications for the company and directors of making mistakes in reporting.

The risk surrounding disclosure is significant. Extensive judgement is required to determine whether to disclose information — and, if so, how — in order to meet disclosure requirements that are only ever tested in hindsight. Directors further have the complication of timing and often need to delegate some of their disclosure responsibilities to ensure it takes place between board meetings as required. This delegation requires substantial trust to be placed in the executives involved, for which strong, open, transparent relationships between the board and executive are a prerequisite. Some non-executive directors were of the view that the laws on disclosure should be changed because of the inherent difficulties faced in being expected to know everything that must be disclosed without being involved in the day-to-day management of the business.

Risk from external factors

Directors are also focused on various risks that stem from external factors to the operations of the compny. In particular, directors are concerned about potential areas of risk they failed to identify: the "thing they don't know" or "didn't plan for". Unknowns they are concerned about include their business becoming obsolete in the market or being faced with a catastrophic incident they had not adequately planned for.

Aversion to risk

ASX 200 directors with international experience and perspective shared the view that in Australia, directors "are not willing to take a lot of risk, not willing to put their reputation on the line". They further noted the cultural differences in other jurisdictions where there is a greater degree of tolerance when something does go wrong in governing and managing companies. In these jurisdictions, companies were able to enjoy the benefits or upsides of risk-taking more frequently.

Interviewed directors did not mention the protection of the business judgment rule in the *Corporations Act 2001* (Cth) when considering risk to themselves or the organisation, or their broader governance responsibilities. Most directors were acutely aware of the potential risks to both the company and themselves. "The downside is so great… the responsibility is enormous and you can lose your house, and you can go to jail," summed up one director.

Relationships

The presence of strong working relationships between ASX 200 directors and key parties and stakeholders is essential in enabling ASX 200 directors to govern effectively. The board acts as a team in fulfilling their collective responsibilities, and the team's effectiveness depends on there being strong relationships that facilitate dependency, reciprocity and trust.

The research examined relationships from two perspectives: within the board, and between board and management.

Relationships within the board

While there has been much focus on the need to recruit new blood to the boardroom, the interviews revealed directors are cautious about the recruitment process for new directors, focusing on the necessity of finding candidates who are a suitable fit for the board team. The need to be able to work with the person was seen as being critical, given the negative impact conflict can have on decision making and board effectiveness.

This concern and caution heavily influence the appointment process and how some boards search for board directors. However, there were two distinct schools of thought around director recruitment. One school was strongly of the view of selecting directors from their existing networks to reduce the aforementioned risk.

The second was focused on looking for new talent outside known networks (which some perceived to be riskier). Directors also raised the practical difficulties in removing directors who do not have the right skills and attributes, or who cannot work as part of the team.
The role of the chair was seen by the ASX 200 directors as important in facilitating the effectiveness of the team and fostering relationships between board members. The chair requires strong interpersonal, social and leadership skills in order to facilitate discussion and be able to manage the complex nature of relationships between directors and executives.

Relationships with management

In practice, ASX 200 boards are mostly made up of non-executive directors who rely on executives for resources and information to perform their directing and governing role. Without a good relationship with senior executives, which enables trust and thus the provision of information, non-executive directors are limited in their ability to perform their governing role. Boards and executives must exhibit openness, honesty and trust — all of which are founded on respectful professional relationships — to perform their roles effectively.

The relationship between the board and executives is complex. It must be strong and trusting but also distant enough so as not to impact independence and the role of the non-executive director. "There is always a tension between management and conscientious directors," said one director, although, "what is sure is that you can't have the board managing the business". For the relationship to work, "you need a very open and transparent environment".

The risk associated with relationship breakdowns is significant because it can have a major impact on the effectiveness of the governance of the company. Some ASX 200 directors also reported that boards are increasingly recognising the benefits of connecting effectively and, with employees, more broadly. Some companies have used their board diversity strategy to ensure the board more closely reflects their employee base so as to better connect with that stakeholder group.

Relationships with stakeholders

Relationships that boards have with key stakeholders are critical enablers of good governance and board effectiveness. Stakeholder groups are varied, depending on the organisation and industry, but usually include shareholders, proxy advisors, consultants and regulators. The interviewees made it clear that modern ASX 200 board governance requires chairs and CEOs to have closer proximity to certain stakeholders, including proxy advisors.

In respecting the rights of investors, boards must facilitate open and reasonable communications and also have an avenue for investors to hold the company to account. Despite this, participants made it clear the traditional AGM format is less effective as a mechanism for facilitating an appropriate avenue for this purpose, as proxy voting by major investors usually means smaller investors have little influence on the outcomes of voting matters.

Remuneration

ASX Principle 8 (to remunerate fairly and responsibly) is a contentious theme, revealing the tensions surrounding the process of setting executive remuneration. It illustrates a significant contention around current practices that has emerged following a period of scrutiny and legislative change. As one director noted: "It's the most emotive part of any organisation… externally, it's the thing most people are interested in."

Since the 2011 introduction of the "two strikes" rule in the *Corporations Act 2001* (meaning an entire company board can face re-election if shareholders disagree with how much executives are being paid) and with increased external pressures, directors have experienced and are increasingly concerned about significantly altered power structures in the remuneration process in relation to obtaining stakeholder support and approval.

The role of remuneration consultants has risen dramatically in recent years, with directors and boards using them to provide external validation of their remuneration structures. This is seen as an effective mitigant to risk. Many directors have the view that boards have become beholden to the advice of remuneration consultants.

The complexity of the remuneration report was also of great concern to directors interviewed. The power of proxy advisors has risen dramatically in recent years, and a key strategy for boards in avoiding a strike has been to establish relationships with them and engage, particularly in the lead-up to the AGM, on executive remuneration. ASX 200 directors were critical of proxy advisors for forcing boards to design remuneration structures that centre to norms not necessarily suitable for their organisation, industry or individual executives. They reported that this has resulted in increased complexity and, at times, unrealistic expectations being placed on boards by stakeholders when setting appropriate remuneration structures for their executives.

Directors are concerned about the significant amount of time being devoted to remuneration when managing various stakeholders to minimise the "risk of a strike" (referring to the two strikes and re-election process in relation to the non-binding shareholder vote on the remuneration report). Having experienced various AGMs where the non-binding vote was used by investors to express their dissatisfaction with matters other than remuneration, directors felt stymied by the use of the mechanism in this way.

They also reflected on unintended consequences of the remunerate on process (under the current two-strikes rule), most significantly the effect it has had on putting upward pressure on executive remuneration. ASX 200 directors were uneasy about excessive remuneration for executives and increasing disparity with the average wage in Australia.

"We definitely need to put a break on executive remuneration… The calculation of how many multiples of the average wage is the average CEO salary, and the gender inequity of CEO and executive salaries, tells me there is something really crook," said one director.

How the three themes intersect

The study revealed the three key themes ASX 200 directors focus on in reflecting on their practice of governance are highly relational. Effective risk management relies on the existence of strong board and executive relationships built on trust and openness. Effective remuneration management requires appropriate relationships with key stakeholders, internal and external (remuneration consultants, proxy advisors).

The failure of critical board and executive relationships significantly increases certain risks to the company and can impact judgement at the board level.

Directors used four common elements (trust, values, judgement, rigour) to describe the three prominent themes. They were outlined as essential characteristics directors and boards must exhibit to be successful in their governance.

The current review of the Principles has sought consultation on eight principles covering the same broad governance themes. The review, due to be finalised in 2019, has focused on a number of additional recommendations, including corporate values and culture; whistleblowing; anti-bribery and corruption policies; social licence to operate; board diversity; carbon and cyber risk; and issues raised in the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Hayne Royal Commission).

With a number of these potential new areas being risk-related, it is likely that the risk theme identified by directors in this research will continue to be at the forefront of ASX 200 directors' minds in their governance.

CHAPTER 2

High-performing boards: What's behind their success?

Future of boardroom composition

Tony Featherstone
20 July 2018, *Future of boardroom composition*, Governance Leadership Centre, AICD.

Nine trends that could change the face of boards by 2030.

Predictions about the future of board composition in Australia abound. They include: smaller, more diverse boards by gender, race and skills; younger directors; more investors on boards; a preference for industry specialists; an internationalisation of boards; and 'robo' directors.

Some observers even tip major changes in governance processes, such as the introduction of quarterly board-meeting cycles, to attract international directors. The reality is less dynamic. Board-composition trends, like most governance issues, move slowly. It takes time for directors to serve multiple terms and retire from a board. Also, companies with effective boards tend to favour incremental governance change.

But three factors suggest board-composition trends could quicken in the coming decade. First, the appointment of female directors is making boards younger and more diverse. Second, intergenerational change will see many baby-boomer directors in their 60s and 70s retire from boards in the coming decade, creating opportunity for board-composition change.

Third, the market is paying greater attention to board composition and its alignment with organisation strategy, and environmental, social and governance (ESG) performance. Pressure on listed companies with sub-optimal board composition will continue to build as investors and shareholder activists demand greater say in who serves in the boardroom.

However, the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Hayne Royal Commission) and the Australian Prudential Regulation Authority's Final Report of the Prudential Inquiry into the Commonwealth Bank of Australia (APRA's CBA Report) this year could slow board-composition change if they encourage boards to be more risk averse in appointments.

Launa Inman MAICD, a non-executive director of Super Retail Group and Precinct

Properties New Zealand, and a former director of CBA, says boards will need to find the right balance between entrepreneurialism and compliance in director skills. "I'm concerned that boards could become too risk averse in director appointments as compliance requirements increase."

Here are nine trends to watch in board composition to 2030.

1. Gender-diversity gains spread through market

Progress on gender diversity has been the most noticeable change in board composition in the past decade.

The proportion of female directors on ASX 200 boards was 27.7 per cent in May 2018, from 8.3 per cent in 2009, Australian Institute of Company Directors research shows.

Gender diversity gains have slowed in the past 12 months, but women continue to be appointed to ASX 200 boards at almost the same rate as men — a trend that bodes well for future diversity gains.

It's likely that gender diversity gains will spread to small-cap companies (those outside the ASX 100) in coming years as more institutional capital flows to this part of the share market. Institutional investors are increasingly using responsible-investment filters that incorporate ESG screening and showing greater interest in gender diversity on boards.

One of Western Australia's leading company directors, Fiona Harris FAICD, a non-executive director of Oil Search, BWP Trust and the privately owned Perron Group, expects gradual change in gender diversity in small-cap companies.

"Gender diversity gains in this part of the market will increase as institutional investors expect to see women on boards and as more companies recognise the benefits of appointing female directors. Change will be slow because smaller companies are often resource-constrained when it comes to board size and director appointments."

Inman says there are many competent female directors who would add much to boards of small- and large-cap companies. "I would be disappointed if the fallout from the Financial Services Royal Commission leads to a slowdown in female appointments to boards. The industry's challenges occurred over a long period and had nothing to do with gender, but rather because there was not the right focus on certain issues. "

2. Younger boards

The average age of ASX 200 boards has fallen below 62 for the first time since 2011, according to Australian Council of Superannuation Investors research in 2016. The average age of directors rose steadily between 2001 and 2012, peaking at almost 63 in 2012.

This trend reversal suggests generational change is on the way. An increase in the appointment of female directors is reducing average board ages. Women non-executive directors were on average six years younger than their male peers, ACSI found.

The coming exodus of baby boomers (born between 1945 and 1964) from the workforce is a key driver. By 2030, every boomer will be 65 or older, triggering major board renewal as a generation of company directors hands the baton over to younger directors.

3. Skills

Calls for an increase in the appointment of discipline specialists to boards, such as ESG or human-resource experts, overlook a governance truism: high-performing boards have directors who can govern across a range of issues, not only their area of expertise.

An exception is directors with deep technology skills and experience, and a capacity to govern across a range of issue. As the impact of artificial intelligence, automation and machine learning becomes more profound on business, demand for directors with those skills will rise.

Appointment of such directors in ASX 200 companies has so far been relatively modest. It's likely that boards believe technology, which is everyday business for most companies, is a skill all directors must seek to possess. And that boards can "insource" technology expertise through expert presentations and/or visits to key technology hubs.

4. Industry specialists

APRA's CBA Report, arguably more influential for Australian governance than the Hayne Royal Commission, urged boards to dig deeper in their organisation. That implies directors spending more time on each role and rising demand for industry specialists.

Directors, such as ex-CEOs who have years of experience in an industry, may be able to add value to boards faster, analyse issues more forensically and better challenge management because they are have experience in the organisation's sector.

Institutional investors have long called for boards to have industry specialists who can govern strategy and ensure management is accountable, and fewer governance generalists, such as lawyers or accountants, who may be more compliance-focused.

Graham Bradley AM FAICD, chair of HSBC Bank Australia, EnergyAustralia and GrainCorp, told the Governance Leadership Centre in June: "Inevitably, boards will be looking for directors with deep experience in the company's industry. Unless you have a strong industry background, it can take two or three years on a board to truly add value. That is increasingly unrealistic given ARPA's view that boards urgently need to dig deeper within the business."

An increase in the appointment of industry specialists over governance generalists, should it occur, would affect other board-composition changes. Industry specialists tend to be ex-CEOs or C-level executives, of which there are fewer women relative to men.

Launa Inman is not convinced that boards of large organisations will favour industry specialists over governance generalists. "In this heightened compliance landscape, I suspect we'll see more companies appointing lawyers and accountants to their boards in coming years."

5. Smaller boards

Steven Cole FAICD, chair of Neometals and a non-executive director of Matrix Composites & Engineering, says a move towards smaller boards is well established.

Larger listed companies (and NFP organisations) tend to favour 7-10 directors and smaller companies prefer 4-6 directors, he says. "This seems to be the currently accepted 'sweet spot' for the sharing of the load and diversity of skills and perspective, yet it is still small enough for management of interpersonal dynamics. I believe this sweet spot is as much driven by the human condition as it is by skills and knowledge, and don't see it moving materially from here."

The average ASX 200 board had 8.3 directors in 2015, ACSI found — slightly down from a few years earlier. It's likely that companies with large boards (above 12 members) will reduce board size in coming years as retiring directors are not replaced. But, as Cole notes, dramatic changes in board sizes seem unlikely given gains so far.

The introduction of an office of the board (a board secretariat with full-time resources that repots to the chair) in ASX 200 companies could lead to smaller boards, if such a model was introduced. Remuneration consultant John Egan flagged the idea in the Governance Leadership Centre report in June.

Cole is wary of such change. He says the CEO and company secretary should remain the board's main points of contact. "I do not favour a discrete function as that risks dividing the board and management into a them-and us-outcome. The (board/management) team must be united, cohesive and relatively 'frictionless' to optimise performance outcomes, while respecting constructive challenges and candour."

Fiona Harris also has reservations about an office of the board model. "It's not a structure that appeals to me. If boards need more information to make decisions, management should provide it. Boards should investigate how they can make better decisions through innovation; for example, utilising big data, automated flagging and machine learning techniques to identify outlier risks for their organisation. That would have a bigger impact on board decision making than adding full-time resources and a new structure."

6. Institutional shareholders

Cole expects institutional shareholders to play a greater role on boards in the next decade. Smaller companies often have directors who represent key shareholders, but it's rare for ASX-listed companies to have directors whose day job is funds management.

Cole believes this will slowly change as investors seek greater say in companies they own. That, in turn, could reduce board independence if listed companies have more directors who are substantial security holders in that entity or represent those who are.

"Institutional investors will need to show that by serving on the board they will add value to the interests of the company and its shareholders," says Cole. "The risk is the promotion of interests of narrow shareholder groupings as more investors serve on boards.

A fair balance must be maintained with those with lots of 'skin in the game' and those with a modest amount, to ensure prudential objectivity and independent oversight."

7. Reduction in board meetings could drive composition change

Cole favours a cycle of fewer board meetings, with caveats, and believes such change could quicken diversity initiatives by opening board roles to other directors. For example, a company that holds 10 full day board meetings annually, plus a strategy day, could move to a quarterly cycle. Those meetings could run for at least two days, and include several company presentations, site visits, overnight social/business stimulation and 'deep-dive' strategy discussions.

A shorter, half day compliance-focused board meeting that directors can attend via videoconference if needed, would complement the quarterly board meeting. "It's not uncommon for board meetings for big US companies, for example, to run for up to a week with multi-site visits." says Cole.

This format has three benefits, says Cole. First, it allows better separation of strategy and compliance matters in boardroom discussions. "Obviously, some timely compliance and administrative reporting matters would need to be acquitted at the quarterly meeting, but that's manageable," he says. "The focus of the quarterly meeting would very much be about strategy, risk oversight, industry dynamics, culture and people. The shorter in-between meeting would focus primarily on procedural, administrative reporting and compliance matters."

The second benefit is board effectiveness. Cole believes focusing for two (or three) days on a quarterly board meeting would provide better outcomes for directors, compared to the grind of monthly board meetings. "Having time for longer, more thoughtful discussions on strategy, industry dynamics and organisation people and culture would be beneficial. It would also relieve the tedium (and interruption to productive pursuit) for management personnel in compiling monthly board reports overloaded with transient operational monthly data."

Greater scope to recruit and engage effectively with international or interstate directors is the third benefit of this model, says Cole. "It helps overcome the logistical problems of directors from outside the company's home city, especially in this increasing age of international business and need for diversity (in its broadest sense) on boards. It's hard enough for directors on the West Coast to attend East Coast meetings and vice versa, let alone international directors flying in for board meetings. A longer, quarterly board meeting would make travel much more worthwhile for remote directors."

8. Board internationalisation

Elsewhere in this issue from the Governance Leadership Centre, Dr Ulysses Chioatto calls for boards of larger Australian companies to increase appointment of offshore-based directors. He believes board composition is not keeping pace with the internationalisation of Australian business.

Chioatto says too many listed companies have boards skills that are not sufficiently aligned with their international-expansion strategies. Australian companies, collectively, have been reluctant to recruit overseas directors. That is expected to change as more companies successfully pursue international growth strategies — a feature of the Australian share market in recent years.

Fiona Harris says the challenges of having offshore-based directors in Australia-domiciled organisations can be underestimated. "I've been on boards where we had directors in Australia, Toronto and the United Kingdom. It was very difficult finding a suitable time when all directors could meet via videoconference given time-zone differences."

Lower collegiality among directors is another risk, says Harris. "It's harder to get to know your fellow directors when some are offshore because you don't have face-to-face conversations in and around board meetings. Cultural and language differences can be another challenge if overseas directors are not used to Australian directors and their mannerisms."

9. Robo directors

The concept of robo directors seems far-fetched, even by 2030. But it's likely that more boards will use software algorithms within governance-decision processes to better understand organisations they govern, and to add to board resources and test human-director decisions.

Hong Kong venture-capital firm Deep Knowledge Ventures in 2014 appointed the world's first robo director as a "board member with observer status". The algorithm, named Vital, is analysing trends in life-science companies to predict successful investments.

Ohio State University researchers have examined whether algorithms can be used to select directors of publicly traded companies. A summary of their research, led by Professor Michael Weisbach, was published by the Harvard Law School Forum on Corporate Governance and Financial Regulation in April 2018.

Their algorithm found that directors who are not old friends of management and come from different backgrounds are likelier to better monitor management.

Nobody should expect robo directors to replace human directors in Australia anytime soon, or at all. More likely is software algorithms being used as a substantial additional resource for boards, and as an input in the board decision-making processes, such as modelling executive pay outcomes.

Nevertheless, greater use of robo directors by 2030 could encourage smaller board sizes if technology can do the work of many directors, or more routine tasks.

How can boards perform better in 2019?

Shelley Dempsey
9 January 2019, "How can boards perform better in 2019?", *The Boardroom Report*, Volume 17, Issue 1, AICD.

Why do some boards perform better than others? Elana Rubin FAICD, who sits on boards including ME Bank, Transurban Queensland, Slater and Gordon, Mirvac, and the AfterPay Touch Group, says board success will go well beyond financial metrics this year.

How can all boards perform better?

Reflecting on the current environment, I believe there is a role for boards to reaffirm their social licence to operate and to address the lack of trust the community has in business (and in institutions more broadly). The business sector can do better in demonstrating its important role in society, engaging with communities and recognising concerns. Diversity is one area which is a missed opportunity for many boards. Boards which lack diversity are likely to fail to deliver optimal outcomes.

How important is the role of the chair?

Leadership matters. Strong leadership by the chair is important. The chair has the most direct relationship with the CEO and can assist in the flow of information from the board to the CEO and vice-versa. A good chair will be open and inclusive and encourage directors to share their expertise. The chair also manages the tone of the board meeting and discussion.

Equally, a poor chair can fail to guide the CEO in dealing with the board and can fail to manage a meeting which results in important issues not being fully addressed or different points of view being shut down. Failure to manage board culture and dynamics can lead to a dysfunctional board.

Is it important to oversee business strategy as a close priority?

A key role of the board is to confirm the business strategy and monitor its implementation. Research from McKinsey Global Institute confirms that companies that operate with a true long-term mindset consistently outperform industry peers. The board's discussion can help reinforce a longer-term perspective, rather than the short-term view often driven by the market.

Is it important to be alert to problems early?

All boards say they want to hear the bad news early, but you hear of instances when bad news is regarded as almost an inconvenience or when the executive raising the bad news is viewed as not being a team player. Boards have a key role in promoting a culture where bad news is actively encouraged to be raised — indeed welcomed — and addressed. Moreover, boards have a role to dig beneath the good news stories and ask about the exceptions, to investigate a trail of customer complaints or missed targets.

What makes some boards perform better than others?

Boards are mini social systems and a robust and positive culture will have a significant impact on board effectiveness.

Directors who are comfortable in diverse groups, who treat each other with respect and trust, who genuinely listen to other opinions and are comfortable debating issues and being challenged… create an effective board.

How can you measure board performance?

An interesting question. Increasingly boards look to assess performance using non-financial measures such as board reviews, where directors and the CEO/senior executive team assess how a board performs. Measures can include organisational and board strategy and objectives, director attributes, board behaviour and director skills.

For me, a key measure is how well a board prepares the organisation for emerging issues. Directors bring a wealth of experience to the table, not just from previous roles but from what they see in other sectors and organisations. A good board will bring a perspective of today's issues and emerging issues, and work with the CEO and senior leaders to think about what might be around the corner.

What current trends can help boards perform well?

It is increasingly common for boards to go into the business and visit sites, walk the floor, see operations, meet employees, meet clients and stakeholders. It is hard to really understand the business and assess how strategy is being implemented if you stay within the comfortable confines of the boardroom. Boards are also engaging around the purpose of their organisation and its social licence to operate. As Larry Fink, President of Blackrock wrote in his 2018 letter to shareholders, "to prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society."

High-performing boards invite people from outside their business to brief them on issues as diverse as changing demographics, climate change and energy policy, international trade relations, the digital economy, innovation and trends in social licence to operate and trust.

In your view, could failures identified by the Royal Commission have been minimised by better board governance?

The Australian Prudential Regulation Authority's Final Report of the Prudential Inquiry into the Commonwealth Bank of Australia (APRA's CBA Report) and commentary from the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Hayne Royal Commission) reinforced the importance of non-financial issues and the need for boards to review their governance systems and processes. The extension of 'can we …' to 'should we …' is increasingly being overlaid across the decision-making framework of organisations.

Boards are considering: if the purpose of the organisation is being delivered; whether the right information is coming to the board; whether there are potential unintended consequences of their organisational structure and remuneration practices; whether they have sufficient insight into culture and 'how' results are delivered; whether bad news is brought forward quickly enough; whether accountabilities and responsibilities are clear and being applied; and whether the focus on positive client customer satisfaction has led to insufficient understanding of the drivers of customer dissatisfaction and other measures.

Do you have what it takes to lead a high-performance organisation?

AICD

1 September 2018, "Do you have what it takes to lead a high-performance organisation?" *Company Director*, September 2018, AICD.

Directors share their tips and experience on how to create and operate a high-performance organisation.

Macquarie Group chair Peter Warne FAICD says the important lesson in performance is to make sure you get the best people. At Macquarie's recent AGM, Warne told of asking CEO Nicholas Moore, as a newcomer to the board, "What's Macquarie about?"

"He said it was about getting the best-quality people we can hire and have them solve our clients' problems, which I thought at the time was a bit trite," Warne says. "But that's exactly what Macquarie does. You need to attract, motivate and retain talented people. It's about getting them to listen to customers and come back with solutions."

Warne says the authority around developing strategy at Macquarie is devolved to its people, with a bottom-up approach. "The strategies get pumped up from the business when they see opportunities, then it's up to the centre (risk management) and the board to challenge and see how we can add value."

There's nothing like an immovable deadline, intense public scrutiny, a big budget and complexity of execution to test an organisation's capabilities. In April, the board and executive of the Gold Coast Commonwealth Games Organising Committee turned in a gold medal performance. After eight years of preparation, the event came in on time, within its $1.5 billion government budget, and was beamed to an audience of more than 1.5 billion people with no major dramas, albeit some controversy over the closing ceremony.

Bronwyn Morris FAICD, director of the Gold Coast 2018 Commonwealth Games Corporation and chair of RACQ, says it demonstrated the importance of discipline, collaboration and agility. She says the discipline of early work on the Games bid book by CEO Mark Peters was vital in ensuring financial performance — as well as a close-knit executive team and an effective board chaired by former Queensland premier Peter Beattie AC.

A chartered accountant by background, Morris had a close-up view of the financial and operational risks as chair of the finance and audit committee. "As we got closer to the Games, we were meeting monthly and it was important to be close to the Games team.

At one point, we had 1000 risks in the risk register, but had an amazing collaboration with government agencies."

Morris says it showed the importance of collaboration, particularly when it comes to levels of assurance from different areas of the organisation.

Christine McLoughlin FAICD, incoming chair of Suncorp Group, chair of Venues NSW and director of McGrath Foundation, views effective board performance, dynamics and composition through three lenses. "First is the current business and industry context, second is preparedness to operate in a range of future contexts and third is the foreseeable trends that will either enable or impact the business."

She says that looking through these lenses immediately points to the need for a board with a diversity of skills and mindsets and a commitment to continuous learning. "This assists in creating a discussion that underpins excellence, high performance and growth, provides meaningful stewardship and strengthens the organisation's reputation as a good corporate citizen, which, in turn, will add value for shareholders. Good directors make an effort to understand the communities in which their business operates and their range of sometimes conflicting expectations."

At a time when there's heated debate about how deep the board should go in holding management to account, Peter Hearl FAICD, a director of Santos and Telstra, says it's important for directors to find ways to get underneath potential issues and keep executives focused on performance.

"Boards in this new world need to be more surgical in their demands for action. Keep peeling the onion back to get to the truth. It needs to be done constructively, not as nitpicking. It gets to the quality of the questions to ensure the upward flow of information to board members."

CHAPTER 3

Amber flags: The warning signs that are easy to miss

Organisation culture fallout from the APRA report

Tony Featherstone
15 June 2018, *Organisation culture fallout from the APRA report*, Governance Leadership Centre, AICD.

Boards must be alert to early-warning signs on culture.

Expecting company directors to be responsible for the culture of billion-dollar organisations with thousands of employees has become an "almost impossible contract" for boards.

That is the view of Neil Waters, a partner at executive and board search firm, Egon Zehnder International. "It's naïve to believe part-time, non-executive directors can govern the culture of organisations they don't work at every day or the behaviour of people they do not see," he says.

Waters chooses his words carefully. The search industry veteran, soon to lead Egon Zehnder's board practice from Hong Kong, has advised some of Australia's largest companies, including banks, on executive and board appointments. He acknowledges that boards are ultimately responsible for organisation culture and behaviour, but says it is hard in practice.

"Some of these companies have become so large and complex," he says. "You question how boards can dig deeper into organisation culture and behaviour and have tougher conversations with management — as APRA's report on the Commonwealth Bank recommends — without moving to a more full-time, executive-style role."

Waters says board efforts to ensure organisations measure, reward and punish different behaviours, and identify signs of deteriorating culture, are failing. "These bigger companies have lots of comprehensive systems around organisation culture and behaviour, and very competent people at executive and board level monitoring these systems. Yet there were well-documented shortcomings in culture (exposed through the Financial Services Royal Commission)."

Equally, board efforts to choose CEOs who can lead and sustain positive cultural change are not enough. "Talk about boards now choosing CEOs who are strong on driving cultural change is overstated," says Waters. "Companies have always wanted CEOs who can lead change and grow earnings. Culture is part of that, but I'm yet to see a board chose a CEO mostly based on their skills in this area. I would say it's necessary but not sufficient."

Changing board composition is a likelier outcome from APRA's CBA Report, says Waters. "I suspect we'll see boards (or large companies) change. Increasingly, they'll look for industry specialists over governance generalists. That probably means more ex-CEOs appointed to boards and fewer accountants, lawyers and consultants. But that approach brings different limitations and I am not sure people are considering those yet."

Should it occur, a move towards industry specialists on boards could limit gains in diversity. A lift in ex-CEOs on boards in theory almost certainly means more men and older directors. "Boards now might be less willing to take a risk on, say, a younger director who does not have extensive management experience," says Waters. "I hope this trend does not affect the push toward greater diversity on boards in gender, age, race and so on. It was breathtakingly poor that gender so quickly became an issue during the recent AMP decisions."

Waters says APRA's CBA Report could make it harder for the banks to find "excellent directors". "There's always lots of directors wanting to join these boards, but the exceptional ones by definition are much more discerning and they are asking whether they can realistically fulfil the contract they sign when joining a bank board around stewardship of organisation culture, behaviour and risk."

Water says regulators, market and community expectations of boards will become a larger governance conversation. "At some point, boards will question whether these expectations have become unreasonable. There's only so much boards can do with organisation culture given the current governance model."

A different view on culture and CEOs

Alison Gaines GAICD, managing partner Asia Pacific of Gerard Daniels, believes regulatory focus on organisation culture is already affecting CEO appointments and succession planning. She believes executives who can lead cultural change are in higher demand.

"The cost-cutting, transformational CEO who 'right-sized' organisations during the downturn in the Australian economy after the GFC was important," says Gaines. "But the most successful leaders I see are those with high emotional intelligence and great attention to culture. These leaders transform organisations and align people and culture around rapid change."

Gaines says boards must move from viewing culture as a one-dimension issue led by the CEO, to a multi-dimensional issue that the executive team owns. "I still think companies and boards focus too much on organisation culture as it applies to employee-related issues. There's not enough recognition that there are lots of cultures within organisations and that different executives and managers need different skills to lead these sub-cultures."

Gaines gives the example of an organisation's risk culture. "The board should be satisfied that the chief financial officer is skilled in leading and sustaining a strong risk culture across the organisation. And that the chief information officer is adept at building a culture of information security, and the chief operating officer can lead the organisation's safety culture."

Gaines adds: "Boards can no longer focus almost entirely on the CEO and his or her ability to drive culture. Essentially, boards will have to spend more time with executives beyond the CEO if they want to be satisfied that various cultures are appropriately led."

Greater focus on how middle management drives cultures should be prioritised, says Gaines. "It's often at the general manager or mid-manager level where lots of decisions are made and implemented quickly. Boards must consider the skills of managers who do a lot of the heavy lifting on day-to-day issues. Of course, there's only so much boards can do, but the days of relying only a few executives to lead and maintain organisation culture are fading."

Gaines says strong systems, policies and reporting can help boards fulfil their stewardship of culture. "First and foremost, boards must ensure the executive team has the right people with the right skills leading different sub-cultures. Then, directors must be satisfied that there are the right systems to monitor behaviour and incentivise desired outcomes."

Developing systems that identify cultural deterioration — and ensuring boards receive that information promptly — is key, says Gaines. "A not-for-profit, membership-based organisation, for example, might have detailed systems that measure how long it takes to respond to members, and members' attitude to the organisation. A for-profit organisation with a large employee base might look at staff turnover and industrial disputes as culture indicators."

Gaines says boards must be alert to early-warning signs on culture. "A sudden loss of revenue from a longstanding client or market segment could be a sign of an emerging culture problem. As could a sudden spike in disputes and litigations with customers. Executive and board turnover are often key signs; directors sometime retire from a board because they recognise huge cultural problems in the organisation and lack the energy to fight management or other directors for change. Positive or negative media coverage can be another early marker of organisation culture issues."

Culture starts and ends with CEO

Korn Ferry head of board services, Robert Webster, says an organisation's CEO overwhelmingly influences its culture and behaviour. "The CEO is ultimately the chief culture officer and sets the tone from the top on this issue. If the CEO doesn't demonstrate the right behaviour, the company's culture will always suffer. That said, boards are spending more time with other executives to understand their approach to corporate culture."

Korn Ferry research shows boards are placing greater weight on values, ethics and an ability to drive culture gains, when choosing a CEO and in succession planning. “There’s a lot more focus on this than there has been in the past,” says Webster. “Boards are asking extra questions when interviewing candidates about whether they can drive change and grow the business, while strengthening organisation culture at the same time.”

Webster says boards are encouraging CEOs to make their direct reports more available to directors. “Boards want to understand how the broader executive team views corporate culture, not just the CEO. A CEO who is reluctant to expose senior executives to the board can be a sign of a deeper cultural problem within the company.”

Greater focus on culture will affect board preference for internal and external CEO appointments, says Webster. “If the company has cultural problems, if often makes sense to appoint a CEO from another firm or industry to shake things up. If the culture is positive, it makes sense to appoint a CEO from within who knows the business and can continue the work.”

Korn Ferry’s insightful 2016 report, *The Tone from the Top: Taking Responsibility for Corporate Culture*, interviewed 13 directors and CEOs on leading and governing organisation culture. An overwhelming theme in the report was that the CEO sets the standard for culture and that directors must get out of the boardroom and talk to stakeholders to sense the culture and identify emerging problems.

The report identified 10 ‘red flags’ or culture ‘derailers’ for boards to watch (summarised here):

1. CEO: Beware the command-and-control ‘God-like’ CEOs who can’t bring staff on the journey.
2. Strategy: Is organisation culture aligned to strategy? Bad culture kills good strategy every time when organisations resist change.
3. Executive team: Is the executive team sufficiently independent and diverse, or an ‘echo-chamber’ for the CEO? Does the CEO make executives readily available to the board?
4. Talking culture. Can the board and executive team articulate culture? Do staff at all levels understand the organisation’s values, ethics and desired behaviours? If not, there are problems.
5. Whistleblowers: Is there a formal whistleblower program and policy? Does the board have timely access to whistleblower reports? Are the reports acted on?
6. Toxic subcultures: Understand and measure the organisation’s key subcultures. A spike in safety incidents, for example, could signal emerging culture weaknesses.
7. Media noise: Negative media stories in print or online can be an early warning-sign of cultural malaise. Look for inconsistency in what you read and what you know.
8. Be a customer: Nothing beats experiencing for yourself the organisations you govern. Phone the call centre, visit the stores, buy products and even try to return them.

Understand the company's values, ethics and behaviour from the perspective of customers.

9. Engagement surveys: Use data to be forensic in reviews of organisation culture. Staff turnover that is consistently higher than industry average could be a culture red flag, for example.

10. Recognition and rewards: Ensure remuneration structures have the right incentives for desired behaviours. Be prepared to stick to those structures in good and bad markets, rather than turn a blind eye to inappropriate behaviour when sales are down.

Five finance red flags every director should watch out for

Narelle Hooper MAICD
27 September 2018, "5 finance red flags every director should watch out for", *Company Director*, October 2018, AICD.

Finance fundamentals every director should be across to meet their obligations to scrutinise and sign off on financial accounts.

Financial literacy is not a skill many of us are taught, yet it is a vital building block of the skills of an effective director. As a director, you're expected to have an appropriate level of financial literacy and basic accounting knowledge to tease out the full story in the accounts and meet your legal responsibilities. Directors are expected to understand financial concepts, ask probing questions when presented with financial information at board meetings, draw conclusions and make decisions.

The Corporations Act 2001 (Cth) (the Act) requires listed companies, certain public companies and certain proprietary limited companies, to prepare financial reports in accordance with the Australian Accounting Standards Board (AASB). Section 295(1) of the Act lists the content of a financial report as including the financial statements, the notes to the financial statements and the directors' declaration.

The format and content of the financial statements is governed by AASB 101 *Presentation of Financial Statements*.

The five common finance red flags to watch out for include:

1. declining gross/EBIT/net profit margins;
2. falling cash reserves/poor liquidity management;
3. debtors growing faster than revenue;
4. missed/delayed payments to creditors; and
5. high fixed costs in tight times.

Dianne Azoor Hughes MAICD, author of *Financial Fundamentals for Directors* (2014, AICD, [2nd edition scheduled for May 2019]), describes financial literacy as a language that expresses the activities of a company.

It tells the story of how it has progressed from year to year, transactions it has undertaken and alliances it has entered into. It is fundamental for directors to understand the language of that story, she says.

While all companies are dealing with growing complexity of financial statements and disclosures, the 2011 Centro case confirmed, among other things, that corporations law requires directors and officers to exercise due care and diligence in carrying out their responsibilities and that directors cannot delegate their responsibility for approving the statutory financial reports to others.

Federal Court Justice John Middleton said directors need to be involved in the process themselves, not to delegate that responsibility to management or experts. They need to read the financials, take a diligent and intelligent approach to the information presented, understand the information and apply an enquiring mind.

Azoor Hughes writes that the Centro case put the spotlight on director duties and responsibilities as they relate to financial matters, especially when it concluded with significant penalties for several directors.

For company directors, there are four pillars of financial literacy, she says. It is largely about the ability to:

- acquit formal legal and statutory obligations as they relate to financial matters — such as signing off on the annual financial reports;
- monitor financial results to assess solvency;
- balance risk mitigation (financial and otherwise) with the ability to drive the company's financial performance by understanding the story told by its financial reports; and
- know when financial experts are required to assist with the above points.

Other factors may also shade the depth of financial skills and knowledge needed, such as the company's business model, business plans and strategy, stage of growth and financial health, risk profile, the skills mix around the boardroom table and the state of the economy.

The AICD's *50 Matters to be Considered Before Signing a Company's Financial Statements*, 3rd edition (2016) states that to be able to make the declarations, directors must first satisfy themselves about the accuracy of the financial report. This will require directors to examine and interrogate the financial information of their organisation. It is a director's responsibility to ensure:

- the integrity of the accounting system;
- appropriate expertise is applied and due process is sound;
- essential elements of the process are scrutinised and tested by directors; and
- where appropriate, independent expert advice is obtained.

This will lead to a director's confidence in the integrity of the outputs of the financial and management systems. It outlines two basic questions for directors:

1. Do the financial statements make sense and provide a "true and fair" view of the

financial performance, position and cash flows of the company?

2. What are the major areas involving a higher degree of subjectivity, discretion and/or judgement, and have these areas been subject to additional scrutiny?

In an AICD interview, Azoor Hughes said, "[Directors] should talk to management, to auditors… understand the gaps in their knowledge and not be afraid to ask questions… identify the gaps and take appropriate steps to fill those gaps. Directors can never sit back and say, 'I've done it'. They need to keep updating their knowledge."

CHAPTER 4

A high-performance culture: Driving the right culture in your business

Culture: The human element of business

Steve Vamos
CEO, Xero

Defining culture

There are almost as many definitions of culture as there are articles, books and speeches written about it.

“Culture can be a vague, amorphous term… I think of culture as a complex system made up of individual mindsets”, says Satya Nadella, CEO of Microsoft, in his book *Hit Refresh*.

“Over the years, we’ve come to believe that culture is one of the most important — yet least understood — drivers of long-term value”, from WCM Investment Management’s *Why Culture Matters*.

Culture should be defined as the human element — mindset and actions — that shapes *why* people do *what* they do and *how* they do it.

If culture is so important and we want non-executive directors to be held to greater standards of accountability, we must make the effort to define it and measure it consistently.

In the meantime, given the rise in stakeholder expectations, boards need to be much clearer about their collective definition and approach to measurement and development of culture.

Culture is a hot topic today because digital technologies such as smartphones, the internet and applications like social media, have amplified the potential of people to have a voice and impact — for both good and bad.

Digital technology has provided the ability for communities of interest to raise and share concerns about what they see as bad business practices and activate for change.

We need to think about how we think

The traditional, industrial age mindsets that have dominated in the past are exemplified by being in control, not making mistakes, and always knowing the answer to questions asked. These are still very relevant and appropriate mindsets to apply to things that aren’t changing or should not change, like established workplace safety practices.

In these rapid-paced and fast-changing times, the traditional way of thinking can be dangerous because it's harder for an organisation to adapt to new and changing external market forces. We need to apply a way of thinking that is not about control, but more about caring and connecting, not about fear of making mistakes, and more about creating safe places to try new things at work.

We must be determined to listen to and learn from all around us rather than rely too much on our past knowledge. We need to show genuine empathy towards others.

These attributes require a culture that demonstrates people are really valued and safe to challenge how things are done and to say what they think.

The motivations and actions of people, that shape culture, are the driving source of business value creation and destruction.

There are plenty of data points to demonstrate this, such as the significant growth in recent decades of the portion of market capitalization represented by intangibles (non-financial and non-physical value) which has grown from 12 to 84 per cent between 1975 and 2015 of the market value of S&P 500 companies.

The character of the leader and the leadership team

The CEO is the 'culture executive officer', and regardless of the organisation or the industry should be held accountable for the development and quality of an organisation's culture.

The most important consideration for boards and non-executive directors to foster a high-performance culture is to ensure they have a CEO and leadership team with great character who will obsessively focus and operate around three key attributes:

1. **Make it safe** for people in the organisation to speak openly and to challenge the status quo — the 'why' and 'how' things are done. Google's Project Aristotle identified that the core attribute of high-performance teams was psychological safety.
2. **Encourage hard conversations** about mistakes they have made and areas where they could have done better and to encourage that behaviour throughout the organisation. A 'bad news travels fast' environment must exist.
3. **Demonstrate genuine care about people** inside and outside their organisation. This is shown through actions, not just words. People are at the heart of every organisation and establishing that connective tissue across all levels of the business is vital.

A good start in measuring the character of the leadership team is to create a survey and have them rate themselves as a team against these attributes.

The Xero board receives the results of a leadership team performance survey every four months. Team members are very objective and honest in the assessment of team performance and value the focus on improving the areas where needed.

The accountability of boards has been under the spotlight in recent times, so it is essential that there is a clear understanding of the role of the board. I see boards responsible for:

- hiring the right CEO;
- deeply understanding and continuously observing the character of the CEO; and
- making sure, through engagement and feedback, that the leadership team is a strong team, with all team members demonstrating good character.

Nothing to fear more than fear itself

The one element of culture that should matter most to a non-executive director, is how safe it is for people to challenge others at all levels of the organisation.

Fear of speaking up or challenging others is a dangerous cultural attribute.

Non-executive directors also need to overcome their fear of asking hard questions and must dive deeper into their organisations to find out what really is the state of play.

The line between board and management is important to understand in order to avoid confusion about who is accountable for running the business and delivering results. However, this line should never become the excuse for not diving in deep to understand the character of the CEO and leadership team and the quality of interactions between them and others inside and outside the organisation.

Dealing with culture in an organisation is a 'contact sport', so the challenge for non-executive directors is finding the time and then putting effort into drilling down into what matters and how it affects people.

It is important to work on the assumption that possibly where there's smoke there's fire and while there might not always be a fire there's comfort gained in knowing a potential issue has been explored or investigated.

Ultimately, non-executive directors need to increase their interactions with people inside and outside their organisation to gather quality insights needed to make sure what is being said in the boardroom reflects people's real experience.

Five key culture questions for boards

Gabrielle Schroder FAICD
1 November 2018, "5 key culture questions for boards", *Company Director*, November 2018, AICD.

Culture is easy to talk about but challenging to get a handle on, and its important directors send the right signals.

Appointing the CEO and setting the strategy of the organisation are two of the most important levers the board can use to drive organisational performance. A key enabler of performance is the right culture. Just as the board must be clear about the strategic direction of the organisation, it must also be clear about the kind of culture required to enable its achievement. High-performing boards ensure that strategy, culture and leadership are intimately aligned with the purpose of the organisation and the promise of its brand to customers and stakeholders. The board should be deliberative in shaping the culture required for strategy achievement, acting as an exemplar in the carriage of its role.

The AICD has worked with many boards that have missed the importance of their role in this regard. In one example, board and management had developed a great strategy, but could not get traction in implementing it. On closer investigation, the organisation didn't have the right cultural underpinning. The strategy required high levels of shared knowledge and collaboration, and yet an entrenched culture of individualism, built over many years, had created separation between business lines. This was evident in the way information was coming to the board, the way products were taken to market, and ultimately, in the overall performance of the organisation.

Changing the prevailing culture is often hard and it takes time. It starts with a realisation that what is occurring in the business is preventing the organisation from performing at its peak. At times, this can be triggered by a change in the board. New directors bring new perspectives and this can lead to good questioning as to whether the culture is best serving the organisation and its goals. A change in an organisation's life cycle, a shift in market dynamics, the entrance of new competition or an altered business structure can all act as catalysts for a new culture and new leadership.

If a culture change is required, the board needs to be clear about what the change is and the quantum of that change. A new CEO can be the most immediate and effective way for the board to facilitate change. Recruiting for a new CEO needs careful deliberation. Too little change in leadership style and approach is unlikely to result in a noticeable shift; too much and the board risks losing top talent, which can pose a risk to organisational stability. A careful eye on employee turnover can give the board a steer as to whether adjustments need to be made.

The board also needs to ensure its own culture is aligned with the change requirement. For example, an organisation may require a culture of heightened innovation to respond to market dynamics that require speed, agility and responsiveness. An overly conservative board can thwart the ability of the organisation to achieve the precise culture it believes is needed to compete. Actions the board may take to address this may include exposing itself to new thinking through board briefings or workshops led by specialists in different fields; considering what factors might increase the board's confidence levels in management to take on increased experimentation; or contemplating whether a change in the board's composition and skills matrix is needed.

So, what of the board's role in influencing the culture of the wider organisation? While it is the job of management to develop and lead the required culture, it is the role of the board to provide ongoing and effective cultural stewardship. As part of its oversight function, the board, through the CEO, should be providing clear direction regarding the ways of working expected of all employees in the pursuit of organisational goals.

There are a number of mechanisms that can help achieve this, including making sure the organisation's structures, policies and practices, including reward and incentive schemes, are actively supporting the realisation of the desired culture and not working against it. Again, we have seen where a misalignment can frustrate desired behaviours and outcomes. Reward schemes that drive an obsessive focus on quality may see an organisation failing to keep pace with the industry. Schemes that send the message that sales trump all may drive behaviours not in line with organisational values and customer expectations. The board needs to closely monitor the extent to which these structures and systems are driving the right behaviours and results and adjust accordingly.

Just as the board, through its actions, takes responsibility for setting and approving expected cultural standards and overseeing the ongoing culture of the organisation against these standards, it also needs to ensure that it has access to information to understand what's going on. Having independent mechanisms in place to monitor culture, and the contribution that the CEO makes toward it, helps to maintain focus. Staff and customer engagement surveys are particularly useful to the board in this regard.

A board that is itself having cultural issues can send confused messages to the CEO and management regarding what is expected of them. Boards that find themselves operating in a suboptimal cultural environment can find it very difficult to reset as a group. We have worked with boards that have been challenged by board dynamics.

In one example, the board had developed a level of 'deafness' to the contribution of certain board members with different backgrounds, who used a different 'language' during board deliberation and debate. Over time, this meant the board effectively shut out alternate views and the organisation lost the benefit of the contribution of high-value members.

In another, a rift between the chair and CEO served to create factions on the board. Relationships rapidly deteriorated and the board found itself in a state of heightened dysfunction.

It is in these situations that the organisation's stated culture and the values that underpin it can be useful in guiding the board to a more productive state. Once expected board behaviours are defined, board members are able to hold themselves and each other to account and prevent the risk of a future decline.

The board can strengthen behaviours by taking time at the end of each board meeting to review the extent to which it lived the culture in its discussions and decisions; what signals it sent to the leadership team; and what behaviours it reinforced. In doing so, the board can continue to reflect on its own alignment with the type of culture it is promoting, as much as the behaviours that underpin it.

Ultimately, the test of an effective board and organisational culture is the creation of value over time. As we have seen in a number of high-profile cases recently, an organisation can find itself under high levels of pressure when corporate actions do not meet the expectations of customers and wider stakeholders. A strong culture, supported by sound ethical underpinnings, can help to ensure the organisation is best placed to build sustained value into the future.

Five key culture questions for boards

1. Does the board provide clear direction to the organisation regarding the culture that is expected of staff in the pursuit of organisational goals?
2. Does the board closely monitor the culture of the organisation and the contribution the CEO makes toward it to help ensure the culture fits with the organisation's strategic direction and plans?
3. Are the organisation's structures, policies and practices (including reward structures) supporting the realisation of the desired culture and not working against it?
4. Does the board have ready access to reliable and comparable data to assess whether the promoted culture of the organisation is being realised in practice?
5. Are the current cultural and values espoused by the board the best ones for the organisation now and in the foreseeable future?

This is what good organisational culture looks like

Jessica Mudditt
1 November 2018, "This is what good organisational culture looks like", *Company Director*, November 2018, AICD.

These four organisations have high performing cultures. Here's how they approach culture from an operational perspective, and what they're doing right.

Canva

HQ: Sydney
Offices: Manila, Beijing
What: Global design tools platform
Employees: 300

Founded by Melanie Perkins, Cliff Obrecht (who initially started online school yearbook publisher Fusion Books) and Cameron Adams, Canva is a web-based platform aimed at making the tools of design available to all. It now has 10 million people in 190 countries around the world as clients, including the US Marshals Service, which uses it to design wanted posters.

"One of the skills that Melanie has is being able to simultaneously think of living in the future, while also living in the present," says co-founder Cameron Adams. Canva has been voted the best place to work in Australia by LinkedIn and Great Place to Work Australia 2018.

"It's about getting things done now to get things moving, while also keeping a vision of what we ultimately want to build and always trekking towards that," says Adams. "That's definitely been one of the things that's driven Canva to become a company with a grand vision and one that has been able to attract the talent we have, and to build the passion among all of our people."

Adams says Canva's workplace is designed to make people feel comfortable and be high-performing. Their cafe, for example, functions as both a place to share meals and to work. "Here we actually do focus on the cultural aspect of coming together and sharing food," he says. "From the very early days, we've always sat around the table together at lunchtime. It gets us together talking and sharing: not just business ideas but learning about the people you're working with and what they enjoy, and who they are as people. That's really important to us. We're always pushing against remaining in stasis. You have to be constantly rethinking everything, big and small, to make sure you're not just settling into a groove."

Mars Australia

HQ: Macquarie Park, Sydney
What: Confectionery, food, pet care, drinks
Employees: 2000 in Australia and NZ; 110,000 worldwide

Getting the workforce focused on health and wellbeing has paid off substantially for the privately-owned global consumer products company whose brands range from MasterFoods to Uncle Ben's and Wrigley. The company has a program that includes mental and physical health, nutrition, financial planning and learning and development components.

Over the past five years, there has been a 245 per cent improvement in fitness, obesity levels have dropped by 35 per cent, employees have reported fewer sick days and rates of depression have reduced by 72 per cent.

Natalie Jones, director of people and organisation, who headed up Mars' global health and wellbeing program, says, "the most common mistake companies make is to just focus on a list of activities. They'll just go, 'OK, here's a 10,000 steps program, and then we'll do some meals-on-wheels programs or whatever' and off they go. Until you can really ground yourself in a holistic program, you'll struggle to see real traction and that's why the board probably won't get too excited over it because it's probably not going to produce results."

Mars Australia has been a consistent high performer on best-employer surveys and ranked number-one best workplace in Australia of businesses with 1000 or more employees in the 2017 Best Places to Work poll. It participates in the Gallup engagement surveys and runs a quarterly employee experience poll.

Slack

HQ: San Francisco (offices in Melbourne, New York, Vancouver, London, Toronto, Dublin, Tokyo)
What: Cloud-based software collaboration tools and services
Employees: 1000+

Slack was founded in 2009 and has an ethos of deliberate inclusion, from its approach in the workplace to its products (from multiracial emojis to quips from its bots that aim to make it feel welcoming and easy to use).

Dawn Sharifan, Slack's senior director of people and operations, says CEO Stewart Butterfield sets the tone at the top and has built a team around values that reflect empathy, courtesy, craftsmanship and playfulness.

"Every CEO says that people are the most important asset, but I've never worked for a CEO who genuinely cares in the same way he does," Sharifan says. "That comes from the humility of pivoting from what's failed." (Butterfield's multiplayer game *Glitch* was closed in 2012, but it revealed the strength of the internal collaborative tool.) "It also comes from the type of people we hire and the conversations we challenge ourselves with having."

Sharifan notes that culture is a regular topic at board level. "There are standing conversation points around attrition, hiring, development, leadership opportunities, and there's a deeper dive every few months into something such as a diversity program.

"Culture is not HR's job," says Sharifan. "Culture is everyone's job. Having a winning culture is about having those challenging conversations out in the open — that any questions or concerns are discussed at the leadership and management level. If you don't think those conversations are happening, that your employees aren't thinking about these important things, you're wrong. Where your culture starts to atrophy is when those conversations happen in the shadows."

From an HR perspective, Sharifan believes the future is in coaching and he hires people who are either certified coaches, or working towards being a coach. "It's listening and helping people know that they have the answers within themselves."

On Glassdoor.com, 98 per cent of Slack employees approve of their CEO and 93 per cent would recommend working at Slack to a friend. Within the company, it has been transparent with data on diversity and efforts to invest in diversifying the wider tech ecosystem.

The challenge for Slack now is consistency during rapid growth. "Our culture is a breathing organism and has to evolve," says Sharifan, who has what she dubs "culture canaries", a small group of people who've been with the company since the early days to bounce ideas off and ensure the company is holding true. "That rate of growth and pressure on an organisation is tremendous. We've opened offices all around the world and make sure that our culture is exported, while also allowing each local office to have their own unique twist on it. [You have to] come at culture with clarity about what it is. A lot of times that's hard, because defining your culture in more than generic terms can be challenging. You have to define what your values are and, perhaps more importantly, what they're not."

Starlight Children's Foundation Australia

HQ: Sydney (offices in Melbourne, Brisbane, Perth, Adelaide, Darwin)
What: Provides entertainment, education and technology to critically, chronically and terminally ill children
Employees: 333

Louise Baxter GAICD, CEO of the Starlight Children's Foundation, says the board is interested in culture from a governance perspective. However, in more recent years, it's been less of a focus because the board understands and has absolute confidence in the management team's commitment.

"We have an annual [employee engagement] survey and share that with our board," says Baxter. "Your management and leadership team need to have that clarity and alignment around your culture. Alignment does not mean we all nod our heads, smile and agree to everything. It means we have really robust debate, because you must have that to be pushing yourselves, to make sure that you are innovating, that you are really pushing your business objectives as hard as you possibly can."

The organisation has a low turnover rate of around five per cent and an average staff tenure approaching five years, up from two years when Baxter came aboard. "You've got to be constantly improving and asking questions," she says. "Look for insights in the data — were those who left the company all from the same team or region? It's the disruption on the perimeter that people always get caught by. Our board sees our turnover numbers at every board meeting, which means they have confidence that the management team is working. Our people numbers are up there with our program delivery numbers and revenue numbers."

CHAPTER 5

Artificial intelligence and the considerations for boards

AI responsibility considerations for boards

Nicole Murdoch and Mike Trovato GAICD
Directors of the Australian Information Security Association

Traditional machine learning algorithms simply train a device to perform a task. True artificial intelligence (AI) allows a device to make connections, self-correct and reach conclusions without relying on predefined algorithms or human interaction. It is not merely performing a repetitive task, it is determining the task itself and reaching conclusions itself to determine a way forward.

AI involves deep learning through artificial neural networks comprised of many layers. These layers are further developed and built upon by the device to develop even deeper layers. The creation of these multiple layers creates a treelike structure which continues to grow, reason, self-correct and learn without human intervention.

The ability of a device to self-learn and operate autonomously is a big promise and AI can, with limitations, deliver on its promise. Whilst not a practical example, we have seen IBM Watson defeat humans in a game of Jeopardy all without being connected to the internet. AI is used for monitoring machine fleets, factories and to predict repairs and upkeep for machinery. AI monitors the health of mining equipment operators and alerts when the operator shows signs of tiredness. Insider threat detection software uses AI to learn behaviour patterns of staff, takes account of changes in roles and alarms when staff step outside their predicted behaviour pattern. Uber is currently testing autonomous vehicles and in early 2018, Californian regulators approved the testing of self-driving cars on public roads without human drivers monitoring inside. There will be no operator of the vehicle.

AI is a valid consideration for boards who are looking to streamline operations. However, AI is not without risks and limitations. Whilst AI can have practical and effective applications, it is often falsely sold as a silver bullet due to its risks and limitations being overlooked. The true magic in AI lies with the device's ability to reason and learn without human intervention but that magic is also its Achilles Heel.

An AI device left to work autonomously cannot be trusted to be effective. AI devices are sold as 'load and go' devices but that is the ideal not the norm. Put simply, a device cannot know what humans need, either in the short or long term, without being guided by a human. The device needs to be trained, which can take significant time and resources. Given the passage of time and shifting landscapes, by the time the training is completed it may be out of date. Accordingly, the investment a board makes in time and effort may not give a suitable reward.

The other major issue with AI lies with the subset of data from which it grows. To use a commonplace turn of phrase — garbage in equals garbage out. The data needs to be consistent and appropriate for the domain. If the subset is incorrect, incomplete or not comprehensive, the outcomes will be unpredictable and worthless or even harmful. Laks Srinivasan, COO of Opera Solutions, says "80 percent of the work the data scientists are doing is data cleaning, linking, and organizing, which is an information architecture task, not a data scientist function."[1]

AI also raises issues of liability and directors must take into account their obligations as board members. If AI is able to reach conclusions and act on those conclusions, who is responsible for the decision and the act? The machine cannot be held legally responsible because it has no legal personality. Should the responsibility go to:

- the manufacturer of the device;
- the programmers of the device;
- the trainer of the device; or
- the company (and therefore board) who allowed the device to operate without supervision?

Should responsibility for the decisions and acts of the device lie in the hands of those that control the device or those that created the device that is capable of doing those things? Should the acts of an AI device be treated any differently to the acts of a machine programmed by traditional machine learning algorithms? In reality, the machine is owned and is capable of being controlled even if control is not exercised. Thus, the use of AI should not be treated any differently than the use of any other tool used in business and the use of an AI device is unlikely to absolve boards of their responsibilities.

And therein lies the significant challenge for boards today: How do we fulfil our director duties and responsibilities to guide our human organisation, while viewing decision making through the modern prism of AI?

[1] S Earley, 2017, "The Problem with AI", *InfoQ*, 13 September, https://www.infoq.com/articles/problem-with-ai, (accessed 24 January 2019).

Could AI predict your next crisis?

John Green
1 November 2018, "Could AI predict your next crisis?", *Company Director*, November 2018, AICD.

Smart data analysis of internal communications can prove a useful tool to alert directors to what's really going on across your organisation.

What do motherhood and Enron have to do with the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Hayne Royal Commission)? Everything.

The mother of all employee questions is simple: Would I want to treat my mother the way my boss wants me to treat this customer?

If the answer is "no" — and assuming you like your mother (that's a whole other avenue we could go down) — the treatment is likely to be suspect and should be questioned, challenged or stopped. The 'mother question' can be asked in many other ways. The Australian Prudential Regulation Authority's Final Report of the Prudential Inquiry into the Commonwealth Bank of Australia (APRA's CBA Report) put it as: We can do this, but should we?

Unsurprisingly, every director I've spoken to about this agrees. But what do we do about it? We don't work on the shop floor, we're all part-time, so how do we know if asking the 'mother question' is a routine part of a company's culture?

How do we know that even if people do ask the question, the right steps are taken if they get the wrong answer? Satisfaction surveys and complaints data are two methods. One problem is that they are lagging indicators, so the bad stuff has already happened. Worse, they can snow us with an avalanche of data that buries what's important.

APRA's CBA Report pointed out that these kinds of data can encourage us to focus on a company's aggregate success rather than its outliers. If, say, 85 per cent of your customers are satisfied and it's better than last year, human nature will see you patting yourself on the back. But why, asks APRA, aren't we digging deeper into finding out why the other 15 per cent are unhappy?

This is where mixing the collapse of energy, commodities and services company Enron in 2001 with a dose of artificial intelligence (AI) can give us a useful answer. Super-smart people are working on AI all over the world, but I'm going to tell you a true story about some geniuses in a Rotterdam startup called KeenCorp.

KeenCorp developed an AI system using psycholinguistics to examine employee engagement in real time. The system analyses internal communications — but not what employees are saying rather how they are saying it. It's the scanning equivalent of analysing body language. First, the software is run against historic email traffic, allowing it to create a baseline. Subjectivity is achieved by determining what the company's normal 'tone of voice' is, then tracking all the pattern changes in the language to determine the collective mindset. The employee data is anonymised and complies with the strict privacy regulations in both the US and European Union.

To test the AI, KeenCorp researchers applied it against the years of publicly available emails from Enron's top 150 employees. What they wanted to know was whether the AI — if it had been available back in the 1990s — could have provided Enron's board with an early warning, a red flag, ahead of the devastating bankruptcy.

What they found was very material, a dramatic plunge in employee engagement. But it was problematic for three reasons. The plunge occurred in June 1999, more than two years before the collapse. They didn't know what caused it. Lastly, it seemed counterintuitive because it happened at the same time as Enron's share price and market capitalisation were skyrocketing, when the company was being feted as among the best in the world — the now infamous "smartest guys in the room".

Worried their AI was flawed, they contacted the very architect of Enron's collapse, former CFO Andrew Fastow. Once reviled as the most hated man in America, Fastow had just been released from prison after serving six years.

Still paying penance, Fastow was giving talks — for free — to business schools and director roundtables explaining precisely why he deserved to go to prison and that unless they didn't change some of the ways business was still being done today, they might follow him there.

Two years ago, I was invited to one of Fastow's talks and it was one of the best sessions on corporate governance I've ever attended. Not only didn't Fastow make excuses for himself, he plainly took responsibility that what he'd done was wrong. Now out of jail, he was on a public service mission, like a canary in the coalmine, pointing out how many directors and companies are unwittingly committing the same mistakes he did.

While Fastow doesn't use the 'mother question' — or APRA's 'can we/should we' model — his test is similar. He focuses on rules versus principles. How, as Enron's CFO, the only question that he thought mattered was: Is it legal? Rather than: Is it right?

Fastow told us that at Enron, if the auditors, lawyers, bankers and board members all signed off on a deal as legal, then that was as fine by CFO Fastow as it was by all of them.

Enron's big problem was that neither Fastow nor any of those gatekeepers asked: Is it right? Their only real concern was to make sure that it complied with the rules. It didn't matter that the rules were dumb. Loopholing was 'smart'. But then the guys from Rotterdam contacted Fastow. And it took him a nanosecond to realise that they had something.

What their AI had pinpointed was the precise day — 28 June 1999 — when Fastow had actually persuaded Enron's board to accept the dodgy off-balance-sheet partnerships that led to the death of the company.

Their AI was red-flagging how appalled the top 150 people in the company were at the board's decision, many silently screaming: How the hell could the board have fallen for Fastow's flim-flam accounting?

Yet, while these employees knew the board was making the wrong decision, none of them raised their hands. Not one of them spoke up. The magic of the AI was that it was picking up — effectively in real time — what had been left unsaid; what was felt.

Imagine if this kind of AI had actually been available back in 1999. Imagine that it's you sitting at the Enron board table, presented with the chart that shows the plunge in employee engagement caused by your last board decision. You ask: What's going on? You're told: The employees are really unhappy the board agreed to those dodgy partnership deals. There'd be a pretty good chance you'd have wanted to unwind those deals. If you did, you would have saved Enron.

What if it's today and our Australian companies started seeing this kind of internal early warning data? It just might give us the mother of all answers.

Human and robo directors set to rub shoulders

Tony Featherstone
19 October 2018, *Human and robo directors set to rub shoulders*, Governance Leadership Centre, AICD.

Artificial intelligence expected to have a bigger role in board decision making.

On paper, artificial intelligence (AI) and governance look like opposing ends of a spectrum. AI uses technology to make decisions mostly about routine tasks. Governance is an art that relies on people who use experience and instinct to make complex decisions.

No computer could fully replace a director; no boardroom could be automated. But the intersection of AI and governance will be much larger — and sooner — than widely realised. Top boards will use AI not to replace directors but as a tool to augment director decision making.

Executive teams are increasingly harnessing the power of big data and AI to analyse large data-sets, so it makes sense that boards follow suit.

For now, boards of large organisations are more concerned about the impact of big data, automation and AI on their organisation and its industry rather than the boardroom itself. Forward-looking directors want to understand how AI could create opportunities and risks in their industry and disrupt the organisation.

Less considered is how directors can use AI within the boardroom to process larger data sets, test management assumptions, run more scenarios around capital-allocation decisions and gain greater insight into real-time organisation culture.

The idea is not as far-fetched as it seems. AI is already influencing governance at the edges: machine learning programs used to recruit directors; algorithms used in board decisions; and boards using big data in strategic decisions, for example.

It's early days, but as technology disrupts more industries, as the speed of global business increases, and as organisations become larger and more complex, human boards could struggle to keep up. Incorporating big data and AI into the boardroom, to supplement rather than replace human decisions, could redefine the nature of governance and aspects of corporate law.

Director/CEO recruitment and AI

Governance applications of AI are potentially widespread. Ohio State University researchers have examined whether algorithms can be used to select directors of publicly traded companies. A summary of their research was published by the Harvard Law School Forum on Corporate Governance and Financial Regulation in April.

The researchers evaluated whether a machine learning algorithm could forecast if an individual will succeed as a director; alternative approaches to forecast director performance using algorithms; and why directors who are counter to shareholder interest are chosen.

Using publicly available data on firm, board and director characteristics, the researchers claimed their algorithm could accurately predict the success of individual directors. As well as those directors who were likely to be unpopular with shareholders.

Unsurprisingly, the algorithm found that directors who are not old friends of management and come from different backgrounds are likelier to better monitor management — a point not lost on institutional investors who have argued for greater boardroom diversity. As director-selection algorithms become more advanced, and more data on directors is available, it's possible that boards could use machine learning tools in director-selection processes. A chair who identifies a director for nomination could run that selection through an algorithm to identify if there is a large discrepancy between the human and computer view.

The same technology, by extension, could be applied to CEO recruitment. Machine learning programs scouring millions of executives worldwide and filtering it to a shortlist of, say, five candidates who are the likeliest to succeed in the CEO role.

Again, the technology is not replacing the human-compiled list or the interview process, but is another tool to test CEO recruitment — the board's most important task. In time, such algorithms could extend to executive and board succession planning.

'Robo' directors

Robotic (robo) directors are another consideration. Hong Kong venture-capital firm Deep Knowledge Ventures in 2014 appointed the world's first robo director as a "board member with observer status". The algorithm, named Vital, is analysing trends in life-science companies to predict successful investments.

According to Deep Knowledge Ventures, Vital was appointed because of its ability to "automate due diligence and use historical data-sets to uncover trends that are not immediately obvious to humans surveying top-line data". The potential to use AI in capital-allocation decisions made by boards, and to run more scenarios on different decisions, is enormous.

More boards could introduce a robo director (presumably without requiring a shareholder vote) in coming years as other governance algorithms are created and back-testing shows they are a valuable addition for boards. Having a robo director working 24/7, in addition to part-time non-executive directors, could vastly expand board resources and monitoring.

Risk management

Boards could also use AI in risk-management oversight. Global accounting firms are investing in AI to automate routine functions in audit and other services and harness the power of data mining. It's possible that algorithms could be used to continually monitor firm risk from the board's perspective, providing real-time insight into current or future risk.

As directors read hundreds of pages of board packs to understand organisation risk, algorithms could process millions of data points around identified or unidentified risks.

In time, boards could spend more time assessing the algorithm's risk-management advice rather than trying to identify risks from source material, which will become harder as the complexity and velocity of global business increases.

Culture

Organisation culture and values are another potential AI governance application. High-performing boards monitor organisation-culture surveys and meet senior or frontline staff and suppliers to gauge firm temperature. Algorithms could analyse digitised communication within the organisation to gauge employee sentiment in real time.

Just as global investment banks use algorithms to analyse CEO language in company announcements, so too could firms use technology to analyse employee language — in aggregated terms — to better understand the organisation's values, ethics and culture.

It's possible that algorithms could predict environmental, social and governance (ESG) issues within the firm through communication analysis. For example, whether an increase in employee turnover is likely because of deteriorating organisation sentiment. Or whether the risk of organisation fraud is rising because of inappropriate communication.

Technology, of course, will never replace director instinct in gauging organisation culture, but boards need all the help they can get in understanding the organisation's human capital and culture — factors that are continually shown to differentiate high- and low-performing organisations.

Corporate reputation

Governance AI could extend to corporation-reputation monitoring. As directors read analyst, industry and media reports to know what is said about the organisation, AI could analyse millions of comments about the firm in social media and elsewhere. Boards could use the technology to assess the organisation's reputation in real time against rivals.

AI, of course, will pose many challenges for boards when it arrives in full force. Legal framework procedures would have to change to accommodate advice if robo directors are given equal voting rights with human directors.

AI in the boardroom also challenges shareholder voting rights and numerous other policies and procedures based on the appointment of human directors. Then there's the issue of boardroom composition and whether enough organisations have directors who understand AI and can embrace it. Directors with a strong background in data science — and the skill to govern across multiple aspects of business — are in short supply.

The biggest challenge will be the balance between human and robo directors. If AI is shown to make better governance decisions over time than human directors, it's possible that robo directors could have a bigger say. That might mean slightly fewer human directors and more governance robots that make decisions free of emotion, 24/7, and for a fraction of the price.

Granted, it's science fiction for now. But AI, data analytics and machine learning could knock on the boardroom door faster than the governance community expects.

CHAPTER 6

Take a deeper dive: Looking beyond the board papers

Looking beyond board papers

Marina Go MAICD
Non-Executive Director

Traditional machine learning algorithms simply train a device to perform a task. True artificial intelligence (AI) allows a device to make connections, self-correct and reach conclusions without relying on predefined algorithms or human interaction. It is not merely performing a repetitive task, it is determining the task itself and reaching conclusions itself to determine a way forward. There wouldn't be a board of directors in this country that hasn't examined its procedures for procuring key information from the business since the publication of the Australian Prudential Regulation Authority's Final Report of the Prudential Inquiry into the Commonwealth Bank of Australia (APRA's CBA Report).

The financial results of an organisation do not tell the complete story. The role of a board is to ensure that an organisation is performing in a manner that increases the likelihood of long-term sustained success. The *how* matters as much as the *what*. Gaining a thorough understanding of how an organisation achieves its outcomes involves directors fulfilling their duty both inside and outside the boardroom. One year of a super profit, for example, could be masking a poor culture that could impact negatively in the next few years.

To understand the culture, directors need to get under the skin of the organisation. That can involve planned and unplanned site visits, formal and informal discussions with leaders and staff, attending as many of the organisation's events as possible to listen and observe, attending industry and stakeholder events and reading everything that is written about the company. I have Google alerts set up for every company that I serve as a director. At company and industry events, people like to tell me what is positive and negative about the relevant organisation. While not all of it is factually accurate, most of the information collected in this way does matter.

Techniques for gaining insight

There is a real danger of data overload, given the plethora of information that is being collected by management and agencies and made accessible to boards. Too much data can risk shielding the real story.

The challenge remains to determine which data informs the risks that are likely to have the greatest impact on the business. For areas of significant risk, that may result in needing to look beyond what is being presented in a board meeting.

An area of increased focus for boards is the potential for business disruption. Topics such as cybersecurity, digitisation and the gig economy should be on the agenda of for-profit boards at the very least. Many boards have acknowledged the need for a deeper understanding of emerging risks by appointing directors to their boards with experience in dealing with the new types of business disruption. Regardless, all directors should be constantly educating themselves on the new risks to the business.

In a business environment where most sectors are experiencing some form of disruption, currency of data can be critical. What occurred yesterday will not necessarily inform what might happen tomorrow. Therefore, live customer data and feedback, for example, may be key to understanding changing customer sentiment and therefore determining if the business is facing headwinds. Listening to what is being said about your brand via feedback mechanisms, including social media, is vital.

Information that comes from outside of the business can also help inform the board about the challenges of the business, particularly with regards to the political and regulatory landscape and customer demand. Increasingly, trends will emerge via the media and social media that directors need to be aware of, particularly around reputational risk and competitive threats and opportunity.

Organisations are constantly evolving to meet the ever-changing demands of customers, regulators and, in some cases, politicians. The risks and opportunities to any business are therefore also evolving. Boards cannot afford to become complacent. The company's risk register needs to be updated regularly, perhaps more regularly than in the past.

Boards have traditionally relied on the CEO and the various reports in the board papers to get a clear understanding of the key challenges and opportunities for the business. But what if the CEO was keeping a key piece of information from the board? Boards will say that they want to hear bad news but if the board's reaction to bad news in the past has been negative there might be a reluctance to share in the future. The board needs to trust its CEO but there is a need for directors to satisfy themselves, beyond the board table, that all is as it should be in the business.

Getting the right information

In order to verify that the information I am getting from management is the information that I need, I ask myself if the information offers enough insight into the mitigation of the significant risks and highlights the future opportunities, because that is the information that boards need.

Information that provides deeper insight into key risks will necessarily involve speaking directly to the people responsible for delivering the data. Having the opportunity to speak directly to senior leaders in the business about the projects they are managing can be invaluable to a director's understanding of the risks to the business strategy. Directors will often learn more about the nature of the risks to the business by asking direct questions to the people with an intimate knowledge of them.

Visiting the various sites of the organisation and speaking directly to people who speak to customers, work with equipment, are protected by our safety guidelines and make decisions that move the organisation along, offers directors an understanding of the business that cannot be achieved sitting around a board table. Getting a feel for the people and spirit of the organisation is the best way to verify what is being said about the culture. Directors need to be accessible to people in the business if they ever hope to be spoken to candidly.

Boards are responsible for the culture of the organisation and it has been well-documented that poor culture can be a red flag that something is about to go wrong with the business. Directors who have an eye on culture can be in a position to identify a significant risk before it hits the financials and therefore save the company from shedding value.

In order for directors to fulfil our duties, we need to spend as much time understanding the business outside of the boardroom as is spent within.

Top tips for making the most of your board papers

Narelle Hooper MAICD
31 August 2018, "Top tips for making the most of your board papers", *Company Director*, September 2018, AICD.

Senior directors and facilitators explain how brevity, clarity and colour can help you get the best out of your board papers.

"I have made this letter longer than usual because I've not had time to make it shorter." Variously attributed to Mark Twain and George Bernard Shaw, but with the rightful source a translation from French philosopher Blaise Pascal, this quote comes to mind while wading through page after page of board papers that don't seem to be getting to the point.

The AICD's Director Tool *Board papers: Meeting effectiveness* bluntly notes that if the board is not receiving the board papers in a format that makes them comprehensible for directors, it is partly to blame.

The board is responsible for:

- setting expectations and providing directions to management on the content, format, timing and timeliness of board papers and the amount of information provided;
- ensuring it has sufficient information with which to make decisions;

- ensuring management has in place the processes and controls to ensure the integrity of the information provided; and
- setting KPIs for management to report against.

As set out in s 180 of the *Corporations Act 2001* (Cth), directors have a statutory duty of care to have read the board papers to be able to contribute effectively to board meetings. The Centro case highlights the need for boards to carefully manage the board paper process and focus on the manner in which information is provided to the board.

Boards need to ensure that they receive meaningful information and not merely data. In the Centro case (*ASIC v Healey* (2011) FCA 717 at 226), Justice Middleton noted: "A board can control the information it receives. If there was an information overload, it could have been prevented. If there was a huge amount of information, then more time may need to be taken to read and understand it."

The AICD says the information contained in board papers should be consistent, coherent and complete. Board papers are part of the official records of the company and a complete set should be maintained for future reference.

Getting it right

Alexandrea Cannon FAICD, chair of the South Australian Tertiary Admissions Centre (SATAC) SA Leaders Institute, as well as *Company Directors Course* facilitator, first did the course a decade ago while in executive management. She reveals what board practice works best in her experience.

"After the change in the legal status of SATAC, we've put in a lot of time developing a board charter, setting up board papers and the minutes. It's almost like starting from scratch even though as an organisation we are 25 years old.

"To my mind, a good set of board papers is as short as it can possibly be, but conveys the information it has to provide with clarity and appropriate information on the pros, cons, risks and benefits." Cannon also seeks real clarity from the CEO on what they're asking of the board.

A format she has found helpful is a one-page sheet itemising what sort of action is required of the board: approval, discussion, endorsement or noting; what's the recommendation; an executive summary of the issue; a list of any attachments; a draft resolution and the decision (noted, approved, not approved, further action required).

Prioritisation of the agenda is essential. During meetings, the board works through decisions first, then discussion, information and issues for noting. "So, if someone has to leave early, we've dealt with the most important items."

"We also keep a list of actions showing the date of the meeting they were generated from, a list of recently completed items so that we can keep track, and a running list of decisions." When it comes to reading board papers, Cannon makes liberal use of the highlighter with a traffic light system. "I colour code — positive is green, pink is for negatives and yellow is for issues for noting."

Effective communication

Rebecca Davies AO FAICD, a director of Catholic Healthcare and AICD facilitator, maps out the path to better board papers.

Problems with board papers are one of the main sources of friction between boards and management teams. Management often feel they are guessing at what boards want — or, often, what particular board members want — and boards often express frustration with papers that don't give them the information they need.

Based on my experience as a board member, and a facilitator and advisor, I would say that we all need to chill a bit and acknowledge that perfection is both close to impossible to achieve and is also subjective. What one person thinks is ideal might not be the same as what someone else thinks. So as a first step to better relationships and better papers, agreeing that this will be an iterative process would be a good move.

Boards and management are in a partnership in this — we all want to do the best for our organisations and support each of us to play our respective roles effectively.

What I like to see in board papers includes a clear statement of what the board is being asked to do for each item, right at the beginning of the paper. Is this for information, for noting, for decision — and if so, what decision is management recommending — for advice? Don't make this too complicated. If a complex resolution is required, summarise it up front in a sentence or two and put the full-form resolution at the end. I've seen resolutions that go on for many paragraphs, and if that is first in the paper, I still won't know what the subject matter is.

For decision papers, have an agreed template on issues that must be addressed. Each organisation will be different but I would want to see the following:

- How does the proposal fit with the board agreed strategy? If it's opportunistic, call that out and discuss how the proposal advances the business and doesn't cut off other opportunities.
- Is the proposal consistent with the values and culture we have and aspire to?
- What is the financial impact of the decision — what assumptions have been made about cost and revenue impact?
- What are the plans for implementation and are we confident we can deliver on those plans?
- What risks have been identified with the proposal and what plans are in place to manage or mitigate those risks?
- Has management considered alternatives to the proposal and why is this one the best for the business?

For each paper, I like to see who has written it and who has signed off. This helps in getting a better understanding of the bench strength in the organisation, but also who is taking accountability for the quality of the paper and the recommendations made.

Depending on the nature of the decision, I might also expect to see a discussion of who has been consulted in formulating the recommendation — are key stakeholders supportive or is that something that will be done later, in which case, is that part of the risk profile?

Ideally, papers should be maybe two or three pages long. It's much harder to write concisely than waffle on, but for board members, a short but comprehensive paper gives greater confidence that clear thinking has been applied.

If the paper is supported by detailed background material, I appreciate management summarising the key points and then having the report available on request.

What can be really annoying is a paper accompanied by large numbers of attachments with no guidance on the significance or impact of each of them. That just means I have to read each of them and try to work it out for myself.

Technology is making this more of a problem, with electronic sets of papers making it easier just to put everything in. Obviously, accounts have to be included in full, but that doesn't mean a paper with the key issues highlighted can be dispensed with.

After reports are finalised, senior management should have another read, thinking about the paper from the point of view of the board. Is the communication clear and comprehensive? Can the use of diagrams, dot points, embedded videos or other techniques assist to help make things clear?

For regular reports, find time to have a discussion about what is really needed and how often. Management can find themselves spending excessive time producing reports for each meeting when maybe not a great deal has happened in between — perhaps because time hasn't been spent on actually doing things. An open discussion with the board might prove to be very helpful.

Getting the right information balance

AICD
17 May 2018, *Getting the right information balance*, Governance Leadership Centre, AICD.

Some key aspects to consider when compiling board packs.

Ensuring directors have the right information to make decisions is becoming a bigger governance challenge. As stakeholder expectations rise, the temptation is to add more information to board packs. But that risks swamping directors in unnecessary detail. Also apparent is the need for more board information on organisation intangibles: human capital, culture, ethics and values, for example. Board packs, however, have been traditionally slanted towards tangible information, such as financial statements and operational reviews.

Here are 13 considerations in getting the balance right with board information.

1. Context

Although board packs tend to follow a uniform format, directors should resist a one-size-fits-all approach. Every organisation is different. A startup venture will need a different board-pack structure compared to a larger organisation. So too a charity compared to a listed company. Directors should ensure the board pack reflects the organisation's needs and context.

2. The chair

The chair decides the board agenda and board-pack structure, in conjunction with management. It's important, therefore, that directors understand the chair's view on information requests and board protocols when sourcing data. The chair might request that he or she coordinates all information requests from the board. There should also be protocols for how new information requests are treated in board papers and meetings.

3. Agreed board pack structure

A good chair will ask directors for their view on the board pack. Are there information gaps? Is unnecessary data provided? Is the board pack appropriately structured and cross-referenced with other information? Are the board papers too long or hard to read?

Having achieved consensus, the chair works with management to deliver the best board paper structure.

4. Related to strategy

Strong board packs are closely aligned with organisation strategy. For example, a not-for-profit organisation outlines five key strategic goals and key risks during a strategy offsite with management and the board. Key issues and their performance indicators are agreed, and the board pack is structured along those lines.

The pack has other information, but the focus is on aligning information to strategic goals and risks and using it to guide boardroom discussions.

5. Readability

A well-structured board pack is not enough on its own. Information must be clear, concise and valuable. Readability issues such structuring information in dot points rather than long-winded paragraphs, using graphics and tables to summarise information, and proof-reading the document for typing, grammar or style issues can make all the difference.

An interesting, informative pack aids comprehension; a text-heavy, dour report that is over-run by unnecessary details risks directors skimming or glazing over it.

6. Information delivery — part one

A common complaint from directors, particularly those in smaller organisations, is board papers being delivered too close to the board meeting. Receiving the papers a day or two before the meeting makes it harder for directors to prepare. There should be a clear schedule that requires the board pack to be available the week before the meeting.

At a minimum, boards should insist there is a weekend in between the delivery of the board pack and the board meeting, so that directors have time to digest the information and reflect.

7. Information delivery — part two

Many boards have moved to electronic delivery of information via mobile devices, such as iPads or laptops. Digitised board packs have benefits over paper-based ones; they are more secure, easier to update and have tools to find or reference information.

However, some directors find paper-based reports easier to read and the board should consider whether the board-pack structure should change to better suit electronic delivery and consumption. Digital media requires a different style of writing compared to traditional report writing: for example, more lists, dot points and cross-headings that help readers scroll down information.

8. Beyond the board pack

Although the board pack remains the primary source of board information, it should be considered in the context of a broader information set for directors. High-performing boards create opportunities for directors to gather information about the organisation, beyond the board pack. They might devise an information set comprising analyst, industry and media reports about the organisation that directors receive daily.

Other boards arrange site tours, opportunities for directors to meet staff and suppliers, and hear from independent experts.

9. Human capital

This is one of the great governance challenges of our times. How boards can better understand organisation culture, value and ethics — and what customers, suppliers and other stakeholders think. Such intangible information is harder to capture in board papers and surveys on organisation culture and the like are no substitute for talking to people.

Good boards create opportunity for directors to understand the organisation's human capital: for example, a dinner with the executive team the night before the board meeting; attending focus groups with frontline staff or customers; or sanctioned fireside chats with the CEO's direct reports. They also ensure board papers address human-capital issues.

10. Relationship with company secretary

In larger organisations, the company secretary is the day-to-day conduit for the board. New directors should build a good working relationship with the company secretary to understand board protocols and for information requests. Good company secretaries know where information is stored in organisations and who can provide it.[2]

11. Information requests

Strong boards have inquisitive directors. But that does not mean every director request for information must be fulfilled. At times, chairs might push back on information requests because they do not want to distract the management team with unnecessary data.

[2] Refer to J Robertson, 2018, *The role of the company secretary: Influence, impact and integrity*, AICD

A good chair will know which requests provide 'nice to have' data and which provide 'must have' information. And how best to source those requests and include them in board packs for discussion at board meetings.

If the board pack is tightly aligned to organisation strategy and risks, there shouldn't be regular requests of management for left-field information.

12. Information cycle

In fast-moving organisations, a board pack and meeting every six weeks might not be enough. Many chairs structure a weekly or fortnightly meeting with the CEO and some relay that information to the boards.

Others might arrange a brief CEO update and video conference with directors every three weeks between board meetings. Or the chair might organise an opportunity for directors to meet in between board meetings, through a site visit or expert presentation.

The key is having some structure to the information cycle outside of board meetings without adding unnecessary bureaucracy.

13. Annual review

Directors should review the board paper structure and content at least annually. Is the pack still meeting their needs? Is there evidence of board paper 'creep' because more data was added and kept there? Which information can be removed? How long is it taking directors to read each set of board papers? Are the papers too much of a slog to read?

Ultimately, board packs are like any other facet of business: if you don't measure it, you can't manage it, adapt and better meet user needs.

CHAPTER 7

What is measured matters: Harnessing your governing team to incentivise the right outcomes

Executive pay and trust

Tony Featherstone
21 September 2018, Executive pay and trust, Governance Leadership Centre, AICD.

New thinking needed to better align pay, performance and community expectations.

Boards of ASX 200 companies have collectively strived to improve the alignment of pay and performance, and respond to intense market pressure on executive rewards. But is more needed to help restore community trust in big business?

As the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Hayne Royal Commission) exposes a litany of bad behaviour, and as regulators question bank remuneration structures, the public could ask whether board efforts on executive pay are nearly enough or if new thinking is required.

Regulators believe more work on pay is warranted. Australian Prudential Regulation Authority (APRA) chair Wayne Byres in September 2018 said remuneration policies across large APRA-regulated entities met minimum requirements but were "some way off best practice".

APRA's review identified three problems with pay. One, employees at lower levels of organisations received downward adjustments to pay that were not always matched by corresponding adjustments at an executive level to recognise line accountability.

Two, performance measures for pay incentives are too focused on shareholder metrics such as Total Shareholder Return (TSR) — and that excessive weightings of such metrics can drive behaviour that does not support long-term organisation success and sustainability.

"The current structure of long-term incentives in Australia is particularly problematic in this regard, and is out of step with how best practices in remuneration are evolving internationally… This will also have to change," said Byres in a speech *Helping Regain the Trust*.

The third problem is shortcomings in oversight by board remuneration committees in some APRA-regulated entities. Stronger governance of executive pay is needed, argues APRA.

The Australian Securities and Investments Commission (ASIC) is also focusing more on pay. It signalled in September 2018 that it will investigate executive remuneration practices.

"Remuneration is a clear driver of conduct," said ASIC Commissioner John Price in a speech on improving conduct and restoring trust. "We will be looking at whether executive-remuneration structures, grants and vesting of variable remuneration are driving the right behaviour and accountability of executives in Australia's listed companies. An initial issue we will be considering is focusing on the decisions by the board remuneration committee to award and grant variable remuneration."

Taken together, it seems that regulators believe there is too much weighting on financial metrics in performance assessment for pay incentives (hard targets) and not enough weighting on broader non-financial measures that also drive company performance and sustainability, such as organisational culture and customer satisfaction (soft targets).

Investors still favour TSR

Boards of ASX 200 companies might be exasperated by the thought of introducing or increasing a weighting on soft targets for pay to improve corporate behaviour and help regain public trust. Some boards have tried to include soft targets for pay, but institutional investors have objected.

Others, such as National Australia Bank, have recently overhauled their remuneration structures to make them more customer and shareholder focussed.

Global proxy firm ISS Governance, in its April 2018 updated pay-for-performance methodology *Evaluating Pay for Performance*, said the one common measure for investors in the context of long-term pay-for-performance evaluations was TSR.

ISS added: "This does not imply that ISS advocates for companies to use TSR as the single metric underlying their incentive programs; many companies and shareholders may prefer that incentive awards be tied to the company's business goals more broadly than TSR.

"However, if a company's business strategy is sound and well executed, the expectation is that it will create value for share owners over time, and this will generally be reflected in long-term total shareholder returns. TSR is therefore the primary measure used in ISS's quantitative pay-for-performance alignment models."

Some institutional investors privately argue that TSR or return on equity (ROE) is the most reliable measure of executive performance. Soft targets, such as organisation-culture outcomes, can be hard to measure, and management can 'game' net promoter scores and other metrics to achieve rewards.

Thus, in one corner are regulators that want greater use of soft targets in reward performance incentives to help improve corporate behaviour and rebuild trust; in the other corner are institutional investors and their advisers that want the performance focus to remain on TSR.

Boards are caught in the middle. An upside from the Hayne Royal Commission might be a renewed push from the governance community on executive-pay innovation. TSR-based frameworks, at least for APRA-regulated entities, may not be incentivising the kinds of behaviour that organisations, investors and the community expect.

TSR, of course, is a crucial performance metric, but on its own is a poor distinguisher of 'good' or 'bad' revenue. An executive team might boost revenue by exploiting customers, reach profit targets, boost the share price and TSR, and achieve performance incentives.

An over-reliance on relative TSR is equally problematic. Shareholders wonder why the CEO earned large rewards when the organisation's TSR was poor, although relatively better than peers, and the share price fell. A misalignment between CEO and shareholder rewards is an ongoing issue in the pay debate.

Moreover, current disclosure and reporting practices arguably do not sufficiently inform the market about reward punishments for bad behaviour at lower rungs in organisations.

The Governance Leadership Centre asked leading remuneration experts for innovations on executive pay. The ideas below are conceptual and may receive push-back from executive teams, proxy advisers and institutional investors.

What is clear is that a new debate on pay-for-performance is needed that better aligns executive reward structures with community expectations and trust.

Here are three ideas.

1. Group-wide soft targets based on outcomes

John Egan of Egan Associates says there is merit in introducing soft non-financial target performance metrics for groups and individuals in corporates. For example, a large telecommunications company might include a target for its top 100 executives and managers based on customer complaints to the Telecommunications Industry Ombudsman. If, say, more than 20,000 complaints are received in the financial year, the bonus of the top 100 managers is affected.

The same concept could apply to financial services, utilities or other large organisations that are scrutinised by independent parties. Egan accepts the idea would be complex to implement; choosing the right metrics, ensuring data is reliable and selling the idea to management and the market would be difficult. But the idea of group-wide soft targets deserves debate.

"The benefit is that performance is based on an independent third-party such as an industry ombudsman, rather than internally-generated data by management," says Egan.

"Also, the data is based on measurable outcomes and observable behaviours, not information around culture that is harder to measure and therefore can be gamed by management."

Another benefit, says Egan, is that the targets would better match community expectations. "The public wants to know that a telco's top staff are not earning their reward if the organisation is torturing people with bad service and excessively cutting costs. Or that leaders in a bank are not getting their reward if the Australian Financial Complaints Authority is being bombarded with complaints about people being sold the wrong product or treated unfairly by banks."

Extending measurable soft targets to more managers sends a powerful message, says Egan. "Boards are saying to the top people, 'if the organisation gets more complaints than is deemed acceptable, everybody suffers with their bonus'. All the leaders are affected, not just that seven or eight in the executive team who may or may not have soft targets in their incentives."

He says modifiers could be used with group-wide soft targets. "For example, the group might lose 20 per cent of their bonus in a year if the complaints target is not met. In the following year, if complaints are sharply lower and it is clear the firm's leaders have done a good job to fix the problem, they could achieve 120 per cent of the bonus if they meet all targets."

Egan adds: "Management and their staff are paid a competitive salary to act honourably in their dealings with all stakeholders, to uphold their employer's code of conduct while seeking to be recognised financially for excelling at their job playing by the rules."

2. Disclosure of bad behaviour

Mechanisms for listed companies to disclose bad behaviour, actions taken and bonus penalties, has had little consideration during the Hayne Royal Commission. All too often, bad behaviour is first disclosed when a whistleblower alerts a newspaper.

It is hard for the public to assess how large organisations respond to lower-level bad behaviours or how it affects pay. Companies are usually on the back foot when misconduct is revealed publicly, or they only disclose inappropriate behaviour by executives.

"Disclosure of identified bad behaviour in corporates, generally, is poor," says Michael Robinson, a director of Guerdon Associates. "We need a grown-up conversation about this: in every large company in every country, someone, somewhere will be doing the wrong thing. That's inevitable. Organisations must assume that this behaviour will eventually become public and that they need to be more transparent about it."

Robinson says there is scope for better self-reporting of bad behaviours. For example, the executive remuneration report in the annual report could include a section that outlines identified instances of bad behaviour, actions taken and how this affected pay rewards.

"I'm not proposing that organisations name names for lower-level bad behaviour or get into specifics," says Robinson. "But they could in tabular form highlight the problem identified, report in broad terms on actions taken, and how it affected the incentive of the manager responsible and those he or she reports to."

For example, a bank might disclose that an internal audit of its call-centre identified that a small group of telemarketers breached organisation policy and sold products inappropriately. The bank would disclose in the annual report that it is aware of the problem, has counselled and retrained affected staff, reviewed its systems, and reduced the incentive for managers of the call-centre by a quarter, as well as the executive responsible for customer service.

"By self-reporting, corporates would be much more upfront about bad behaviour and able to show the market and public that those responsible have had pay reduced," says Robinson. "They would demonstrate that they are proactively addressing the behaviour."

Robinson likens self-reporting of bad behaviour to occupational health and safety (OHS) reporting. "Listed companies are typically very upfront about how they report OHS data and that disclosure has led to meaningful improvements in safety. There should be the same type of self-reporting with identified bad behaviours and outcomes."

3. Extending accountability for bad behaviour

Robinson agrees with APRA's view that organisations need remuneration structures that penalise executives when bad behaviour occurs on their watch, even when they are not directly responsible. "Companies have been quick to dock the employee responsible for the behaviour, but often there is no penalty for people higher up in the organisation who manage them."

Malus and clawback provisions are key mechanisms for corporates to reduce pay for behaviours that cause reputational damage. Malus is where a short-term or long-term incentive that has not vested is cancelled. Clawback provisions — the recovery of remuneration that has already vested — require executives to pay back remuneration if problems are later identified, under certain conditions.

Malus is typically applied at lower rather than executive levels in organisations and its application is too discretionary, says Robinson. Overseas research indicates that it is more effective, according to Robinson, for reward structures to have a default position where the executive is automatically docked part of their incentive if bad behaviour occurs in their area of responsibility. The company retains discretion to undock the penalty.

"Almost no Australian company currently has this approach," says Robinson. "Introducing a default position where the executive is penalised if one of their reports, or someone further down the chain, behaves poorly, creates a stronger incentive to stamp out bad behaviour throughout the organisation. The onus is on the executive or manager to show why their bonus penalty should be undocked and the company has discretion to do so, if warranted."

Rethinking the purpose of pay

AICD
1 September 2018, "Rethinking the purpose of pay", *Company Director*, September 2018, AICD.

If boards are to persuade management to focus on creating long-term value, they need to question the purpose of pay.

It's a troublesome time to be chair of a company's remuneration committee given the range of issues on the agenda. For starters, there is the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Hayne Royal Commission) and the Australian Prudential Regulation Authority's Final Report of the Prudential Inquiry into the Commonwealth Bank of Australia (APRA's CBA Report) highlighting the role of incentives in encouraging poor behaviour. Add to that the backlash from shareholders through the two-strikes rule, press headlines over perceived excesses in executive pay and new regulatory interventions on components of pay.

Boards in all sectors have a tall order: to implement future-proof pay structures that will satisfy myriad stakeholders whose interests do not always converge. There has also been a range of responses on how to influence corporate culture to better serve shareholders, customers, employees and the community. Reactions from remuneration consultants, proxy advisors and regulators suggest the optimal approach is to redesign executive and staff incentive plans to be more explicitly based on long-term value creation.

This is apparently to be achieved through initiatives such as tightening of performance standards within annual key performance indicators (KPIs) and introduction or lengthening of deferral periods for short-term incentives (STIs), long-term incentives (LTIs) and consideration of malus. In effect, the thinking seems to be that since incentive design got us into this mess, a redesign will fix it.

These responses largely involve tinkering with the current model and continue to privilege incentives as the main tool for corporate leaders — which is often at the expense of serious analysis of how long-term value is really created and appropriately thoughtful management.

Shareholders demand that executives have 'pay at risk'. Headhunters say incentives are critical in the war for supposedly rare executive talent. Some directors confide that they are actually quite content with fixed pay and the occasional bonus but are obliged to implement incentive plans to satisfy shareholder and executive demands.

Complicating matters further, remuneration disclosures have become so long and complex they tend to obfuscate rather than enlighten observers on exactly how remuneration structures support, or corrode, sustainable value creation.

With rare exceptions, most disclosures on remuneration are the same. They almost always purport to aim to attract, retain and motivate through a mix of fixed, short-term (based on a 'balanced scorecard' set of KPIs) and long-term incentives (until recently, almost always dependent on relative total shareholder return relative to a defined peer group and an earnings measure). Pay outcomes are eerily similar.

The 2018 Australian Council of Superannuation Investors (ACSI) survey *CEO Pay in ASX 200 Companies* showed that about one third of ASX 100 CEOs received bonuses equal to 80 per cent, or more, of their potential maximum payout and the median outcome was 70.5 per cent of maximum. ACSI noted that "ASX 100 CEOs are more likely to lose their jobs than their bonus" and that "bonuses continue to resemble variable fixed pay" rather than at-risk performance pay.

Not only is there some scepticism about the way these plans actually operate, their persistence flies in the face of a substantial body of behavioural science research showing extrinsic rewards rarely work except for narrow, repetitive tasks. Daniel Pink, author of several books on work, management and behavioural science, argues that proffering extrinsic rewards for predetermined goals in such environments narrows thinking, sublimates conceptual thought and diminishes intrinsic motivation. Jonathan Finlay, head of remuneration governance at Minter Ellison agrees, noting that "when a board puts large enough incentives in front of employees their good judgement will be subverted and their intrinsic motivation dulled".

Finlay, who has 35 years' experience in the field, claims, "if you task them with too many KPIs, they will focus on the one or two that represent the best money for effort trade-off". He further says, "a board's best defence against conduct risk failure is the intrinsic motivation of employees. One guaranteed way of increasing the risk of conduct failure is to strengthen employees' extrinsic motivation at the expense of their intrinsic motivation."

Acknowledging hard-wired financial incentives have led to undesirable outcomes has led to remuneration plan tweaks, including the use of so-called 'soft' measures, such as those relating to culture proposed by CBA when it received its first strike from shareholders in 2016.

The CEO of the Australian Shareholders' Association (ASA), Judith Fox MAICD, notes that it is appropriate for boards to set targets around culture, but maintains the ASA is sceptical about providing incentives to executives for hitting those targets. "Achieving targets related to culture can be likened to making budget — it should not warrant an extra payment."

Three approaches

Macquarie Group

Comparatively low fixed remuneration and profit share based on realised after-tax profits. Significant retention and long deferral periods. For the CEO, 80 per cent is retained, vesting over three to seven years (with performance stock units, effective deferral rate 82 per cent for the year).

"Our approach to remuneration is a partnership where profits are shared between our shareholders and our staff. The board believes this approach is integral to Macquarie's sustained success and creates a strong alignment between staff and shareholders."

SEEK

Total reward opportunity targeted at 50 per cent fixed, 25 per cent equity rights, 25 per cent LTI. Equity rights vest after one year (plus one-year lock-up period). LTIs offer a choice between rights and options.

To "reflect the challenges of the task at hand, we offer a fixed amount for our executives to do a good job in all market conditions. There are no short-term incentives with complex formulae and lists of KPIs that do not link to long-term shareholder value."

Bendigo Bank

Total pay is targeted at the market median. Relatively high fixed pay as a proportion of total pay, delivered as a mix of cash and deferred equity. LTI includes a customer hurdle.

"The executive's remuneration arrangements strike an appropriate balance between community expectations and the alignment of executive remuneration with shareholder outcomes."

New pay rules for UK companies

In June, new rules were introduced to UK parliament to compel large UK companies to publish the pay ratio of CEOs to their average workers from June 2019. Under a package of corporate governance reforms, listed companies with more than 250 employees will have to justify their chief executives' salaries and reveal the gap to their employees. They will also require listed companies to show what effect an increase in share prices will have on executive pay to inform shareholders when voting on long-term incentive plans.

Another tweak implemented by many companies in response to shareholder criticism has been to increase deferral periods for "earned" incentives, or to extend performance periods for long-term incentives as if it is possible for the performance of an organisation to be neatly mapped to the tenure of its leaders plus the mandatory three or four years, (a truly laughable claim for some sectors, such as mining, where the fruits of investment can take decades to realise).

Incentives and these kinds of tweaks can, in the main, be characterised as defensive. They are based on an assumption that executives won't act in the best long-term interests of companies unless they are in place. Not only does this reflect poorly on the executive talent selection process, it invites inevitable gaming and work-arounds.

Using incentives as a proxy for management promotes a dubious assumption that people are purely economic creatures. Incentives narrow thinking, so objectives not on the horizon at incentive design time are sidelined. They subjugate other, more meaningful forms of reward such as developing others; they rarely encourage teamwork, and they create a culture wherein the people who are most incentive-driven are the ones who strive to obtain (and inevitably achieve) leadership positions, often to the detriment of our institutions, the economy and society.

Rethinking remuneration

So how should boards rethink remuneration in the current climate? Here are a few suggestions from the experts.

Develop a remuneration policy genuinely supportive of, and tailored to, the unique characteristics of the organisation.

Daniel J Smith, general manager of proxy advisory firm CGI Glass Lewis, says boards should, for example, consider "whether they are overseeing a high-growth speculative company or a mature business preserving and growing capital, providing income stream and steady employment within the community — and disclose properly to shareholders how remuneration supports such positioning".

Make an unblinkered consideration of what leading a particular organisation is worth.

This requires suspending market comparisons and ascertaining what the candidate/incumbent is prepared to work for. Bob Joss, the former Wells Fargo CEO who is credited with introducing US executive pay practices to Australia when he joined Westpac in 1993 on the then astronomical salary of $1.9 million (with $36-45 million in incentives over his six-year tenure), concluded that companies fail to apply basic market principles in paying executives. He argues boards should take stronger negotiating positions and many companies could get the job done for a lot less.

Have a clear view on what demonstrated competency should be covered by fixed remuneration.

Fox is adamant that directors should think long and hard about the forgotten purposes of fixed remuneration — often a large sum.

"It is arguable that the incentive for measures such as maintaining a positive culture ought to be getting to keep your job," she says. It is worth examining why, at the lower echelons of an organisation, one is expected to be happy to exchange one's labour and perform to set standards for a fixed amount of money and the opportunity to progress, and yet at the top, pay must be doubled or tripled for performance — especially when, according to ACSI's 2018 report, the average fixed pay for an ASX 100 CEO is $1.91 million, or $36,730 a week.

To enhance teamwork, pay levels should not be divorced from actual contribution to value creation, which has occurred when CEO pay becomes a function of market belief in a corporate superstar, ignoring the multitude of factors, including decisions of former executives, a competent board, the toil of the total workforce that contribute to an organisation's success and favourable market conditions for the company's products.

Examine assumptions about aligning the interests of executives and shareholders without corroding other stakeholder relationships.

Having completed years of research on company value creation, Denis Kilroy, managing partner of KBA Consulting, claims, "the true economic obligation of a listed company to its investors is to build an enduring institution that can create wealth for its shareholders on an ongoing basis, with an explicit and unwavering focus on the long term. Importantly, the longer the time horizon, the more the interests of all the company's stakeholders align." SEEK provides an example of a company with that long-term focus and a differentiated remuneration policy that supports it. The company has taken a brave step in eschewing STIs altogether.

Conversely, it is critical to maintain an open mind about how, and with what type of shareholder, 'alignment' occurs. Roger Martin, former dean of the Rotman School of Management at the University of Toronto, claims equity-based compensation is an incentive to increase expectations, not performance, and that the rational response to equity-based incentives is to game the system.

In what could be seen as a cynical view, he argues that, "since [CEOs] spend most of their time trading value around rather than building it, they lose perspective on how to contribute to society through their work. Our theories about the fundamental goal of corporations and the optimal structure of executive compensation are fatally flawed."

Not all Australian boards have the depth of skills in human capital management to properly consider and interrogate remuneration structures. For some, there remains a stubborn, if unspoken belief, that experience with leading large teams and having been in receipt of an executive pay package, provides sufficient expertise to oversee this critical realm.

As we have seen from a multitude of scandals, and despite the vast amount of effort expended by remuneration committees on this issue, that can be insufficient in certain circumstances. Greater capability at board level in these areas will help take the necessary steps to fix the model.

Questions for directors

Objective

How is long-term value created? What conditions support this? What stage in the business cycle is the business? How is performance defined for multiple stakeholders?

Philosophy

What should be the defining characteristics of the reward program for executives and all staff to support the objective? Market competitive? Differentiated? Fair? Encouraging of teamwork? Proper account of risk? Pass the pub test? Maximise retention?

Reward total target remuneration

What is the real talent market for this role? What assumptions have been made in selecting market comparators? Would someone as competent do it for less? What are the internal relativities between executives? How does it compare to the average national wage? How important is remuneration to executives versus other benefits of leadership?

Reward elements (fixed, STI, LTI)

Is there necessity at all for each element? What are the minimum expectations for fixed remuneration? Are LTIs simply deferred STIs? What behaviour will they encourage? What behaviour may be discouraged? What are the longer-term ramifications for executives and shareholders?

Reward instruments (cash, equity, equity-based)

Has due weight been given to supporting the objective, benefits, risks, level of complexity, administrative/compliance costs, personal circumstances of executives in determining appropriate reward instruments? Are they genuinely appropriate for the business or copying predominant practice?

Malus

Is there scope for the return of performance-related compensation as a result of the discovery of a defect in the performance?

CHAPTER 8

What high-performing boards are doing to harness artificial intelligence

Artificial intelligence: The machines are here so boards need to step up

Dr Catriona Wallace
CEO and Founder, Flamingo AI (ASX:FGO)

Although artificial intelligence (AI) has been in existence for over 70 years, it was previously in the domain of universities and technology companies. Today AI is regarded as the most powerful transformation to affect business and society since the invention of electricity — so it is now the domain of the board. Frameworks, governance models, organisational design, human rights and ethics considerations for AI are all topics that boards should be discussing. So, lets unpack what AI is and how boards should think about it.

The term artificial intelligence was coined in the year 1956 at Dartmouth College, where a group of scientists determined that “every aspect of intelligence can in principle be so precisely described that a machine can be made to simulate it”.[3]

AI is now defined as applying to any technique that enables computers to mimic human intelligence, using logic, if-then rules, decision trees and machine learning.

Machine learning is a subset of AI and includes statistical techniques that enable machines to improve at tasks with experience. The core capability in most machine learning is called deep learning or neural nets. These neural nets work by programmers feeding a particular learning algorithm with terabytes of data, say hundreds of thousands of images or speech samples, to train it, then the computer figures out for itself how to recognise certain images or words or sentences. And now essentially computers can teach themselves.

The main types of AI that boards should be aware of include:

- machine learning, used for modelling (predictive, prescriptive, fraud, recommendations);

[3] Refer to *Dartmouth workshop*, Wikipedia, https://en.wikipedia.org/wiki/Dartmouth_workshop, (accessed 22 January 2019).

- computer vision, used for recognition (image analysis, facial detection, sensors);
- conversational platforms, used for engagement (virtual assistants, chatbots, translations); and
- autonomous machines, used for motion (self-driving cars, drones, robotic delivery).

According to the analysts, AI is the fastest growing technology sector in the world (50 per cent CAGR). Currently, the $7.3 billion of investment per annum will surge twelve-fold to $89 billion in the next five years (JP Morgan, 2018). This investment into AI technology falls into two major areas: intelligent automation, and labour and capital augmentation.

Forrester (2017) states that AI-driven companies will take $1.2 trillion from competitors by 2020 and Gartner notes that AI will generate $2.9 trillion in business value and recover 6.2 billion hours of worker productivity by 2021.

Gartner states that by 2020:

- 30 per cent of all customer interactions will be performed by machines;
- the fastest growing companies will be conducting over 50 per cent of transactions using machines; and
- 40 per cent of enterprises will have virtual assistants serving customers.

Let's look at some examples of AI:

- Google Translate now renders spoken sentences from one language into spoken sentences from 32 languages plus text translations of 103 tongues.
- Google has over 1000 deep learning projects underway.
- Microsoft recently announced that AI was its primary strategy. Microsoft now uses AI for its search rankings, photo search and translation systems.
- Facebook uses neural nets to translate 2 billion user posts per day in 40 languages.

And what do customers think of AI, bots and virtual assistants? In Flamingo AI's own research of consumers (500+) we found:

- 77 per cent were comfortable to very comfortable using a chat bot;
- 78 per cent thought a bot would improve their online experience;
- Consumer opinion on AI-based bots included:
  - it would help me to get things done;
  - it would ensure that I make a purchase without any hiccups;
  - it makes it easier to access instant and basic help; and
  - because if it can answer my worries I would complete the purchase.

So why now?

Essentially there have been two forces at play — one is the increased computational power and the other is the existence of big data that is used to train the algorithms. But more than this, by acting like a capital-labour hybrid, AI offers the ability to amplify and transcend the current capacity of capital and labour to propel economic growth.

The primary reason why there is such an emphasis on AI is the recognised decline in the ability of traditional levers of production, capital investment and labour, to propel economic growth.

With this in mind, it is time now for boards to step up and start to learn about AI — its uses, frameworks and shortcomings — and build an AI strategy that will amplify or augment the traditional operational model.

Issues that boards should be considering

The primary questions boards must ask themselves in relation to AI include:

- What is our company's AI strategy?
- What AI or shadow AI (AI that is being done without the knowledge of the CIO or CTO) is there already?
- Who will be the head of AI and who will coordinate all types of AI being introduced?
- Does AI sit with technology, the CIO, digital, transformation, innovation or another department?
- Should we build AI in-house, or engage one vendor, or select best of breed?
- How will we ensure the algorithms that are being used by our organisation are accurate and the right models for our business?
- Who has trained or is training the algorithms?
- How will we ensure that the algorithms have not been trained with bias?
- What are our security requirements around AI?
- Given AI will replace or augment human jobs, what will be our future organisational structure that will include digital labour positions as well as HAVA (human assisted virtual assistants) or HAMA (human assisted machine assisted) roles?
- How do we develop a culture that embraces human-machine workplaces in order for the technology to amplify legacy system capability and augment human capability?
- How will we manage communications to employees about AI and how it might affect their employment?

The imperative

I thoroughly agree with Andrew Ng from Baidu, the world's largest AI company, who notes: "A lot of S&P 500 CEOs wish they had started thinking sooner than they did about their internet strategy. I think five years from now there will be a number of boards and CEOs that will wish they had started thinking earlier about their AI strategy. AI is the new electricity. Just as 100 years ago electricity transformed industry, AI will now do the same."

And from Elon Musk, the world's most active AI entrepreneur: "Companies have to race to build AI or they will be made uncompetitive. Essentially, if your competitor is racing to build AI, they will crush you."

Runs on the boards

Lee Hickin
National Technology Officer, Microsoft Australia

Boards have the responsibility and the opportunity to play a pivotal role in preparing and encouraging businesses to take advantage of AI's enormous potential — but first they must prepare themselves

Artificial intelligence (AI) has been evolving for over six decades but it is still an unknown quantity for many businesses. Its potential stands as one of the obstacles to exploiting the opportunities it represents. There's a fear of the unknown.

This is where the board can play a key role. While a CEO's day-to-day responsibility revolves around the one-to-two-year vision for the organisation, the board's role is to look further, to the five-year horizon and beyond. A board can bring in diverse perspectives to bear on issues, helping to break through potential impasse. Importantly, boards can take up the mantle on helping organisations move beyond fear to find the opportunities that AI represents by asking the necessary questions around critical topics such as security and ethics while encouraging experimentation at a time when there are still many unknowns.

The obstacles to opportunity

We're not here to pretend the risk factors in AI don't exist. There is still so much that could be better understood. At the heart of this lies a language problem. I often find that businesses have not yet developed the right way to talk about AI. The difference between intelligent virtual assistants, complex machine learning models executing against large data sets, and cognitive services such as voice, vision and language APIs is largely unknown and collectively described as AI despite the wide variation in complexity and cost. Having a productive conversation about use cases and risks becomes significantly more difficult and circular without a firm grasp of these nuances.

Another obstacle to AI roll outs is a perception that AI is often viewed as a future step in a longer digital transformation journey. Yet AI is one of the most transformational tools available to businesses at this time. If it is to be done right, it must be factored in at the early stages where the foundation for future AI projects need to be laid.

Security is a key concern and for good reason. Given that AI revolves around the use of massive quantities of data, data protection and cybersecurity becomes even more critical in an environment where AI is in play. Other risks take on a more ethical slant, as reliance on AI's algorithms raises questions of transparency in decision making and accountability. Businesses are rightly concerned about brand reputation if something goes wrong. If done poorly, AI can introduce, or reinforce, prejudice.

The financial case is another common constraint on progress. Given its nascent status, historical data on which to make a data-driven investment decision is lacking. Similarly, many AI projects do not immediately point to a quantifiable outcome — they are learning exercises as much as they are about measurable ROI.

The board's role

To start unravelling the potential of AI, the board needs to demystify AI. This demands a common language and a growth mindset, which starts with education. It's important for boards to make sure they are appropriately constituted with a deeper mix of technical and research skills. The appointment of Professor Genevieve Bell, an anthropologist, technologist and futurist as a non-executive director by Commonwealth Bank of Australia is a great example of a business branching in a way that should serve its AI agenda well.

It's incumbent on the modern board to help businesses treat potential paralysis and start unlocking the AI opportunity. AI represents a fruitful area for exploration and those who use it effectively will disrupt markets to their advantage and drive growth. Like most investments it can generate risk but AI can also be used to help manage it: for example, by improving customer experience, increasing fraud detection capabilities or supplier risk modelling. AI can also play a role in changing how the board plans. Combined with big data and analytics, it can enhance decision making and provide invaluable strategic insights.

Inviting in security analysts to address the risk factors — like the security implications of AI's handling of large quantities of data — will be key. Guest speakers can also bring diverse thinking into the boardroom, which is a necessary ingredient when beginning to think about potentially curvy ethical issues.

The board should develop its own view, and that of their organisation, of how AI is positioned. It's an investment rather than a cost. The old adage 'sometimes you win, sometimes you lose' must be upgraded for the 21st century to speak of learning, not losses. Most successful AI experiments I've seen start out without a clear vision of what the impact will be. Businesses start experimenting in order to discover what AI can do.

The board should ask the right questions of their key business stakeholders: Are they considering AI opportunities where appropriate? If they are, what is the customer impact, the ethical impact, and the market impact of that potential AI solution? If these questions aren't being addressed at the board level they'll never be inculcated throughout the business.

Lastly, the board should also play a part in ensuring the organisation puts in place the correct building blocks for AI. This ties in with the need to address AI's role in digital transformation plans from the outset. Considerations include developing a data platform capable of supporting data-hungry AI and preparing the organisation from a skills perspective.

The aha! moment

By taking these steps, the board can play its part to encourage experimentation and the crucial aha! moments. These are the turning points when businesses discover exciting use cases for AI, innovative ways to solve old problems or opportunities to create value anew. An inspiring recent example lies in how the Northern Territories Department of Primary Industry and Resources worked with Microsoft to create an AI solution that drastically enhances their conservation capacity by cutting time to count fish populations from dozens of hours to just minutes.

Despite all the obstacles, Australian businesses are already relatively mature in their implementation of AI compared to other markets. Although certain sectors are getting out in front, such as mining and resources, retail and utilities, we have the opportunity and the responsibility to do so much more.

The challenge exists today to place an emphasis on driving experimentation with new technology and advance AI understanding at the board level. In doing so, directors will demonstrate the exciting privilege they have to show the way and bring out the best in their organisation.

Board leadership in the fourth era of computing

Ash Fontana
Managing Director, Zetta Venture Partners

The shift to the fourth era of computing requires companies and their boards to manage new categories of risk and allocate capital to new categories of assets. By way of context, the first era was the development of computer chips that enabled us to quickly calculate things. The second era was the development of software to line up the calculations on those chips. The third era was about putting all of those chips in the cloud to increase the number of calculations we could do at once and reduce cost. The fourth era is about running calculations over huge volumes — zettabytes — of data in the cloud to make predictions. Just as software is eating the world, AI is eating software. Computers will have cognition; machines will have intelligence.

What's the role of a board member in era? What new issues must be considered and what questions must be asked of management? How can board members help companies lead the way to both commercial and ethical ends in this new era?

Liability: Data privacy, explainability and competition

Managing huge volumes of data and putting AIs into the world exposes companies to new categories of risk.

Data privacy

Companies are collecting more data than ever, either as part of operations or to create data products such as AIs. Consumers are somewhat savvy to this data collection. Perhaps consequently, governments are starting to regulate data collection. For example, the General Data Protection Regulation (GDPR) in the EU mandates that companies collecting consumer data must enable individuals to know what data is collected, understand its use, revoke permission to use specific data, update data and obtain proof that the data has been erased. The penalty for noncompliance is four per cent of global revenue or €20 million, whichever is higher. Both consumer expectations and such regulations mean that companies must shift from indiscriminately collecting data in a piecemeal and decentralized manner to establishing an organized process with a clear chain of control. This chain of control can extend right up to the board level given the potential financial and reputational impact of breaching data privacy laws. Board members must thus work to compile an inventory of personally identifiable data held by a company, how that data is used by the company, and how that maps to both consumer expectations and regulations.

Explainability

AIs automatically generate predictions and sometimes make decisions. For example, AIs can figure out everything from how much credit to extend to whether someone has a blood clot. However, AIs are probabilistic in nature so will sometimes make the wrong decision. Explanations for such decisions will be required by both customers and governments. For this reason, boards need to hold their technical leaders to standards of explainability. One way to test this, and perhaps a proxy for explainability, is to require a written report of results from AI models that include explanations of how certain predictions are made.

Competition

The basis of competition changes in the AI era such that companies with the most data and best-performing models enjoy a significant competitive advantage, and one that compounds very fast. Companies such as Google and Amazon enjoy dominant positions in the market thanks to the large 'moat' of data that allows them to deliver better products than their competitors. However, such companies are starting to attract the attention of governments both in the US and EU thanks to this dominance. Boards must be across government sentiment around the monopolistic potential of data network effects.

Capital allocation: Data, infrastructure and talent

AIs allow companies to increase efficiency through automation and enjoy a significant competitive advantage over companies that fail to make the transition into this era. This requires an investment in new categories of assets: data, infrastructure and research for machine learning.

Relevant, high quality data is the fuel that powers AIs. Collecting such data is often the most difficult and thus expensive part of building AIs. Investments in the form of purchasing third party data, forming partnerships with complementary data sources and building products to collect data will need to be approved by managers and boards. Once acquired, this data must be managed on computing infrastructure of a different scale and type than in previous eras. Even though Moore's Law allows for cheaper computing than ever, computing and storage costs are more significant than ever given the increase in data volume and computational intensity of AI models. Some companies have to produce or assemble their own, custom hardware to run certain AI models. Finally, teams capable of building AIs must incorporate not only software engineers but data scientists, data engineers and machine learning researchers. Forming a fundamental understanding of the potential of AI will help boards understand the potential payoff from allocating capital to data collection, computing infrastructure and machine learning research. Boards can perhaps parlay their understanding of research and development budgeting to allocating capital to both data and staff for machine learning research.

Summary

The basis of competition is changing thanks to the emergence of data network effects. Board members can responsibility usher companies into this new era by focusing on the new categories of risks and assets that exist in the intelligence era. Data privacy, model explainability and the monopolistic potential of data network effects are important risks to manage. Data assets, infrastructure and talent are the assets to build. Boards that help management manage those risks and accumulate those assets will not only put themselves in a safe position but put their companies in a position to dominate the next era of technology-driven progress.

The new governance of data and privacy: Moving beyond compliance to performance

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(extract from *The New Governance of Data and Privacy*, AICD, 2018)

With the digitisation of everything, rising surveillance capitalism, intensive national security monitoring and large intelligence gathering activities, directors and boards worldwide have moved beyond seeing privacy as a compliance line item.

As organisations endeavour to prosper, leading directors are asking themselves much more dynamic questions:

- Why do our customers and other stakeholders care about privacy and security?
- How can we increase organisational performance and innovate by using technology?
- What is the value of our data to our stakeholders and those that might do us, or society at large, harm?
- How do we protect our data? Are our business, risk, IT and assurance functions engaged and providing reasonable performance and protection metrics?
- Are our actions ethical? If they became public knowledge, would we build or lose trust and social licence?

- Do we understand what it takes to be resilient and to be able to handle an unexpected breach?
- Do we have the right level of privacy and cybersecurity board literacy to make these judgements, while not placing reliance on executives or outside advisers?

These are difficult questions to answer, especially as many organisations have acquired a technology and risk debt in the form of legacy processes, systems and people, which groan and creak under the demands of a modern economy.

These questions also emphasise the importance for boards to understand not just the compliance risks of the current privacy landscape, but also the opportunities this landscape offers to drive performance.

Foster a culture that values data and privacy

In terms of driving culture, it is imperative that the board sets the tone from the top by making respect for privacy one of the entity's core values. This should then be reflected in the entity's strategy, business model, risk appetite, and compliance and governance frameworks. Directors should lead by example and treat culture formation as a personal responsibility. They can do this by ensuring that they make decisions about data after considering, and consulting where appropriate, a wide range of stakeholder views (including individuals). They should also take care to safeguard the personal information in their possession or control.

The board, with the help of the executive team, should ensure that a privacy-respecting culture is disseminated throughout the entity. They should communicate the entity's privacy stance, how it aligns with the entity's overall visions and values, and how that helps to achieve the entity's objectives. There are a variety of communication channels, including:

- code of conduct;
- policies and procedures around data and how it is used;
- on-boarding process;
- privacy (re)training;
- specific awareness-raising events (for example, during Privacy Awareness Week); and
- internal correspondence, visual aids, physical design of work spaces, etc.

The board, with the help of the executive team, should ensure that the right culture is embedded into the entity's everyday functions and activities. Based on the supporting structure from the DPP framework, this could mean the following:

- People:
  - ensure understanding interests and expectations of customers is a selection criterion for staff;
  - ensure the right people receive the right amount and type of privacy training for their role(s) and responsibilities; and
  - implement incentives for privacy performance.

- Systems:
  - ensure systems only collect, and grant access to, information that is necessary for relevant functions and activities; and
  - take reasonable steps to implement security controls.
- Processes:
  - formalise and document data handling processes throughout the information lifecycle; and
  - identify relevant checkpoints and introduce measures for considering data and privacy issues.

Finally, the board should exercise its monitoring and accountability functions by receiving periodic reports about the entity's privacy practice, including the extent to which its people, systems and processes are aligned with the culture. It may also be useful for directors to do a culture 'stocktake'. For example, what is the entity's current privacy stance, and what is its preferred privacy stance? What are the attitudes and practices of people within the entity with respect to data and privacy?

Directors can gather information via interviews, surveys and meetings. They should ensure that feedback is diverse and representative, spanning key functions (such as ICT, security, HR, legal, risk, HR and product development) as well as both managerial and frontline staff. Worldwide, regulators and customers are increasingly expecting accountability to be based on evidence gathered by competent, independent processes and not just unsubstantiated assertions.

Future-proof the board

Future-proofing the entity begins with future-proofing the board. As a starting point, this means the board should understand what the changes are and how they might affect the entity. How do new data-driven business models and value chains enhance, or threaten, what the entity is doing? What new technologies can be deployed to enable the entity to do more with, and to protect, its data assets? What new laws must the entity adhere to, and what frameworks, standards and guidelines should the entity take heed of? Amid all this change, what are the attitudes and mind-sets of individuals, stakeholders, regulators and lawmakers?

There are a variety of approaches that can be taken to ensure that directors individually and the board collectively have the necessary awareness. At the outset, the board's composition should be such that there is coverage of each of the business, technology and regulatory domains. The board can invite subject matter experts (for example, in data analytics, privacy or security) to speak at board meetings, organise dedicated workshops for key personnel, participate in data breach exercises or attend external conferences. Where the board considers data to be a particularly valuable asset, it can set up an advisory committee (ideally chaired by a non-executive director) to provide expert input on data and privacy matters.

The next step is for the board to apply a future-minded data lens to its deliberations and decisions. Directors should bring a questioning approach to all matters before the board. How does the entity's culture and privacy stance inform the issue at hand? How does the changing environment and the entity's data assets affect strategy formulation? What practices or processes need to be introduced or changed to facilitate this? It may be useful to dedicate a portion of each board meeting to data-related planning or consideration of a data-related issue.

Finally, it is necessary for the board to be continuously aware of the changing environments. The issue should be explicitly addressed at least once a year in a board meeting or planning session attended by directors.

Appoint key personnel and hold them accountable

The board should ensure that there is a senior executive who has overall responsibility and accountability for privacy practice. That executive oversees the entity's privacy program and ensures that management's decisions and actions are consistent with the entity's privacy stance. In very large entities, this executive may even see this reflected in the title of the position: chief privacy officer (CPO). More commonly, the senior executive will have privacy as one of his or her responsibilities, as supported by a privacy officer.

At the next level down, the board should ensure that management appoints a role with privacy expertise, often known as a privacy officer. The privacy officer role can be performed by the legal counsel or a separate person. He or she would have a strong knowledge of the entity's privacy obligations and data practices. He or she would also play an active role in developing and carrying out the entity's privacy program.

As the data deluge unfolds, there is an increasing trend for entities to appoint chief data officers (CDOs) to the C-suite. In contrast to CPOs (responsible for meeting privacy obligations and expectations) and chief information officers (CIOs) (responsible for information technology and systems), CDOs are responsible for the enterprise-wide governance and utilisation of data as an asset. The board in its performance function should consider whether a CDO may be beneficial and appropriate for the entity's long-term vision and objectives.

The board should ensure that there is alignment between those responsible for compliance and performance functions, respectively. Misalignment may arise due to tension between a new data use and the entity's privacy stance, or due to functional silos that pursue their own objectives while treating privacy as a low priority. Practically speaking, the board should direct the responsible senior executive to implement alignment steps. These could include, for example, fostering a strong working relationship between CPO and CDO (or their equivalents), ensuring both compliance and performance representation in planning meetings, and training key managers across different groups on both data utilisation and privacy.

For these reasons, it is not sufficient for most entities today to appoint a privacy officer who brings only a legal or compliance lens to the role. The privacy officer needs to bring a business and customer/stakeholder lens to the role in order to contribute to the entity's mission and not just be seen as a naysayer or roadblock.

Finally, as part of its supervisory role, the board should hold key personnel accountable for their compliance and performance duties. This can take the form of periodic (for example, annual) reports to the board and/or the risk and audit committee, as well as ad hoc reports if an issue has entity-level significance. Accountability measures must be supported by valid and consistent mechanisms for defining and recording data- and privacy-related key performance indicators. The board should direct the responsible executive to develop such indicators.

Enhance privacy and security resilience

Leadership is key to enhancing resilience, which is a natural extension of the board's role in fostering culture and future-proofing the entity discussed above. Taking into account the entity's values and its changing environments, the board should consider the following questions when formulating strategy and making policy:

- What does success in treating data as an asset look like in the long term?
- What are the potential downsides for pursuing this or that data-driven strategy?
- How ready is the board and executive leadership to deal with a data-related crisis?
- Who is the organisation dependent on, both within the entity and with others above and below in the supply chain?
- How can the board diversify and enhance business networks?
- How can the board improve resilience capabilities, such as in change readiness and incident management?

The board should hold the executive team accountable for implementing effective practices that support its strategic goals for enhancing resilience. These include explicitly incorporating privacy risks in the entity's holistic risk management framework, formalising both business-as-usual and change processes for data handling, implementing privacy and security by design in all products and systems, and building productive relationships between groups that share and manage data, both inside and outside the entity.

The board should also ensure that management not only identifies privacy risks but also takes robust steps to deal with them. A helpful way to categorise the steps is in terms of 'prevent—detect—respond'. From a data and privacy perspective, the board (and especially the directors serving on the audit/risk committee) should periodically examine the efficacy of:

- Prevent measures. Does the entity have the necessary precautions in place to minimise both human and machine error in data handling? How effective have the precautions been and what, if any, new measures should be introduced based on past performance and changing circumstances?

- Detect measures. Does the entity log and triage all relevant activities pertaining to data access, use and sharing? Have there been any irregularities in the last audit period?
- Respond measures. Does the entity have clear procedures and defined roles for managing when something goes wrong, whether in the form of data breach, public relations, complaint handling or business continuity? How well did the entity respond to a recent data breach or near miss?

Handling data properly is essential for privacy and security resilience. On what basis should a stakeholder trust an entity's data handling and on what basis should an entity trust someone else to handle their data? There is a growing recognition of third-party assurance as an enabler of trustworthiness. Assurance can be conducted on aspects such as contractual claims, technical measures to de-identify personal information and security controls—for example, ISO/IEC 27001 information security standard, ISO/IEC 27018 cloud privacy standard, the US National Institute of Standards and Technology (NIST) Cybersecurity Framework, Service and Organisation Controls Type 2 (SOC 2) or the Australian Signals Directorate's Information Security Manual. The board should direct management to ensure that the assurance, whether conducted on the entity's own claims or those of a contracted service provider, is carried out by an independent, credible and expert third party.

Focus on your stakeholders

Directors should start from the position that the entity is required to earn stakeholder trust, even if it can, or does, collect data relatively easily. They should ensure that relevant stakeholder perspectives—such as individual or business customers—are represented or at least accounted for at the board level. This is especially important when the board is developing strategy, making decisions and conducting supervisory activities. Directors can do this by inviting representatives to board meetings, setting up a representative committee and as part of the broader future-proofing initiatives outlined above.

The board should examine its position on care and regard for stakeholders. Is there a clear statement on the importance of this, as communicated in the entity's vision and values? How well do the board's decisions and the entity's practices align with this position? In many cases, the aspirational values are not translated well into reality. Ascertaining the entity's true position can be part of the fact-finding process outlined in the fostering culture section above.

A key component of social licence is transparency. This means being clear about what the entity does with data (and what it doesn't do), what are the benefits of data use and how its stakeholders can exercise control over the data they provide. The board should establish the key principles and direct management to translate them into both practice and communication to stakeholders.

If an entity cannot publicly explain its data practices without using broad generalities or adding lots of caveats, this is likely to erode stakeholder trust and is a sign that the communications, key principles or both need to be tightened.

Once again, demonstrable, credible and independent assurance mechanisms will support transparency initiatives.

Five major trends in emerging technologies

AICD
1 December 2018, "5 major trends in emerging technologies", *Company Director*, December 2018, AICD.

From AI to biohacking, the 2018 Gartner Hype Cycle identifies the life cycle of 5 major trends in emerging technologies.

The 2018 Gartner Hype Cycle finds five major trends in emerging technologies.

Democratised AI

One of the most disruptive technologies, AI is fast becoming available to the masses thanks to cloud computing, the open source and the 'maker' community. It includes PaaS (platform as a service software) and smart robots.

Digitalised ecosystems

Emerging technologies will need support from dynamic ecosystems with newer business strategies and a move to platform-based business models. Examples include blockchain and digital twins, a virtual copy of a real object.

DIY biohacking

2018 was the beginning of a 'trans-human' age. This will range from simple diagnostics to neural implants and be subject to legal and societal questions about ethics and humanity. It includes nutrigenomics and experimental biology.

Transparently immersive experiences

Technology within smart workplaces, such as smart whiteboards, is becoming increasingly human-centric. Interlink devices, sensors and tools in the home allow for contextualised and personalised domestic experiences.

Ubiquitous infrastructure

Cloud computing and the 'always on' limitless infrastructure environment have changed the landscape. Quantum computing will have a huge impact on machine learning, encryption and analytics.

Artificial intelligence profoundly changing the business landscape

AICD
13 April 2018, *Artificial intelligence profoundly changing the business landscape*, Governance Leadership Centre, AICD.

Governing in the era of 'disruption' requires boards to understand the impact of advanced technologies on strategy.

John Barrington FAICD, a leading not-for-profit chair and strategy consultant, is unequivocal about the impact of technology-led disruption and the preparedness of boards to govern through the coming Industrial Revolution 4.0.

"Boards, collectively, are not ready for the effect of advanced technologies on their organisation," says Barrington. "When it arrives in full force, growth in artificial intelligence (AI), automation and the internet of things (connected devices) will be exponential. That is, the longer AI change occurs, the faster it becomes."

Barrington says boards that govern strategy, risk management and organisational culture in a linear or sequential fashion will be left behind. "The scale of change ahead from AI is unprecedented. Boards that are naturally change resistant, risk averse or unable to tolerate failure will not be agile enough to govern through AI uncertainty."

Directors who are well read on advanced technologies, of which AI is the connecting force, will have encountered much hyperbole on these trends. A widely quoted 2013 Oxford University study by Frey and Osborne, for example, estimated almost half of all jobs are susceptible to computerisation — a trend that would shake industry and society to the core if proved correct.

Barrington has a more practical view. As chair of Anglicare WA, an innovative NFP that helps the disadvantaged, and the Perth International Arts Festival, Barrington has seen first-hand the challenges that confront boards when assessing AI opportunities and threats.

AI, he says, is as much an issue for NFPs and government boards as it is for those governing commercial organisations. "AI, in one form or another, will affect all organisations across industry. It's not just an issue for startup entrepreneurs who are attacking large organisations. Every board should be focused on technology-enabled disruption."

As a consultant who specialises in AI, Barrington works at the intersection of technology, strategy and governance. He has advised dozens of executive teams and boards on strategy and governance and recently co-founded a technology startup, AlphaIntell, which is partnering with IBM to provide AI services and rapid prototyping of AI technologies for organisations.

Barrington was awarded the AICD PwC Director Award for Excellence in the NFP Sector in October 2017. Here is an edited extract of his interview with the Governance Leadership Centre on the impact of AI on boards:

Governance Leadership Centre (GLC): John, there's a lot of hype about AI. Is there a risk that boards overreact?

John Barrington (JB): There's always a risk that boards overemphasise their focus on advanced technologies, distract the executive team and take the organisation in too many unfocused directions. That said, AI represents profound change. We have historically seen technology as a tool for workers. Now, technology is becoming the worker. As more industries become digitised, the effect on organisations and boards will be immense. Directors have a responsibility to their organisation and to their employees to ensure that appropriate re-training, re-skilling and re-deployment programs are in place to cope with this change.

GLC: You argue that boards are collectively unprepared for AI. Why is this the case?

JB: Partly it's because some directors are underestimating the speed of change. They see AI as an issue for the 'future' when the reality is it's here now and rapidly getting bigger every day. It's already on our smartphones, for example, and in search engines. Also, some boards don't have the people or processes to deal with AI and other technology-led disruption.

That is no criticism: understanding emerging technologies and their effect on organisations, and integrating that into strategy, risk-management frameworks, compliance processes and organisation culture is complex. AI is very challenging for boards.

GLC: Should more boards appoint directors with strong technology skills and experience?

JB: Yes and no. A board that lacks tech skills might benefit from recruiting a younger, tech-savvy director who is well versed in these trends. But I believe AI and disruption is an issue for every director, not something that should be delegated to a director or two who have a leaning towards this field. The strategic governance challenge is ensuring all directors are capable of questioning how the organisation responds to AI opportunities and threats.

GLC: Is boardroom diversity the answer to AI governance?

JB: Absolutely. Boards need directors who can approach issues through different lenses and avoid groupthink. That is true of all board issues, not only advanced technologies. Most of all, boards need directors who are capable of challenging assumptions behind strategy and are willing to 'rock the boat'. It takes a special director who is prepared to prove management wrong and can do so in a way that is productive, collegiate and strengthens the board/executive relationship.

Boards also need a culture where directors feel safe to present divergent views and not always converge quickly to the consensus decision. It's a question of balance: you don't want directors shooting off on random tangents and distracting management. Equally, you don't want a boardroom culture where directors are hesitant to express left-field views about emerging technologies and their potential impact.

GLC: Should boards develop special processes, such as technology sub-committees or working groups, to deal with disruption from AI and other emerging trends?

JB: Generally, I'm wary of working groups or sub-committees on technology issues because the risk is they delegate the issue to a few directors and take the full board's focus off it. More committees or working groups can also add to board complexity and workloads.

AI must be an issue for the entire board. It's dangerous to be prescriptive on how each board should develop processes to consider it; there's no one-size-fits-all approach. I've found presentations from management or outsiders on AI topics, before some board meetings, can be effective, as is having AI and strategy as a structured discussion point within some meetings.

GLC: John, how do boards find the balance between focusing on today's business and commercial realties, and future impact of disruption?

JB: It's a good question. A simple model is thinking about strategy in three horizons. The first horizon is the here and now and what the organisation needs to do to keep performing. Horizon two is about building on that through business development, and horizon three is about buying options for the future through new ideas and experimentation.
In every boardroom, you'll find directors who gravitate to different horizons. Some directors are very good at governing today's business; other are more forward-looking and creative. The key is ensuring the board has the collective skill to cover all three timeframes. Horizon three requires organisations to seed several innovations, knowing only a small percentage of them will succeed. It's in this horizon that AI experiments should be conducted. Here, boards need to tolerate failure and ensure executives are incentivised and rewarded for the failure and its positive outcome, such as new organisation capabilities that are developed from learning through a failed innovation. The learning outcome is fundamental to success in innovation.

GLC: How can boards create structured thinking about industry disruption?

JB: The key is to be relentlessly customer-centric. The executive team cannot go off on wild tangents that distract them from the main game. Rather, they should focus on a small number of experimentations in horizon three that the board approves. A relatively small amount of capital is devoted to each and the board acknowledges that several innovations will fail. The trick for a board is to encourage the organisation to engage in radical innovation, in a way that is part of a carefully considered strategy and does not detract from other strategic horizons.

GLC: How can directors use AI within the boardroom to create a stronger culture of evidence-based decision making?

JB: The use of AI by directors has not had much consideration. Done well, it could make a vast contribution to boardroom decision making. AI, for example, can allow organisations to run thousands of decision-making scenarios in real time, rather than focus on just a handful.

In time, we'll see more boards encouraging, even requiring, executive teams to use AI to test decisions by running a much larger number of strategic scenarios and outcomes. There would create be a culture of evidence-based decision making in many organisations. We're seeing that now in the energy sector, for example.

GLC: John, you have developed the PRIMER model to help boards assess advanced technologies and the impact on strategy and governance. How does that work?

JB: The P in PRIMER stands for purpose. It's critical that the board understands why the organisation is developing an AI strategy. Is it to serve customers, take cost of out of the supply chain and improve production efficiencies, create vast amounts of real-time data for analysis, or a combination thereof?

The R in PRIMER stands for resources. Having identified AI's purpose, the board must understand the human and financial resources needed to implement it. Does the organisation have sufficient AI skills, can it get them from outside and how does it upskill staff with AI skills through real-time learning and development systems?

I recommend that organisations have an integrated AI strategy, linked to the main strategic plan, which outlines resources required, delivery timeframes, milestones, targets and expected return on investment.

The I in PRIMER stands for insight. That is, how will the organisation use AI to learn more about current and prospective customers?

The M in PRIMER stands for move. Big data, AI and robotics are all about speed. The winners in the data wars will be organisations that are able to spot trends in vast amounts of real-time data and react before the competition.

The E in PRIMER stands for experiment. In some ways, AI will allow larger organisations to work like smaller entrepreneurial ventures through rapid experimentation.

The R in PRIMER stands for reputation. Every organisation that embarks on AI must consider its ethical implications and effect on the organisation's corporate social responsibility. The board must be clear on the line that the organisation will not cross with technology, which is not always clear cut. For example, how far will the organisation go with analysing customer data and encroaching on privacy? How will it protect that data and use it ethically?

GLC: How can AI affect the NFP sector?

JB: Anglicare WA, for example, could use AI to scan thousands of phone calls from people who experience financial distress around the payment of utility bills. It's early days, but we could consider a form of robo-advice could help the organisation deal with escalating volumes of calls and provide a high standard of advice that is complemented by human interaction in more complex cases. At this time, such considerations are hypothetical. But that is the point — boards must be actively considering hypotheticals if they are to remain relevant in the future.

Some banks are using robo-advice to screen mortgage applications and the like; there's no reason why the NFP sector cannot use this technology to serve more people and augment advice from human counsellors. Research shows some people experiencing distress prefer to deal with an automated service because it does not provide subjective opinions or, in some cases, judge them.

In the arts, AI could be used to extend the patron relationship by providing more information before, during and after an event — and innovating the overall experience. In time, more arts organisations will analyse big data to better tailor arts events for stakeholders.

GLC: John, what advice would you give directors who want to focus more on AI?

JB: The obvious first step is to be well read on the topic. Directors should ensure their information set covers emerging technology developments relevant to their industry and others. They should read well beyond their industry; AI will increasingly blur sectors, creating opportunity for organisations to move rapidly into new fields.

As part of this information, directors should actively look for opportunities to hear from leading AI thinkers, either by attending events on their own or through board-organised events. Tours to innovation clusters, such as Silicon Valley, can be beneficial.

Networking is equally important. More than ever, directors need to have diverse networks; knowing successful startup entrepreneurs or tech innovators can challenge your perspectives.

Again, it's about being prepared to listen to different views and, if needed, prove things wrong in a way that fits within your broader director role and responsibilities — and is part of a collegiate boardroom decision-making process.

CHAPTER 9

Secrets of success: From startup to sustainable global business

Evolving from a startup to a sustainable global business

Cameron McIntyre
CEO and Managing Director, carsales.com

Nicole Birman
General Counsel and Company Secretary, carsales.com

In a startup environment where you must run fast or die, how does a company become successful and also build the right governance framework?

carsales.com Ltd is one of Australia's great technology success stories. From a Melbourne startup to an ASX 100 company with thriving operations in countries around the world, we consider some of the key learnings along its journey.

Within three years of its founding in 1997, carsales became a public unlisted company — just in time for the tech wreck! In addition to dealing with common startup challenges such as reaching profitability, evolving its business model and developing new technology, becoming public meant it now had compliance requirements similar to those of a listed company but without the benefit of liquidity. However, this heightened governance framework enhanced the business' ability to establish good practices in transparency, shareholder communication and compliance and risk management, ensuring many a misstep was identified and avoided early.

The fine balance between governance and performance

There has long been a tension in the startup environment between the necessity for speed to market and business performance on the one hand, and good governance on the other hand.

In the early days of carsales, governance was viewed in two distinct categories: compliance and risk management. From day one, compliance was non-negotiable — the company sought advice early to comply with relevant legal requirements. The key to dealing with risk management was having the right skills around the board table which enabled risks to be effectively assessed and decisions made at speed.

While the company's risk management structure today is more formal, and the risks more numerous and complex, the principle of having the right people at the table who understand the industry, the technology and the potential impacts of their decisions applies as much in 2019 as it did many years ago.

Get the right help

As late as 2007, carsales had no internal legal team, no human resources department and just a few finance staff, one of whom also played the accidental company secretary role. Like all true startups, everyone was responsible for everything.

With such a lean staff comes additional risk for the company and its directors; matters that get missed could be fatal down the track if severe enough. This is why it is important to supplement the skills of the management team and the board with the right advisors during the early days of a startup. Regularly engaging with experienced advisors along the journey was particularly critical to the success of carsales in its early years.

Two undervalued but critical skills for startups are knowing when to bring essential advisory functions in-house, and finding people with the right combination of technical expertise and commercial nous. Getting this right is important to ensure that the classic 'speed vs governance' tension does not get pulled too far in either direction, costs don't get blown out and the culture of the company doesn't suffer.

Growing up and expanding offshore

As a business moves from its startup phase, it may begin to look globally for opportunities, as carsales did. Before making a move into new territories it is imperative to have sound governance frameworks that are appropriate to the more mature stage of the original business.

Differences in governance standards, culture, business practices, regulatory environments and language can all play a role in shareholder value destruction when a company expands globally. In the context of getting the governance right there are a few critical principles to note.

Alignment with partners

Entering a foreign jurisdiction for the first time can be made easier by partnering with a local business. However, many ventures have failed because of differences in philosophical outlooks, governance principles and business practices between partners. These differences can erode confidence, create misalignment and lead to the loss of valuable local management. Due diligence required in this area is often overlooked or under invested in, but is critical in establishing a successful business partnership.

To avoid misalignment, nothing beats the investment of time. Company directors too often see their roles limited to what happens in the boardroom. The success of a global strategy may be amplified by more actively involving directors pre and post deal to build deeper and more meaningful understanding of potential partners, strengthening knowledge of areas of commonality and differences to circumvent future conflict.

It's a marathon not a sprint

As much as you constantly feel like you are sprinting in a startup, and more often than not that is the case within carsales, it is important to view business development, particularly relating to global expansion, as a long-term investment.

Taking a long-term focus will impact a range of factors. It may influence the jurisdiction a company is willing to enter, the speed at which technology or products are introduced to a market, or the business model adopted. Significant diligence is required for a company to understand the dynamics of the market it is entering. With this knowledge, and the right amount of patience, a company can give its new venture the best opportunity to thrive.

One size does not fit all

When it comes to globalising any organisation, being adaptable and ready to pivot is imperative. Too often companies try to impose their business models in international markets, expecting immediate success. The attitude of 'we know best' is not only arrogant but fraught with danger as no two markets are the same.

Through trial and error, carsales has learnt to support its foreign businesses with knowledge and intellectual property, enhancing what is already there in the first instance. While there are some immutable standards carsales requires all its businesses to comply with, only where it makes clear commercial sense does it apply its global technology and entire governance framework.

Final thoughts

A startup requires careful nurturing to grow into a sustainable business through the appropriate application of commerciality and governance at the right time in its evolution. Global expansion requires a similar sensibility. Each new foreign venture may be regarded as its own startup, but there may be added complexity and heightened governance requirements owing to any number of factors, including a listed parent company. The company must balance the needs of its new venture with those of its established businesses. One way carsales has managed this challenge is by taking on a greater level of responsibility for each new venture's governance requirements within its established and better resourced entities. This has allowed carsales to maintain its commitment to good governance while giving its newer ventures more latitude to focus on the commercial imperatives they need to grow into their own sustainable businesses.

Scaling governance in early stage businesses

Ros Harvey
Founder and Managing Director, The Yield

Despite the incredible success stories of startups that emerge to become billion-dollar companies and household names, the reality of early stage technology businesses is far more sobering — the majority of startups fail, mainly due to self-destruction rather than competition.

The reasons behind the failure rate are many and varied, but much of it can be put down to not having the right management and governance. Often the focus on is on the technology or the widget rather than the basics of running a successful business.

Good governance is always critical to success no matter the size or scale of a business. But it has to the be right type of governance that matches the needs of the business. For rapidly growing, early stage technology businesses, the key to being part of the small percentage of companies that succeed is to apply the right type of governance for each stage of the business as it matures.

Right governance to match the needs of the business as it scales

Governance needs to be appropriate to the stage of development of the business. The maturation of governance processes should then be managed as part of the maturation of the business.

The standard board structures and recommended board committees recognised by large corporates aren't always effective in an early stage business. Firstly, businesses would spend too much time and valuable resources supporting the governance structure, and secondly, the business simply moves too fast. Early stage technology businesses are so incredibly fluid because they're growing and changing every day. Attempting to manage a full governance arrangement with a complete set of board sub-committees would risk killing the business.

In the early days of our business, with a handful of key people working around the kitchen table, we had a board of three people representing the angel investors who all had deep capability and experience to contribute. Now we have a five-person board. We appointed our first independent chair in 2018.

We are currently closing an investment round which will see our board change again. A priority for the board is getting the right skill mix and diversity. We still don't have formal committee structures but tend to form ad hoc board working groups on particular issues. As the business matures, I would expect that we add more formal board sub-committees.

Our adaptation of traditional governance models went further than just structures. In the first 18 months of the business we purposefully departed from the traditional governance model of separating execution and strategic planning. The traditional role of a board is to set and oversee strategy while management oversees execution. Our strategy evolved and shifted so rapidly and continuously in the early stages of the business, that the board could only do its job if it was more engaged with management and the execution strategy. We also needed the expertise of the board members in a more hands-on way in those early days. For example, board meetings were more frequent and board members participated in execution planning at annual and quarterly meetings where we set and updated our one-page strategic plan.

Following our seed investment 18 months later, we made a conscious decision to separate the board and management again. We now run a more traditional governance structure where we report on our execution of strategy and metrics to our board each quarter.

As a business matures and learns its own products and sales cycle, planning becomes easier and as a natural result, so too does setting strategy. Finding the right intersection of board and management, strategy and execution, is going to be different for each business at various stages along the growth cycle.

Being clear about risk appetite

Governance is inextricably linked to understanding the company's risk appetite. As such, the key to good governance is the assessment of potential risks and being very clear about the risk appetite of the business. Once a risk appetite is set, appropriate governance and management practices should be designed to support and work within it.

Large, global organisations and mature, publicly listed companies have a completely different risk profile and risk appetite to an early stage technology business. I worked for the United Nations for many years and the governance systems around finance and risk were exhaustive because of the environments in which we were working — operating in a geopolitical environment, emerging markets where corruption was a huge risk, and accountability to donors and governments high. A mature, publicly listed company has a different risk appetite again — they have disclosure obligations and responsibility to arguably less sophisticated shareholders.

Risk is inherent to early stage businesses that are innovating and bringing to market new products and services. I would also argue the same for a mature enterprise which is trying to innovate. Some people position risk taking as something that needs to be avoided.

Often, though, the biggest risk for an early stage technology or an innovative business is not doing enough. Doing too little is just as bad as doing too much. It's here that undercapitalising, being too slow, over-engineering a product to get it perfect rather than into market or sticking to the status quo can be more dangerous.

Making way for management

One of the key risks in any early stage business is the founder syndrome. Often highly charismatic people with an immense sense of ownership over every element of the business, founders can struggle to let go. Founders need to adapt to their scaling business and bring in governance and management expertise vital to scaling a business. Creating a genuine board and governance structure is often challenging for founders. But if we don't help founders do this, they risk myopic thinking and not tapping broader thinking and expertise.

Thinking beyond the product

The challenge of an early stage technology business is that it's easy to focus on the technology and the product in development. Businesses shouldn't fall into the trap of spending all their time and energy on the technology and product, but ensure time is also spent developing strategy, testing for market fit, go-to-market plans, managing risk and setting up a governance and management structure that will see the business, not just the product, succeed.

Managing cash

Cash is something that must be closely managed as an early stage technology business, particularly if there is a product to sell. It is easier for services companies to scale and grow the business organically by adding people with sales. Product companies face a bigger up-front cost to design and to develop the product, made even more challenging if a product includes hardware. A technology product needs to be executed and delivered before it can start making money and the business can scale. Starving the business of cash and under-capitalising to avoid dilution are risks that boards of early stage businesses need to avoid.

Governance for investment

An often-unexpected benefit of good governance is the translation of that into company valuation and investment or funding. We've done four capital raising rounds in the lifetime of our company through engaging with the investor community. We get very positive feedback from investors about our governance and governance documentation. In our most recent investment round the lead investor cited our governance documentation as a key factor in their decision to invest. They felt it demonstrated that we are a well-run business. For us, good governance has directly impacted our valuation as a company and secured investment.

Learnings

My advice to early stage businesses is not to treat governance as a formality, something that can be put off. Governance isn't something to address at the last moment or to tick a box, it should be at the heart of managing any business. Having a good board gives you great networks, broader thinking and experience, access to advice, resources and capability, as well as access to investment. These are massive benefits. The key is to always ensure you have the right governance for the right stage of business and designing governance to match your scaling.

Eight tips for startup boards

AICD
1 December 2018, "8 tips for startup boards", *Company Director*, December 2018, AICD.

Digital banking startup Xinja wants to disrupt the status quo of banking. Founder Eric Wilson and chair Lindley Edwards share their tips for startup directors.

Eric Wilson can pinpoint a morning a few years ago, when he entered the elevator in the building where he worked and saw an ad on the wall that repelled him. It was an offer to transfer credit card balances at zero per cent interest for a fixed time, after which the charge would revert to normal level — apparently aimed at providing relief.

Wilson saw only cynicism. “It wasn’t so much that the company was offering that credit card — all banks do that — it was more that we were so comfortable with that, we were advertising it in the lift where everybody went every day,” he recalls.

To him, those deals, which as he notes many banks offer, say: “We’re trying to identify the people who can’t manage a credit card, who are debt refugees and then we’re going to absolutely screw them”.

Wilson had spent almost two decades in banking and consulting, and at that time was CEO of NAB’s National Australia Trustees. Now he wanted out. If the ad was the push factor, he was soon to feel the pull of an alternative. “I was on the phone to Jason Bates, an old friend of mine in the UK,” Wilson recalls. “I was saying, ‘I don’t really want to work for these people anymore and I don’t really want to work for any of the others because they’re all the same’. He said, ‘For God’s sake Eric, stop whinging and start yourself a bank’. I said, ‘Don’t be ridiculous, no-one starts a bank’, and he said, ‘Actually, I’ve started two’.”

Bates co-founded Monzo and Starling, two of the UK’s biggest “neo” or digital banks, accessed via mobile phone apps. In short order, Wilson decided to do likewise, despite there being no precedent here and a tighter regulatory regime, requiring a long wait on the Australian Prudential Regulation Authority (APRA) for the restricted licence necessary in order to take deposits.

Xinja — “not a bank yet but we want to be” declares the home page blurb — founded in May 2017, is Wilson’s answer to the culture laid bare by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.

Ultimately, Wilson says he thought: “You know what? I actually can start a bank.”

It’s an attitude that characterises founders, says Xinja chair Lindley Edwards MAICD, group CEO of corporate advisor AFG Venture Group. “You actually are contrarian,” she says. “You take a contrarian view and say I want to disrupt the status quo — Australia deserves more than the banking system it has now.”

Wilson began to pull together “the best people I had either come across or worked with in the past 20 years in this business” — a team to deliver the technical platform, the app, the right products and the customer experience for the right price. They included a technical architect to manage building the system from the ground up and a chief strategist whose credentials included a stint with APRA.

Wilson had met Edwards, who in more than 30 years in banking had gone from teller at a regional bank to a Macquarie Bank associate directorship, then a Citibank vice-presidency. He identified her as Xinja’s preferred chair and began trying to get her on board. In the end, she was a believer, not only because Wilson adapted his business model until she was satisfied, but because Xinja resonated with her values.

"I thought it was a big, hairy, audacious goal to come into the banking sector in Australia, which is dominated by the Big Four, and say, 'Not only will I take that on, but I will use new technologies, I will use digitisation. It's time to transform the system and provide a bank that is really focused on the banking experience for the customer'. Using the latest technologies and data insights to help people, nudge them towards a better outcome, that's all really compelling to me."

Wilson also valued Edwards' commitment to people — she is on the boards of the National Bank of Vanuatu and microcredit provider Grameen Foundation Australia. "I wanted to build a bank that was for-purpose as well as for-profit and this woman embodies that," he says. "She is a great banker with an enormous heart who wants to make people's lives better."

Other board selections were Wilson's old friend Bates, another Macquarie Bank alumnus, Craig Swanger, now at Revolver Capital, and shareholder representative Stephen Garner. Xinja announced at the end of October that it had appointed American neobank pioneer and futurist Brett King as a permanent advisor to the board, focusing on innovation and strategic direction. The founder of New York-based Moven — a mobile financial services provider — King is a former advisor on the future of banking to the Obama White House and the US Federal Reserve.

So far, the build phase has been successful. Full-time staff now number 40 and original private investor backing has been topped up to $16.8m — including crowdfunding of $2.7m — with another round underway for $10m–$20m, which would value Xinja at a shade under $100m. The aim is to be profitable within three years, with $10m–$12m annual revenue and a $1b loan book with approaching 3000 mortgages — that's if APRA grants the restricted banking licence. Wilson and Edwards are "hopeful".

Xinja has launched its phone app, a prepaid card and a home loan. Wilson was pleasantly surprised that the cost of money has been manageable, allowing a variable interest rate of 3.64 per cent fully offset. So far, mortgages have been offered to a handful of friends, family and early investors to test. The prepaid card has been a broader enterprise, with more than 5000 issued and a waiting list of 19,500. "It's our first way of working with customers, getting feedback," Wilson says. "It's a spend card, so it helps you control what you spend — and it's an excellent travel card."

It also glows in the dark — the result of Wilson listening to market feedback revealing women prefer to carry cards loose in their bags during evenings out, but in dark environments such as bars or taxis, often can't see them, or tell them apart.

The human touch

Bringing back the humanity to banking via a mobile phone interface may not be as counterintuitive as it sounds. For people truly at home with their smartphones, the Xinja proposition is simply to be value for money, easy to use and helpful. "The majority of people never want to speak to their bank," Wilson says. "They don't enjoy it, have any interest in it or want to be sold stuff. Our job is to make that whole process of money as comfortable as possible and at the same time help customers make good financial decisions. I'm not talking about them racking up debt on their credit card, but getting out of debt as quickly as they can."

This means fast, efficient transactions, tracking of expenditure and accounts backed by sophisticated data analytics that generate screen prompts to suggest improvements — such as moving money out of a current account to cover a credit card debt. "And not just telling you that, but making it really simple, a little thing that pops up on your Xinja app and says, 'You're not optimised today, do you want us to do these three things?'"

Success relies on large numbers of accounts with small margins for the business. Wilson tells Xinja investors, "We are going to make less money per person than probably any other bank in this country."

Digital banking is catching on and there are fintechs that could also potentially compete. "It's important to be clear about who is a neobank and who is just a digital distribution strategy," Wilson says. That's a swipe at Bendigo Bank's Up, among others.

Wilson is more generous about Volt Bank, the first neobank to gain a restricted licence in Australia. "Volt is a good business and we don't think of them as the enemy. The UK experience was that a rising tide lifted all boats, so we're really keen to see more genuine neobanks in the market because we get the category more established. My competition is CBA, ANZ and Bendigo — not Volt."

As for the fintechs: "My job is to take deposits and offer home loans, and if there is something outside of that a fintech can do better, then I am all for partnering."

Edwards says life for the board of such an experimental endeavour is "an incredible opportunity, but also an incredible challenge — to set a culture from scratch. One of the things that the board is embracing is ongoing learning." So, when a little help was needed with its licence application to APRA, Xinja went in search of outside guidance.

"It is critical to have the ability to ask for help," she says. "We are also focused on people playing to their strengths, so in a board dynamic, whoever has the most knowledge about something tends to lead it."

That extends to the operational side. "We have had to muck in. We'll say to a staff member, 'Who in our contacts and networks [can help]?' We're not doing it, but we're prepared to help. So, it's a very collegiate board because no single person can do this on their own."

Wilson speaks to the directors weekly and to Edwards more often. "I use them as a sounding board. When you get people of that calibre, to stick them in a room for two hours once a month seems crazy to me."

Directors of a startup require abundant energy, Edwards says. "Everything takes longer and is harder that you imagined it was going to be. It's incredibly exhilarating and on another level, it challenges you to the limits of your knowing."

"We're developing interfaces and technology, building our team and doing all of our licensing. All those things require that when things look like they might go off-track, you're actually over the top of it. There is a management role in that, but also a board oversight one. It's like building a plane while you're flying it."

Transparency to all stakeholders is also crucial for Edwards, who proudly recounts the outcome of an extraordinary general meeting Xinja held in Sydney in July. The constitution limited the capital that management could raise without consulting shareholders, which had proved a drag on progress. About 90 people attended. "Eric stood up and said, 'You can ask me any question you like, I'll keep answering until you're satisfied'. That level of transparency is quite incredible. It started at 5.30pm and we had to ask people to leave at 9pm because they wanted to close the building."

The board had entered the meeting room with the vast majority of shares in favour, so it was a done deal. For Edwards, the gratifying moment came when the motion was carried by ballot — there were no new 'No' votes.

One of Wilson's strengths, in Edwards' view, is his lack of defensiveness and his ability to deal with dissent. Failure to do this is the downside of a founder's contrarianism, she warns. "You have to know when to take a lot of notice of people and when to take none. It's a fine line."

Although in the thick of the startup phase, Wilson and Edwards are already in sync about the future. Edwards recalls when Wilson asked her to be chair. "I said yes, until someone better comes along. Eric replied that I couldn't keep saying that, but it's true. All of us as directors of Xinja have to be aware that we are the appropriate directors — for now."

Wilson also accepts the board can fire him. "Whether I am the founder or not, at some point, I won't be the right person," he says. "We always say Xinja is bigger than any individual — and that includes me."

If that day comes, he will at least have had a crack at fixing the problem that crystallised for him that day in the elevator. "There's also a karmic balance," he says. "I spent the best part of 20 years working in these financial institutions and Xinja is my way to rebalance that, to build something good that lasts and will help people — something that will be on their side."

Eight tips for directors of startup boards:

1. The CEO is a contrarian — be comfortable with that
2. Share their values
3. The board's networks matter
4. Be willing to learn as the company grows
5. Be energetic.
6. Remember, you are setting a new culture
7. Be a sounding board
8. All roles are 'for now'

Governing startups through a haze of information uncertainty

Tony Featherstone
17 May 2018, *Governing startups through a haze of information uncertainty*, Governance Leadership Centre, AICD.

Less board materials and higher uncertainty of ventures force a more hands-on approach

Picture this: a young entrepreneur raises $1 million for her startup. Investors require a fiduciary board of directors to be formed, to protect their interests. The startup suddenly has a three-member board, including the CEO, that supplants the previous advisory board.

The chair coaches the CEO on governance structures and they jointly develop a board pack that satisfies directors and management. A board meeting schedule is implemented and the founder is accountable to a board and investors and has extra governance work.

Before long, the board pack degenerates into a short operational review from the CEO, a cash-flow statement and minutes of the prior meeting. Financial reporting is limited, supporting documentation for decisions is not included and nothing in the board pack is cross-referenced with previous papers.

Worse, directors receive the board pack the night before the board meeting, leaving them unprepared for discussion and frustrated with management.

Directors complain to the chair that management is not providing enough information to make decisions. Legally bound by director duties in the *Corporations Act 2001* (Cth), and with their reputation and the interests of investors on the line, they rightly want extra detail in the board pack.

That strains relations between board and management. The founder is effectively CEO, chief operating officer, chief product officer and chief marketing officer at once. She has limited capacity to produce detailed board packs and there is no in-house company secretary.

Tensions peak when a director asks the founder for written information on the startup's cybersecurity policy. The founder, already working 18-hour days, is furious at the request. She thinks the information is a luxury at this stage of the startup's lifecycle.

With relations stretched, the founder becomes less transparent with information. She knows the board cannot keep up with a venture that is rapidly discovering its business model and customer base as it scales the opportunity.

Challenges of startup boards

Welcome to the world of startup governance. A world where hyper-growth ventures can change direction at short notice, where directors often make decisions when they do not have all the information and where internal resources to help boards are often stretched.

Not all startups, of course, go the way of the above scenario. Some make a smoothless transition to boards, benefit from the counsel of directors and lay strong governance foundations to scale the venture. But startup governance can be tricky.

Holger Arians knows this world well. The startup expert has served on several boards of emerging ventures, mostly in an advisory capacity. As CEO of Dominet Digital Ventures, an investor in early-stage ventures, he deals daily with high-growth emerging companies.

Arians says directors of large organisations can underestimate the speed at which startups operate. "A startup could fundamentally change its direction in the six weeks between board meetings. Directors who rely on traditional board approaches and meeting cycles to govern disruptive startups find out too late to fix problems when they arise."

Startups can be a governance conundrum. Although the term 'startup' is widely used, there are significant governance differences in the lifecycle of emerging ventures.

An early-stage venture, for example, will typically have an advisory board over a fiduciary board of directors. The unlisted venture, usually funded by the founder, friends and possibly small investors, is often discovering its customer base and best business model. It hasn't sought larger amounts of capital to scale the opportunity because it is still validating the idea.

An expansion-stage venture, in contrast, has proof of concept, has de-risked its technology and has small but rapidly growing revenue. The venture seeks capital from professional or high-net-worth investors, forms a board of directors and implements governance structures.

As the business grows, more capital is needed, so the venture seeks admission on a stock exchange through an initial public offering (IPO). The board expands, and more formal governance structures are implemented now that the organisation is under the stock market's glare, ASX Listing Rules and continuous disclosure requirements.

Each scenario presents boards with a common challenge: entrepreneurship requires management and governance in conditions of high uncertainty. Yet emerging ventures have fewer resources to provide information to boards to reduce this uncertainty.

Understanding the nuances of startup information

Dr Katherine Woodthorpe FAICD has long experience in startups and governance. She is the former CEO of the Australian Private Equity and Venture Capital Association, a non-executive director of Sirtex Medical, chair of two co-operative research centres and of Fishburners, a leading provider of co-working space for startup ventures.

Woodthorpe says startup boards must win the founder's trust. "Startup founders may not have worked with a board or understand the distinction between board and management. Sometimes, they are wary about sharing information on the venture with directors they are not yet familiar with. So, they hold information very close to their chest."

Startup boards can cause problems, says Woodthorpe. “Some startups have inexperienced boards or directors who come to the startup from a management or board role at a large organisation. They don’t understand the nuances of startups and they struggle to make decisions because everything moves faster and there is less information to go on.”

Woodthorpe says startup board packs tend to be much shorter and focused on near-term opportunities and issues, compared to board packs in larger organisations. “There’s a lot more focus on monitoring the venture’s short-term cash position, sales, cash-flow projection and R&D spending. The venture’s cash burn rate is often analysed to the nearest minute.”

Woodthorpe says good startup boards coach management on governance expectations and structures. “The starting point is ensuring the founder understands that directors of fiduciary boards have significant legal responsibility and are within their rights to ask for, and expect, the right information from management to make decisions. The founder is no longer dealing with an advisory board that is there to bounce ideas off or help the organisation through its members’ networks.”

The next step is agreeing on the board pack’s structure, timing and board-meeting cycle, says Woodthorpe. “The chair needs to help the founder/CEO allocate resources for the board cycle. It’s mutually agreed as to what information is required and when it will be delivered. I’ve seen startups over the years that give the board pack to directors on the night before the board meeting. Or provide a quickly written, short board pack because management is too stretched.”

Woodthorpe says directors from large organisations should consider how they can tailor governance processes to the startup. “You can’t slow down the startup with layers of reporting and governance structure. You need to ask what the board can do to fulfil its compliance requirements while freeing up as much time as possible to focus on the opportunities and challenges that matter most to the venture. It’s all about balance.”

Pushing back on poor board information

Theo Hnarakis FAICD, chair of ASX-listed companies Crowd Mobile and DropSuite, says directors must resist giving too many governance concessions to startups. Hnarakis is a former CEO of Melbourne IT and one of Australia’s most experienced directors with startup tech companies and boards.

“If a small listed tech company is changing its business model every six weeks, it frankly shouldn’t be listed,” he says. “The venture should probably be private and have an advisory board rather than a formal board of directors. Once the venture is listed, it must expect to have a more formal governance structure and provide more information for the board.”

Hnarakis says startup boards must be clear on the venture’s strategy and its performance levers. “Then you work backwards to structure information in board packs. If you know business development is a key driver of the organisation at this stage in its lifecycle, you have more information on that in the board pack and extra time for discussion on that topic."

Startup boards that Hnarakis chairs have a heavy focus on sales. "It depends on the organisation, of course, but boards I'm on spend a significant amount of the meeting discussing sales targets and prospects, conversion rates and sales timelines. Directors of large companies might not be used to discussing things in this detail in board meeting or being as hands-on."

Hnarakis says 50-100-page board papers are appropriate for startups (some large organisations have board papers from 500 to 1000 pages). His board packs require a CEO summary, reports from division chiefs in the organisation and financial information with an emphasis on cash flow. The CEO presents to directors on the venture's highlights and challenges during the board meeting.

He says about 90 per cent of the board meeting is on strategy/performance: 10 per cent on compliance. A typical board meeting runs for three hours in organisations Hnarkis chairs. In addition, he has a weekly or fortnightly call with the CEO and updates the board as needed.

"You can't bog the venture's management team down in long meetings. Even three hours can be a big-time investment for a CEO who is running a high-growth venture with stretched resources. Startup boards must add value to the CEO and not just be there for compliance."

Hnarakis says startup chairs must manage information requests from directors. "You don't want a director who wants to be seen to be doing a good job asking management for information that is not critical. I ask if this request is a 'must have' or a 'nice to have'. If it's not essential, the chair should push back on directors so that management is not distracted."

Validating information from the founder/CEO is equally important, says Hnarakis. "Obviously, you must trust the CEO, but you can't view all board information only through the CEO's eyes. You have to eyeball the rest of management and encourage other executives to give honest feedback about company performance, even if the CEO does not always like it."

Hnarakis adds: "The board must be satisfied it is getting enough information to make decisions, in the context of a startup. If the board feels uncomfortable it should push back on management and say it can't make the decision until it has the information it requires. Directors cannot and should not make decisions on the run, just because it's a startup."

CHAPTER 10

Boards of the future: A deeper exploration

Are directors too busy?

Tony Featherstone
31 August 2018, "Are directors too busy?", *Company Director*, September 2018, AICD.

Proposed guidelines may limit directors with multiple board roles.

Deborah Page AM FAICD is used to juggling a busy board portfolio. Over a long governance career, she has typically served on four corporate boards and a not-for-profit at once. Page says these multiple directorships have expanded her board skills and experience by exposing her to diverse issues. It has also built her director intuition.

"As the chair of audit and risk management committees, I get exposure to different audit firms and consultants, different management and financial reporting, and different approaches to risk management frameworks and risk appetite statements," she says. "What I glean from one corporate's issues or emerging trends puts me on notice for others. My work with a technology company, for example, assists my input into tech developments and challenges across other roles."

Page is a non-executive director of investment managers Pendal Group, the financial technology specialist GBST Holdings, network services supplier Service Stream and building materials producer Brickworks. She also chairs their audit and risk committees.

If Australia follows international trends, market pressure or regulation may see non-executive directors holding fewer board seats.

The trend towards directors holding fewer roles is well established. The majority of directors of ASX 200 companies do not hold a second board position at a company on the index, according to AICD data from the end of March this year. Of the 1193 directors of Australia's largest listed companies, only 230 held another ASX 200 role with the average number of board positions standing at 1.26.

Corporate crises overseas and in Australia's financial services sector have reignited the debate on director 'overboarding', a term used to describe directors who have too many roles. As governance workloads increase, investors need to know directors have enough 'flex time' for unexpected events.

Although there is actually no prescribed limit, a maximum of three to four board roles (in larger listed companies) or two chairmanships seems to be the current market expectation. “The workload required for any board position will vary depending on the organisation and its complexity, and may change over time with circumstances. It is incumbent on each individual director to decide whether they have sufficient time to devote to a role — whether they hold one or several — to fulfil their duties and responsibilities,” said Louise Petschler, AICD General Manager Advocacy.

Proxy advisory groups have guidelines that assess director workloads on the number of board roles but they are problematic because they do not consider each role’s complexity or a director’s skill, experience and capacity to serve on multiple boards. Page describes blanket guidelines on director workloads as “absolutely too simplistic and, frankly, insulting”.

Measuring workloads

This lack of detail has led Diane Smith-Gander FAICD, a Wesfarmers and AGL Energy non-executive director, to raise the idea of introducing a points system to assess board workloads (such a system operates in The Netherlands).

Smith-Gander told the AICD Governance Leadership Centre in June, “The problem with current guidelines on overboarding is they are based on raw numbers. A more nuanced points system could account for differences in the complexity and workload of different board roles across sectors and include any executive-style work.”

Such a system weighs directorships by size and complexity. It would provide an opportunity for directors to talk to the chair about their points profile and help investors compare board workloads across companies. However, others say a points system would be tough to enforce and not resolve workload ambiguity, arguing the current system, which relies on the board’s chair using their judgement to identify overstretched directors, is adequate.

The problem is that both boards and investors tend to be reactive on director workloads. A proxy advisory firm, for example, might single out the board of an underperforming firm and express concerns about overboarding, typically behind closed doors. However, it is not until there is a performance issue or a crisis that the issue flares.

Ed John, ACSI’s executive manager, governance engagement and policy, says institutional investors want to know directors have enough time if a crisis emerges. “A director who has several listed-company board roles might be doing a good job, but what would happen if a major issue struck at one or more of those companies? Would he or she have capacity to spend a lot more time on each role?”

ACSI only recommends against the re-election of directors where performance issues arise, he says. “When it’s clear the board has missed key issues, we examine director workloads. That said, the director community generally has been reducing the number of board seats held, on average, and listening to market concerns on this issue.”

The risk of director overboarding is clearly on the minds of researchers and regulators, as well as investors. In 2017, US researchers Stephen Ferris, Narayanan Jayaraman and Stella Liao found that 70 per cent of worldwide firms in their study had "busy directors" and that the corporate world viewed such directors as "ineffective". Their Georgia Tech research paper *Better Directors or Distracted Directors? An International Analysis of Busy Boards* identified that firms with busy directors had reduced profitability and their boards tended to add less value.

Jeremy Kress, who lectures in business law at the University of Michigan, argues that busy directors could cause the next global financial crisis. He says the drawbacks of director busyness are most severe for boards of large financial services organisations. His research *Board to Death: How Busy Directors Could Cause the Next Financial Crisis*, published this year in the Boston College Law Review, shows directors with many outside commitments are less inclined to participate actively in corporate decision making, less likely to challenge management and likelier to miss board and committee meetings.

Kress wants US proxy advisory firms to implement stricter overboarding thresholds for directors and for US regulators to model director workload rules on European Union reforms that limit outside employment and board seats for financial services directors.

Martin Lawrence, of proxy advisory Ownership Matters, believes the Australian Prudential Regulatory Authority (APRA) could introduce similar directorship limits in financial services. "I suspect we are not far from having such a rule for boards and APRA-regulated entities."

Nature of governance

The issue of overboarding is about more than directors having enough time to fulfil their duties and earn their fees. The debate strikes at the heart of governance.

In the UK, the recently released Corporate Governance Code states that full-time executive directors should not take on more than one non-executive director appointment in a FTSE 100 company or other significant appointment.

APRA's April 2018 report on its prudential inquiry into the Commonwealth Bank (CBA) has heightened fears that boards are being pushed towards a quasi-management role. The report made it clear that Australia's financial services regulator expects boards to dig deeper in organisations. It implies that boards should have more of a hands-on role, but that's something boards of large organisations may want to avoid. A blurred line between management and directorship can distract the executive team and reduce board effectiveness and independence.

There are other issues, too. Would directors holding fewer roles, and spending more time on each, hurt independence? Should directors be paid more if they must hold fewer roles? Would the talent pool of experienced directors shrink if they had to hold fewer roles and have less access to the intellectual, career and financial benefits that multiple directorships provide? And is the push for directors to hold fewer board seats simply ill-judged in this era of digital disruption? As industry boundaries blur, having directors who govern across sectors and can join the dots on trends is vital.

Page says the market should allow directors to use their judgement on workloads. In her 16-year governance career, Page has volunteered for dozens of not-for-profit committees and associations in addition to her corporate boards. Yet she still built a reputation for being one of Australia's most effective directors. The issue, she says, rests on a director's organisational skills. "Most directors are capable of weighing up all the likely demands, including travel, which each board involves and deciding what level of flex time they need.

Key attributes of a good director are as basic as being committed and well organised. A disorganised director who serves on lots of boards is one who will get into strife."

Lawrence puts it bluntly. "I've met directors who have four big board roles and, year after year, are across the detail and appear to make a strong contribution. I've met others where one board role is one too many. It comes back to a director's commitment and skill," he says. "The market should be grown-up on the issue and accept that we appoint senior people to boards and that we should let them decide on their workload."

Managing multiple board roles

Peter Hay FAICD has held numerous board roles in a distinguished governance career. He chairs Newcrest Mining and shopping centre specialist Vicinity Centres, both ASX 100 companies. Describing the push for directors to hold fewer roles as "nanny state stuff", Hay says, "I've regularly served on four boards at a time and sometimes served on committees on all of them," Hay says. "It's entirely feasible for directors to have four corporate board roles and a few smaller not-for-profit roles and still have enough spare time if they have to govern in a crisis."

A non-executive director with four board roles on ASX-listed companies might spend 40-plus days on each in a year, although there is no hard rule. That leaves time if the director needs extra days to govern in a crisis, provided he or she is not loaded up with executive or other roles.

Over 30 years of serving on boards, Hay recalls only a few occasions where he thought a fellow director was not pulling their weight. "Directorship is a serious role and people who take it on tend to be serious, responsible people who do the work."

A former CEO of law firm Herbert Smith Freehills, Hay scoffs at suggestions that directors who have multiple board roles lack time to govern in a crisis. "As a mergers and acquisitions lawyer, I regularly worked on two or three big deals at once. To suggest experienced directors cannot be across multiple boards and issues at the same time is patronising."

Investors risk being distracted by simplistic director-workload metrics, he says.

"On a board, all directors have a strong interest in ensuring there are no passengers. That's by far the best regulating mechanism for director workloads. While it is legitimate for investors to ask questions about workload, the questions should recognise that boards self-regulate pretty well on this. A good chair quickly knows if a director is not putting in." Hay has reservations about corporate executives serving on boards of companies in unrelated industries, an emerging trend in the past decade as boards encouraged the CEO and/or CFO to gain governance experience. "If you are the CEO of a large listed company, I can't see how you can find time for 40 or so days for a non-executive directorship."

Nora Scheinkestel FAICD is another of Australia's most experienced directors and has served on more than two dozen boards over 25 years. She is chair of toll-road developer Atlas Arteria and a non-executive director of Telstra Corporation, energy company AusNet Services and OceanaGold Corporation.

"Directors have to use their judgement as their capacity for work will differ with individual attributes and life circumstances," says Scheinkestel. "You do, however, need enough flex time in the diary when things go pear-shaped, so you have capacity to scale up involvement. Serving on multiple boards makes me a better director. You get breadth of experience and see issues in a different context that helps you with breakthrough thinking. Why should people at the prime of their career idle along in second gear? While a portfolio of non-executive director roles pales into insignificance compared to a senior executive's salary, directors want a portfolio that equates to a reasonable income for the work and liability attached."

Peter Hearl FAICD, a director of Santos and Telstra, says it all comes down to time and attention that directors can pay to companies. "Not all companies are equal — some are complex, international — it's going to vary. The liabilities placed on directors these days, whatever company you are involved with, you really have to make sure that you are committed 110 per cent in time and energy."

Launa Inman MAICD is a non-executive director of Super Retail Group (BCF, Macpac, Rebel and Supercheap Auto) and commercial real estate developer Precinct Properties New Zealand, and a former Commonwealth Bank director. She says board workloads could increase after APRA's report on CBA and the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. "Most boards I am familiar with already work very hard," Inman says. "But I'm seeing directors generally spending more time reflecting on governance issues, challenging assumptions and questioning whether they have missed anything."

She says the market needs to assess the size and challenge of each board role rather than rely on one-size-fits-all guidelines from proxy advisors. "There's no doubt that directorships in the financial services sector, for example, have become more complex in the past few years and have higher workloads due to additional regulatory focus," she says.

Global proxy advisor Institutional Shareholder Services adopted a policy last year that lowers limits on multiple directors from six board seats to five. In addition, many US S&P 500 companies have restrictions on the number of board seats directors can hold. Although effective in reducing directorships (the average number held in the US has fallen to around three), the guidelines are a blunt tool. A director who governs two underperforming companies might be busier than another with four board roles. A director with decades of experience might eat multiple board roles for breakfast; an emerging director new to an organisation and its industry might have less capacity, but there is no allowance for these differences in guidelines.

Workload disclosure

Investors have scant data to assess director workloads. Listed companies disclose ASX directorships in annual reports. However, directors may hold other undisclosed but time-consuming not-for-profit directorships, consulting roles or academic positions.

The proposed new ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations* go some way to address this issue. If adopted, the guidelines would tighten the need for directors to "seek existing entity approval before accepting any new role that could impact upon time commitment expected of the director." [Recommendation 1.3]

The emphasis on "new role" would require directors to discuss with the chair how they would manage the extra workload and give chairs an opportunity to tell directors if another role would affect their current duties.

Disclosure of director effort is also problematic. The guidelines recommend ASX-listed companies disclose director attendance at board and committee meetings. That gives no indication of how many off-cycle board meetings directors attended, how many company sites they visited or other tasks completed.

The market is right to be vigilant on the risk of overboarding. Equally, the governance community is right to push back against moves to limit roles. Directors say only they, their chair and fellow directors can truly assess workloads and effort, and that boards should continue to self-regulate on this issue. But in a jittery market, investors want evidence rather than anecdotes.

CHAPTER 11

Moral and ethical decision making in the boardroom

Regulators must keep corporate boards on track: Graeme Samuel AC

Victoria Tilbury
31 January 2019, *Regulators must keep corporate boards on track: Graeme Samuel AC*, Australian Governance Summit Latest News, AICD.

Regulators have lessons to learn from the Hayne Royal Commission, which was a "massive wake-up call to corporate Australia", according to Professor Graeme Samuel AC. He was a member of the Australian Prudential Regulation Authority (APRA) inquiry into the Commonwealth Bank of Australia (CBA) and a former chair of the Australian Competition and Consumer Commission (ACCC).

What impact will governance failings revealed by royal commissions have on Australian boards?

At first, I think there will be an overreaction, leading to some people saying: "I can't do all this, it's just too hard." I think that's wrong. These discussions don't set a new benchmark for director duties and responsibilities — it's the same benchmark, they are just asking people to comply with it.

The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Hayne Royal Commission) and the Australian Prudential Regulation Authority's Final Report of the Prudential Inquiry into the Commonwealth Bank of Australia (APRA's CBA Report), together with the extensive media focus and discussion of these issues, is a massive wakeup call to corporate Australia and I think it will sit in people's minds — but only for three to five years. History has shown us that corporate memory is incredibly short. So, it is absolutely fundamental that the regulators are constantly reminding corporate Australia of their responsibilities and the need to take an unrelenting approach to failures to meet those responsibilities. Otherwise, lessons flowing from the Hayne Royal Commission and APRA's CBA Report will fade into forgotten history until the next crisis in confidence in our business organisations. I trust that the regulators will themselves learn some lessons from the findings of the Hayne Royal Commission. Regulators are to be respected, not liked. Regulators enforce the law and impose, often through the courts, appropriate penalties and remedies for non-compliance. If regulators are seen as being amenable to soft negotiations on these matters, they will inevitably fail to command appropriate respect and should not then wonder why they have failed to achieve compliance with regulations. After all, that is their fundamental remit.

What steps can a board take to improve performance?

In my view, the list of 30-odd recommendations from APRA's CBA Report is a very useful resource for any organisation's governance leaders. The report has been described by others as the bible for corporate governance — indeed as compulsory reading for all company directors and senior executives. I would provide a copy of the report to each board member and to each of the senior and middle layers of management. Ask each to read the report and to highlight in yellow the paragraphs they think apply to their own organisation. Then hand the marked-up copies to the chair and the CEO — anonymously, if you like. The highlighted paragraphs will provide a blueprint of issues that need to be addressed.

But to start with, you need a chair, a board and a CEO who are all willing to back this process and to encounter those issues. Their attitude and approach need to be: "We have an open mind and accept that we have areas requiring improvement. We accept the need to deal with these issues. We need to attend to rectification quickly and here's the way we'll do it." A legalistic or box-ticking approach to governance won't work. Frank and fearless discussion of issues that have arisen must be the way you reach solutions.

To your mind, what makes a board successful?

There are a number of attributes that I believe are extremely important for a leader — whether they are a director or a member of government. I put being a good director down to four Cs: commitment, conviction, courage and challenge.

A director cannot view the role as a sinecure. It requires a significant commitment of time, interest and insight into the affairs of the company. You've got to have the conviction that you know exactly what the organisation ought to be doing, both in financial terms and in terms of its relationship to its customers and the community in general. Then you need to have the courage of your convictions to be able to insist and stand up for what you believe is right. And most importantly you need to be prepared to challenge management and fellow board members if you have concerns as to any aspect of the company's activities.

When you don't have a combination of all four Cs, the result is a dulling of the senses, as was described in APRA's CBA Report.

Can we define what sort of commitment?

I have spoken of the C of commitment. This requires taking a serious interest in all aspects of the company's business that fall under your remit. If you are a member of a board committee — audit, risk or remuneration — recognise that this carries extra responsibilities of inquiry, examination and analysis. You can't rely on others, for example the committee chair, to undertake those responsibilities for you. And while adherence to legal responsibilities is vital, there is an extra principle to be applied to every aspect of the company's business — to apply the 'should we' test, rather than simply the 'can we' test. Consider society's expectations of your organisation. Finally, keep an eye out for dysfunction on your board: for example, that can be an over-dominant chairman, an over-dominant CEO with a weak chairman, an 'unholy alliance' between the chair and the CEO which tends to exclude the effective involvement of the board, extensive conflicts of interest, board factions, weak or inept board members. The culture and the processes of a board are extremely important.

Is it important to prioritise trust and ethics?

Rather than considering ethics as a separate issue, I think it's a parallel consideration that sits alongside financial performance — to ensure you deal responsibly and ethically with your customers, indeed all stakeholders, while delivering a good return for shareholders. Those two things aren't in conflict with one another.

In terms of considering corporate social sensibility (I deliberately don't use the word 'responsibility'), the Hayne Royal Commission and APRA's CBA Report are not about increasing the duties or the responsibilities of directors. I argue that they don't raise the bar of responsibilities at all. They simply restate what has always been the case. What the Hayne Royal Commission and APRA's CBA Report have revealed is a failure to meet the legal and community expectations of boards and management. Ethical considerations are an integral focus of a good board of directors and executive team.

Up for debate: Is it time to reassess director duties?

AICD
1 December 2018, "Up for debate: Is it time to reassess director duties?", *Company Director*, December 2018, AICD.

Following the Hayne Royal Commission revelations and APRA's CBA Report, leading directors discuss whether it's time to take another look at directors' duties.

Has the time come to take another look at directors' duties?

Charles Macek FAICD
Chair Vivid Technology, member International Governance Network

"The short answer is no. What we are seeing come out of the Hayne Royal Commission from a board perspective is that boards have not been as effective as they need to be. They have failed to execute their duties appropriately rather than not knowing what their duties are. Boards need to add value, and the way to do that is by supporting management to be the best they can be in executing the agreed corporate strategy whilst appropriately overseeing the associated risks.

Board effectiveness is the issue rather than the need to clarify or change director duties. Board effectiveness depends on the effectiveness of the chair, the board chemistry and culture, the relationship with the chair and CEO and the diversity of backgrounds and perspectives of directors. We have a long way to go in terms of board composition in this country."

Alan Kirkland MAICD
CEO CHOICE

"*The Corporations Act 2001* (Cth) (the Act) says that one of the primary responsibilities of directors is to act in the best interests of the company. That's commonly understood as maximising shareholder value. This in itself isn't surprising. People buy shares as an investment, so they expect a return in the form of dividends or an increased share price. We're almost all share investors, either directly or via our superannuation, so we all depend on the system delivering returns over time.

The Hayne Royal Commission, and the community reaction to it, has laid out the huge mismatch between community expectations of how banks treat their customers and the narrow definition of directors' duties in the Act. People expect businesses to act in their customers' interests, not to pursue shareholder value at any cost. That's even more important when the business is a major institution that portrays itself as a pillar of the economy. But we should not assume this expectation is limited to banking. We see a similar theme in community reactions to poor treatment of customers in other industries such as energy and health insurance.

Unless we set about redefining directors' duties, we'll continue to see breakouts of community anger and political intervention on an industry-by-industry basis. That will ultimately be much worse for shareholders and the economy. If you think about the damage to community interests wreaked by the likes of Volkswagen and AMP, you have to wonder whether they would've made the same decisions if their directors were required to focus on more than shareholder value.

Over a decade ago, the UK changed the law to make company directors think about 'enlightened shareholder value'. While they're still required to act for the benefit of shareholders, directors must now have regard for a range of other interests, including those of employees, customers and suppliers. They're also required to think about the long-term consequences of decisions, and the company's impact on the community and environment."

Judith Fox MAICD
CEO Australian Shareholders' Association

"*The Corporations Act 2001* (Cth) (the Act) does not state that directors and other officers must exercise their powers and discharge their duties in the best interests of shareholders, although case law has tended to grant primacy to shareholders' interests. The legislation states that directors have a duty to act in the best interests of the company. As it stands, the law generally links the corporate interests to those of the shareholders, and only derivatively with those of the community, consumers, employees and other stakeholders.

The Hayne Royal Commission has shown how the idea of corporate management seeking profit maximisation at any cost — under the guise of preferring shareholders' interests — can be at a cost to customers, which in turn has had a negative impact on the reputation of companies and directors, and the share price. Ultimately, shareholder interests were affected by the lack of consideration of the interests of stakeholders.

Given that many question whether the law and community expectations sufficiently coincide, there is strength to the argument that only a change to directors' duties will ensure that alignment. An amendment could be introduced to s 181 of the Act, which would permit directors to have regard to the interests of stakeholders other than shareholders. Providing a permissive clause in the Act to consider these interests would assist directors to consider other stakeholders in decision making, as directors may take the view that they could be breaching their duties to the company if they do this. These questions were examined in two inquiries more than a decade ago. Yet the debate as to whether the corporations law should change to have directors take account of stakeholders other than shareholders continues."

Kevin McCann AM FAICD*Life*
Former chair of Macquarie Group
"When I initially considered the Hayne Royal Commission interim report, I was concerned that non-executive directors of financial institutions were challenged because they had not managed financial risk effectively, particularly conduct risk. However, since reflecting on APRA's CBA Report, I have become more optimistic. With proper management of these risks, boards can fulfil their role of management oversight to ensure this will not occur on the scale revealed in the Hayne Royal Commission. It has been common for chairs and CEOs of financial institutions to claim misconduct was due to a few bad apples. It wasn't. The issues have been revealed as systemic.

High level 'sorry' statements are no longer sufficient. Chairs and CEOs need to make a full and frank admission of systemic misconduct, the reasons for this and the actions they propose to take to fix their problems.

APRA's CBA Report is a roadmap for better oversight and interaction between the board and executives. In future, boards will need to be proactive rather than reactive in the way they deal with legislative change.

Another issue is the workload of directors of financial institutions. In present circumstances, directors face a much broader range of responsibilities while banks work to implement programs to deal with issues the Royal Commissioner has identified. Cutting fees is not the way to go. Directors need to be paid to reflect the workload they have undertaken. If the directors of financial institutions are required to sit on fewer boards they need to be compensated for the additional workload they have taken on their bank boards."

Directors, is ethics on your board agenda?

AICD
29 July 2018, "Directors, is ethics on your board agenda?", *Company Director*, July 2018, AICD.

Five ways to start the conversation for your board of directors in the wake of the Hayne Royal Commission from Peter Collins GAICD, Director of the Centre for Ethical Leadership.

An ethics committee on every board

"We live in the midst of a multitude of ethical challenges facing businesses and boards. Some companies are grappling with very difficult ethical issues, yet if they fail to dedicate serious time they will miss the ethical dimension of same. For example, AI is here and organisations need to dedicate time to think their way through issues such as liability, the systems effects of job losses and the deeply complex issues around privacy. Businesses set up incentives schemes and talk of being committed to the best interest of their customers yet incentivise their employees to sell. It's an ethical trap set by the company, as it is almost impossible for a rational employee not to sell. So, it is worth getting your board to take a retrospective look. Count the hours in the past year that the ethics of the organisation was talked about as ethics, not as risk or as legal liability, at board level. Is it enough to work out the right thing to do? In addition, there are good grounds to have an ethics subcommittee, just as BHP has — in my understanding, the only company in the ASX 200 to have one. Just as in medical research, a committee of this kind allows deeper interrogation of the ethical dimensions of issues, and given how difficult some of these issues are, allows them to be dealt with thoroughly and in depth."

A part-time board model works against an ethical culture

"At the risk of being provocative, the part-time model of a half or full day for board meetings often deals well enough with finances but, as is evident in recent Royal Commissions, is clearly inadequate on issues of culture. Many cultural issues are buried well away from anyone's sight, and tools such as engagement surveys are inherently limited. Boards are the custodians of the culture and ethics of the organisations they govern. But boards generally commit insufficient time to probe deeply into culture. Really understanding culture takes a particular set of investigative skills, currently demonstrated by the barristers and others conducting the Hayne Royal Commission. Such skilled forensic probing could be a model for the way boards should operate. After all, boards can gain access to information in the company by right. If you held an in-depth board inquiry into your own culture using a Royal Commission approach, what would your board find? What would you be afraid it might find?"

Moral courage is not enough. You need the right systems

"Skilled ethical leadership from boards requires moral courage and the obligation to ensure that the right systems and processes around integrity are in place in a company. Some companies have systems to capture revenues, but not complaints, so they are missing invaluable data about how customers are impacted. Difficult issues such as sexual harassment and bullying need targeted processes so that the information is available on a constant basis to boards.

In a recent case involving an ASX company, when allegations of sexual harassment were made against the CEO, the head of HR said, 'Oh no, he's at it again'. Clearly, management knew, but one wonders if anything was written down anywhere that a board could find. Years of records tell you something, especially if such allegations occurred in previous workplaces. Processes also matter, deeply. If the Catholic Church had put in place mandatory reporting to police, how many thousands of children would have been spared the trauma of sexual abuse? Stress test your own systems and processes."

Ensure diversity is an ethical issue, not just about results

"Boards that reflect gender discrimination lack the ethical composition to deal fully with the kinds of ethical challenges that play out in businesses in Australia. The debate about diversity has been based on a shallow premise that what matters in diversity is greater productivity and better results. Discrimination of any kind, whether it be gender or race, creates the moral blindness that fails to recognise the gradual decline into unethical behaviour. Do a simple count of the number and percentage of females on your board and ask yourself what this signals to the organisation in terms of inclusion, diversity and unjust discrimination. Ask what message this gives to staff and the wider community about the culture you and your board are setting from the top. Diversity is about rectifying discrimination, not simply getting more profits."

Think like Aristotle

"Almost 2400 years ago, Aristotle said that ethics started with clarity of worthwhile purpose and that one should test one's actions against that purpose. Boards should be vigilant guardians of the way management stays true to the purpose of the company. Prior to that, make sure the company has one that counts.

In my view, boards can surely do worse than channel Aristotle and make sure we act to stop the overwhelming pattern of ethical failure as evidenced by the Hayne Royal Commission. For Aristotle, integrity was a habit. It's time for all of us to practise even more."

CHAPTER 12

The innovation imperative

Governance innovation needed for higher board performance

AICD
20 December 2018, *Governance innovation needed for higher board performance*, Governance Leadership Centre, AICD.

New thinking on past issues and future action should be top of directors' minds.

When asked what impedes board performance, directors nominate usual suspects: an overemphasis on compliance rather than strategy; poorly structured and facilitated board meetings; and overly long, complicated board papers.

Few could argue these and other recurring governance obstacles have been resolved. As boards streamline their processes, extra regulation and rising governance expectations are adding to compliance, board meetings and board pack length.

Company director and governance consultant Anne Skipper AM FAICD, says the core problem is lack of innovation in board processes. "If you look at the typical board meeting and board pack, it's about directors analysing information from the past. That's important, but so too is boards structuring time to think about what's ahead."

Dr Vince Murdoch, a governance consultant, says boards must be bolder with change if they want to lift performance. "Extra regulation and industry disruption are not going away. On the one hand, boards face greater compliance because of heightened community expectations and government regulation. On the other, they need more time to focus on strategy because of industry disruption. It's a hard balance to achieve."

Murdoch adds: "Finding ways to streamline board meetings or board packs is needed, but it is 'low hanging fruit'. When one considers the many challenges facing boards, it's obvious they need to be more innovative to maintain or enhance their performance."

Here are eight ideas to drive governance innovation.

1. Different governance models

Murdoch believes boards could consider aspects of Netflix's governance model, where directors attend senior management meetings throughout the year and board presentations are structured as online memos with links to supporting information.

Netflix's goal is to increase transparency among the CEO, executive team and board — an approach that is working, judging by the US entertainment giant's success this decade.

"I doubt that Australian boards are ready for the Netflix model, but it has merit," says Murdoch. "It addresses one of the great problems affecting board performance: directors having far less information than managers and limited exposure to the firm's day-to-day activities. Finding ways to engage directors more in the firm, without encroaching on management, has value for boards that want to lift performance."

2. Board and management interaction

Murdoch has coached boards on how to ask questions of management. Separately, his firm has coached executives on providing information to boards and liaising with directors. "We assume directors know how to ask questions of management, and executives know how to get the best from the board. But problems in this relationship often detract from board performance."

Executives can think they are being 'interrogated' in board meetings and fear the governance process amid intense regulatory, investor, media and community scrutiny of organisations, says Murdoch. "Boards are under rising pressure to challenge management on issues and the risk is board meetings start to feel more combative than collaborative. And that executives become more defensive and less open with the board."

Murdoch says improving board/management interaction is an under-recognised opportunity. "In one case, we coached management on how to prepare information for the board, present it and respond to director questions. Board productivity increased markedly. Management also felt better about the process because directors had been coached on how to ask questions and get more value from the information."

He recommends executives move from a 'presentation mindset' to one of discussion facilitation in their board interactions. "We have always thought about executives presenting to boards whereas perhaps we should be considering executives as the stimulus for a discussion with the board. Directors complain when they've already read the paper and executives proceed to present what's in the pack. If we allow ourselves to think about it as a discussion, executives and directors can more fruitfully debate the vital issues and the board can use the additional time to reflect and determine their view. It can be a lightbulb moment when executives view board interaction differently."

3. Board meeting cycles

Murdoch says more boards should challenge traditional thinking about meeting cycles. Instead of having, say, 10 meetings a year, a listed company board might move to a quarterly cycle with each meeting running two or three days. Key committee meetings, such as for audit, would stay monthly and the main board could have shorter meetings as needed.

"The current cycle of monthly meetings puts directors and managers on this never-ending cycle of board-pack preparation and meetings," Murdoch says. "Consider a 1,000-

page board pack for a bank board: directors probably expect the pack at least a week before the meeting; the CEO needs to see it a week before directors; managers need to write their part a week before the CEO gets it; and the company secretariat starts on it a week before that. It's quite possible that next month's board pack is being written before the current board meeting has occurred."

Murdoch says fewer, longer board meetings would help directors conduct 'deep dives' on issues and have extra time to meet stakeholders in the field. Quarterly board meetings could be held at different company locations and would take pressure off management to prepare board packs. They would also give directors extra time to digest information.

"Quarterly meetings would not suit all boards and I'm not suggesting boards would not meet monthly in other formats" he says. "Or that quarterly meetings would reduce director workloads, although one could expect a rise in board productivity. But too many boards and executive teams are on a 'hamster wheel' of monthly board meetings and packs because that is how it is always done. Something needs to change."

4. Board packs

Murdoch says board packs remain one of the biggest frustrations for directors and a key factor inhibiting performance. Directors complain that packs are long, too poorly structured, information dense and do not adequately facilitate discussion and decision making.

"The typical board pack is written by several authors, such as division heads, and often lacks a coherent narrative and flow. This is a big problem because the board pack is still the main information source for directors. If the pack is too long, incorrectly structured or has the wrong information, directors have a distorted lens and their decision making and performance suffers."

Murdoch says boards should rethink how they receive information. "Board packs are generally already too long and getting longer. It's not enough to keep pruning the pack because more information is being added as new regulations emerge. One wonders how directors can read, let alone contemplate, board packs that are hundreds of pages long each month."

5. Forward-looking focus

Anne Skipper says boards must find more time to focus on emerging issues and trends. "Industry is changing so quickly. It's critical that board processes enable directors to think how about their organisation and industry could be disrupted or enabled by technology."

Skipper chairs Silver Chain Group, a not-for-profit in the healthcare and aged-care sector that is known for innovation. She is also a director of People's Choice Credit Union, chair-elect of the Future Ageing Co-Operative CRC and chair of Principal Australia Institute.

"I structure up to an hour-and-a-half at the start of Silver Chain meetings for directors to discuss disrupters to the organisation and what the future could look like," says Skipper. "Compliance is critical, but I want the board to be forward looking and strategy focussed. You cannot drive board performance if the focus is mostly on compliance and the past."

6. Information flows

Skipper says the traditional approach of directors getting a board pack each month that collates information, which might be several weeks old, is too slow. "Boards must find ways to ensure they have access to real-time information that is constantly updated. They should be able to contribute to the information, not just rely on what management provides them."

She favours the ideas of interactive board information. "Rather than board packs being sent to directors when they are done, there could be a central repository for this information and sections of the board pack made available when they are completed. In this way, the board pack becomes a living, breathing document that management and directors can add to, rather than this voluminous pack that directors have to grind through. And directors can read this information throughout the month, rather than only in the days before the meeting."

7. Decision-making frameworks

Clearer guides to enable decision making could enhance board performance, say Skipper. "You don't want to be too rigid or have a one-size-fits-all criteria, but I do believe a well-considered framework can improve board decision making and performance."

She adds: "A good framework can help directors test if a management recommendation will make the organisation more efficient or profitable. And whether that decision aligns with organisation culture and values and stakeholder expectations. There's been too many instances of boards approving management recommendations to grow revenue, without testing whether it was the right kind of revenue growth and if that growth was sustainable."

8. Governance pop-ups

Skipper says the main board and its committees risk being too structured as markets are disrupted. "We need to find ways for directors and management to work together to explore emerging issues and trends, without adding yet another permanent committee or board task."

Skipper likens this process to a pop-up store that opens for a short time and achieves fast outcomes — an idea she gleaned from a fellow board director and governance consultant who uses this technique with startups and new business ventures. "A board might form an innovation taskforce to investigate an emerging threat or opportunity for the organisation and work with management. The taskforce reports back to the main board on the project and is disbanded upon completion."

Working groups on boards are not new and many boards are reluctant to add another permanent committee to address emerging issues. Nevertheless, Skipper believes boards are missing an opportunity around working groups as a structure to examine emerging issues.

Innovate before it's too late, warns economist Mariana Mazzucato

AICD

1 December 2018, "Innovate before it's too late, warns economist Mariana Mazzucato", *Company Director*, December 2018, AICD.

To future proof an organisation Mazzucato recommends an immediate long-term, investment-led growth strategy based on innovation.

Act now to rethink the direction of company growth and address important societal challenges because an increasingly unstable society is bad for business, advises Professor Mariana Mazzucato, founding director of the Institute for Innovation and Public Purpose at University College London. The future of health systems, economic inequality and "the biggest challenge, climate change", are among the issues worth tackling.

Visiting Australia in December, Mazzucato has advised policy makers around the world on how to achieve smart, sustainable and inclusive growth.

In Mazzucato's 2013 book *The Entrepreneurial State: Debunking public vs private sector myths*, she argued that the contribution of governments to capitalist economies has been wildly understated.

This year's *The Value of Everything: Making and taking in the global economy* also made a splash when she challenged the meaning of 'value' in Western economies, questioning the elements included in GDP calculation and corporate activity that she argues amounts to value 'extraction' rather than the 'creation' it purports to be. One instance of this is when publicly listed companies use profits to fund share buybacks, boosting stock values rather than for capital and other reinvestment to strengthen and grow the business.

"My work puts just as much emphasis on the direction of growth as on the rate," she says. "There was plenty of growth just before the GFC, but it was problematic and led in many countries by consumption that was fuelled by private debt."

The reinvestment she's advocating may not instantly appeal to boards, but Mazzucato is blunt. "I'm talking to those companies interested in long-run growth, not short-term profits. If that's [short-term profit] your strategy, then none of what I'm talking about makes any sense." However, she says, "it's not about being anti-shareholders, it's about how to position shareholders as being one of the many constituents in a company that will be important. Maximisation of shareholder value is a really faulty concept because it dismisses all the other value creators."

She says our system accepts that shareholders are the only value creators, but declares it a myth she is eager to debunk, together with the assumption that shareholders are the biggest risk takers. "That's completely wrong, no-one has a guaranteed rate of return," including employees "who might start working in the company under the assumption they will have a lifelong career — there's definitely no guarantee there."

Mazzucato believes there is potential in the cooperative model, citing UK retailer John Lewis, where as a staff member "not only are you getting a share in the profits but you are invested in the company as a value creator".

Another business at the forefront of innovation-led growth is German industrial manufacturer Siemens AG, which this year won a £1.5 billion UK government train contract, prompting domestic outcry in the UK. "The real question is what led to Siemens being able to produce fast, smart and green trains," says Mazzucato. "They were part of a much more dynamic and innovative ecosystem in Germany."

Siemens is a beneficiary of the entrepreneurial systems she favours, which should be co-created and fostered by government, to stimulate innovation from the bottom up, while also working top-down in collaboration with business, to frame and realise bold 'missions' involving multiple sectors and disciplines. The 1960s moon mission, for example, involved sectors as diverse as nutrition, footwear and textiles, as well as engineering and technology.

"Reputation is part of the way you create value, part of your theory of value for the company." Mariana Mazzucato

While ameliorating climate change is the modern equivalent, Mazzucato opposes defensive thinking. "We should be seeing them as opportunities… asking what it really looks like to have an investment program guided by industrial strategy or innovation policy that is creating a green direction for a country," she says. "It should not just be about renewable energy, every single sector can be greening itself."

That attitude is also crucial for individual companies and in all aspects of the business. She advises that reputation must also be constructed as part of a long-term growth strategy. "It has to be seen as relationship-building with citizens and stakeholders," she says.

"Reputation is part of the way you create value, part of your theory of value for the company."

Corporate social responsibility cannot just be bolted on or confected. "Not, what should I not do wrong so I don't get a bad reputation? But what can I do right and what does right mean?"

Emphasis should be on transforming the value chain across all areas, from wages and the working environment to government relationships. For example, British-Dutch consumer goods giant Unilever "has been very important with Paul Polman's leadership making a company that has a real responsibility towards rethinking its value chain in a sustainable way".

So how might a director seek to influence their board when a business as usual mindset is enduring? Keep restating the issues, be brave and stand firm. "People nowadays really respect that bravery," she says. "Sincere rethinking and repurposing of yourself can be really important — [and] how you organise yourself. It's going to be really important for your ability to create the next wave of opportunities for future growth and profits."

She poses three questions for directors to reflect on:

- What does value really mean to our organisation?
- Are we investing and reinvesting in our people and business for the long-term?
- What is our bold mission?

Pay attention to climate change risk and opportunity

AICD
1 September 2018, "Pay attention to climate change risk and opportunity", *Company Director*, September 2018, AICD.

Boards of directors should consider reviewing their governance, strategy, risk management and metrics as climate risk integration becomes mainstream.

Climate change has evolved from a 'non-financial, ethical, environmental' issue to one that presents financial risks (and opportunities) within mainstream investment horizons. Mainstream investors and corporate regulators are beginning to demand a step up in climate risk fluency from directors and more meaningful disclosures in annual reports, particularly for listed entities and those with material exposure to climate risk.

In its February 2018 *Regulation of Corporate Finance* report, the Australian Securities and Investments Commission (ASIC) asserted that "environmental and other sustainability risks (including climate risk) generally require a proactive approach to strategy and risk management". ASIC Commissioner John Price has flagged the authority would review this year's annual reports to monitor how companies across the ASX 300 index were disclosing information on the matter.

The Australian Prudential Regulatory Authority (APRA) has signalled it is paying attention to the issue in its supervision of APRA-regulated entities.

Recommendation 7.4 of the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations*, 3rd edition, concerning sustainability disclosures, refers to "environmental and social risks" and proposes that listed entities with material exposure to climate change risk be encouraged to consider implementing the recommendations of the Financial Stability Board (FSB) Task Force on Climate-related Financial Disclosures (TCFD). The FSB brings together senior policymakers from the G20, plus Hong Kong, Singapore, Spain and Switzerland to strengthen financial systems and increase the stability of international financial markets.

In March, the federal government welcomed the final report of the TCFD as a framework consistent with the existing disclosure requirements in the *Corporations Act 2001* (Cth) for investors and companies to assess and price climate-related risk and opportunities. It's an approach that is particularly relevant for large listed entities with material climate risk exposures.

Leading market stakeholders have begun to recognise that issues associated with climate change present significant economic and financial risks and opportunities over long-term and shorter-term investment horizons. Such risks and opportunities arise not only from the physical or ecological impacts of climate change but associated economic transition risks such as capital market dynamics, including technological developments, and shifting investor, insurer and customer views, and litigation exposures (regulatory and private).

Paris accord

The primary catalyst for this evolution in mainstream market concern is the UN Paris Agreement on 12 December 2015. It represents a commitment by the governments of 197 signatory countries to a goal of limiting the "increase in the global average temperature to well below 2°C above pre-industrial levels" and to pursue "efforts to limit the temperature increase to 1.5°C above pre-industrial levels" — and, perhaps most significantly, to shift the global economy to "net zero emissions in the second half of this century".

In order to meet the Paris goals, each country will need to significantly reduce its "business as usual" emissions, while the global economy, which has been heavily reliant on fossil fuel combustion since the industrial revolution, will need to transform, at scale and with speed. The impacts are likely to be felt across all asset classes and industrial sectors, in particular by carbon-intensive industries.

Taskforce recommendations

In June 2017, the FSB released the recommended framework of the TCFD for climate risk governance, strategy, risk management and disclosure by financial sector participants and the corporations they invest in. The TCFD was charged with the development of "voluntary, consistent climate-related financial disclosures" that would be "useful to investors, lenders and insurance underwriters in understanding material risks".

Its recommendations purport to provide guidance on those forms of financial analysis and disclosure likely to be necessary for corporations to present a true and fair view of a company's financial position in terms of performance and prospects. They place specific emphasis on forward-looking disclosures and the impact of climate change on corporate strategy, recognising climate change presents prospective issues "without historical precedent". Accordingly, they emphasise the importance of scenario planning in corporate strategy and planning, including for the Paris Agreement's goals.

What Australian regulators say

In October 2016, the Centre for Policy Development and Future Business Council published an opinion by Australian Bar Association President Noel Hutley SC. He concluded that, as a matter of Australian law, directors 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* (Cth). In the past 12 months, corporate regulators have echoed his conclusion that climate change should be integrated into Australian directors' governance and disclosure agendas, approaching climate change through a financial risk and opportunity lens.

What directors should do

The scale of the shift in thinking, the scope of the issue and the inherent uncertainty involved in stress testing and scenario planning can be daunting for corporations unaccustomed to considering climate change through a financial risk and opportunity lens. Although each case will be determined on its merits, many investors and regulators want assurance that boards understand the relevant risks and are actively considering their implications for strategy and financial planning, even if only at an early stage. Suggested first steps include:

Mechanisms for board oversight

The board, C-suite and finance team should be briefed on the contemporary climate risk landscape, and ensure a mechanism is in place for board oversight, as with any other financial risk.

Risks management

Consider how climate change presents risks and opportunities for companies in your sector. Guidance from the TCFD and the Sustainability Accounting Standards Board can be useful here.

Implications for strategy

Consider how those risks manifest for the unique business, and their implications for current strategy and risk management.

Scenario testing

Stress test business plans against a plausible range of climate futures. At a basic level, your board and executive team should ask: "How will our business thrive across a range of potential climate futures in the short, medium and long term?" What is your strategy regarding strong near-term action (which accelerates economic transition risks) versus business as usual (which accelerates physical impact risks, delaying sharper transition)?

Climate change cannot be consigned to a corporate compliance, public relations or social interest silo. Its impact on balance sheet items and forward-looking risk strategy must be reconsidered in an integrated manner in the light of contemporary economic realities. This is critical for directors who sign off on financial accounts and narrative managerial statements, as well as accounting and risk advisors. Failure to do so may place significant shareholder value at risk.

CHAPTER 13

The power of inclusion: Unlocking the value of doing the right thing

Demonstrating the value of inclusion and making it happen

Jill Hannaford
Technical Services Leader, Australia, GHD and Non-Executive Director, Bridge Housing Limited

In the last 10 years I've seen a dramatic increase in industry recognition of the importance of diversity and inclusion in the workplace. For a while I was concerned that the rhetoric was greater than the reality, but pleasingly and quite rightly, thanks to the efforts of many passionate individuals, industry associations and organisations, policy initiatives and strong research, the issue has attracted widespread commentary and public attention. We are now seeing great programs and activities that really do make a difference to an organisation.

An abundance of data demonstrates the benefits of inclusion, to the point where poor performance in this area has been shown to have a significant impact on profitability and employee engagement and retention.

For example, McKinsey reports that companies in the bottom quartile for both gender and ethnic/cultural diversity are nearly 30 per cent less likely to achieve above-average profitability than other companies.[4]

It's also well documented that creating a diverse and inclusive environment where people feel comfortable to share all aspects of themselves, helps cultivate diversity of thinking, which in turn enhances an organisation's potential for creativity and innovation. In my family for example, I have two recent high school graduates and they have both discussed purpose with me. Purpose in terms of what they will study but also purpose in their part time work and social activity; they speak about legacy and impact, and inclusion is at the forefront of this.

[4] V Hunt, L Yee, S Prince and S Dixon-Fyle, 2018, *Delivering through diversity*, McKinsey & Company, January, https://www.mckinsey.com/business-functions/organization/our-insights/delivering-through-diversity, (accessed 18 January 2019).

Genuine inclusion has been proven to deliver greater productivity, creativity and diversity from deeper pools of talent and fairer processes for all.

The firm I work for, GHD, recognises this and its response aligns closely with its stated purpose — to create lasting community benefit. The projects we deliver, such as water treatment systems, transport linkages and social infrastructure, are a daily reminder of the positive impact we can make on communities.

While we have by no means addressed all the challenges or completed our journey, I'm proud to say that at GHD we have embraced thoughtful and deliberate discussion, trialled some programs and partnerships and taken action to cultivate an inclusive environment.

From a recruitment perspective we understand that by meeting candidates' diversity and inclusion expectations we get stronger applicants and better employees. Good practices don't just bring employees in the door, they encourage them to stay.

A study of Australian employees conducted by the Victorian Equal Opportunity and Human Rights Commission in partnership with Deloitte[5] found that employees in inclusive environments were 83 percent more productive than those in monocultural environments. The study found that employee innovation levels increased by 83 per cent when employees felt included in the workplace.

And from a client perspective, the same report also indicates that when diversity is recognised and employees feel included, they have a better responsiveness to changing customer needs.

The why for me

While it's great to reflect on such data, personal stories and experience are even more important. So I'd like to share my story.

I am a non-engineer who started my working life in a technical engineering organisation where my qualifications and ways of thinking were not the norm and I was one of very few females. I was fortunate that my 'differences' were appreciated and I was listened to. It did make me think and focus on difference and inclusion in the workplace early in my career.

As I went about working with engineers, scientists and planners on infrastructure projects across Australia I realised that there was much to do in ensuring that the infrastructure was not only understood by communities but also that it reflected the needs of the ultimate end users.

I reflected on my time at Griffith High School, in south western NSW, where cultural diversity was the norm and social disadvantage for members of the Aboriginal community was stark. I knew in my early

[5] Deloitte Australia, Victorian Equal Opportunity and Human Rights Commission, 2013, *Waiter, is that inclusion in my soup? A new recipe to improve business performance*, May, https://www2.deloitte.com/content/dam/Deloitte/au/Documents/human-capital/deloitte-au-hc-diversity-inclusion-soup-0513.pdf, (accessed 18 January 2019).

teens that the opportunities I would have, particularly in education, would not be afforded to the Aboriginal girl in my high-level English class.

Fast forward to my career and I understood how important infrastructure provision is to positive social and economic outcomes and how it could be better if the diverse groups of people that make up a community were involved in the concept, design, construction and operation. I hoped that social disadvantage could over time be improved through education and employment opportunities and through authentic inclusion. I knew that GHD would be a better place and the work we do would be better if we were more inclusive.

For many years I have sought to learn more about diversity and inclusion. I have found organisations that GHD could partner with and together we have built lasting relationships that have grown over time and we have learned from each other. In particular, through GHD I've formed close relationships with CareerTrackers, the GO Foundation and CareerSeekers, and we continue to work closely together.

I think it's important too as individuals to look for opportunities to contribute and contribute. In early 2018, I was privileged to join Bridge Housing Limited as a non-executive director. Bridge is an organisation that puts inclusion at the forefront. The community housing sector has an important role to play in our community. Being able to work with Bridge to support their Indigenous employment program and partnership with CareerTrackers and its Reconciliation Action Plan and other education and employment initiatives is important and rewarding to me.

To briefly summarise our approach at GHD, we've formalised our diversity and inclusion strategy which includes: enhancing gender equality, cultural diversity, LGBTI inclusion, generational workers, reconciliation with Aboriginal and Torres Strait Islander peoples and flexible working arrangements for our people.

Our approach has involved many conversations with our board who have listened attentively, been curious, willing to be challenged and influenced. From my perspective, our board has been bold and embraced inclusion and the benefits it brings to GHD. I'm proud to say that our board members have sought active involvement in the programs and initiatives that we have in place.

To achieve a more diverse workforce, we needed to do the foundational work to create the right environment for change. This includes process elements such as policies, procedures and frameworks to enable diversity initiatives, and complex elements of communicating objectives and building understanding within the organisation.

We're incredibly proud of the progress we've made to date, which includes:

- Increasing female representation in leadership positions. Women comprise 36 per cent and 44 per cent of our Australian leadership team and board respectively.

- Cultural acceptance of flexible working. We're proud to see a shift in the acceptance of men and women working flexibly as a way to balance work and life commitments. We are seeing more people who work part-time and flexibly apply for leadership roles. And as a single parent of four, I am one of them!
- Commitment to Indigenous Australians. Our continuing relationship with Aboriginal and Torres Strait Islander peoples reached a new milestone in 2017 with the launch of GHD's Reflect Reconciliation Action Plan (RAP) and in November 2018 we launched our Innovate RAP.
- A successful partnership with CareerSeekers, which creates employment opportunities for asylum seekers and refuges, many of whom have held professional careers in their country of origin.

On the last point, establishing partnerships and relationships with other organisations is critical. For example, through GHD's partnership with CareerTrackers and the GO Foundation we are able to mentor and guide Aboriginal and Torres Strait Islander university and high school students.

Many Aboriginal and Torres Strait Islander students are keen to give back to their community, but very few have thought of doing that through STEM. But that is possible when they know more about the infrastructure and utilities that they use every day. Through our partnerships with CareerTrackers and GO they can have a pathway, they can be supported and enabled. With the right partners, organisations like GHD can have a collaborative impact. We can't do it on our own but with others we can.

In closing this article, I'll deliberately avoid providing a checklist approach to encouraging inclusion. Every organisation is different, as is every board. However, I will share a couple of lessons gleaned over the course of my career.

First, it is very clear to me that it is tremendously powerful for the executive management to reflect the diversity sought. Inclusivity happens organically when you demonstrate diversity at the leadership level.

Second, making progress in this space is about much more than policy. We all know policy is important but it's daily actions, unconscious and conscious, that help cultivate the everyday experience for employees.

It's also about listening and asking questions. It's about acknowledging what you don't know and simply asking. Look for opportunities to foster open discussions and solicit input and feedback. In simple terms, be inclusive.

Inclusive governance: The GO example

Shirley Chowdhary
CEO, GO Foundation and Deputy Chair, YMCA NSW

In my previous life as a corporate lawyer, I never imagined that an aspirational not-for-profit like the GO Foundation would teach me what good governance and inclusive leadership could look like. But very early on in this role, I knew that it would be one of the most enriching experiences of my career.

The GO Foundation is the story of Adam Goodes and Michael O'Loughlin. Two proud, Indigenous men who, with their mate James Gallichan, had a dream. Together, they wanted to give back to their people through an organisation that would create opportunity and access — an organisation that at its core would live and breathe inclusion for all Australians, but one that would also have a deep commitment to strong corporate and financial governance.

That two Aboriginal men focused on inclusion is perhaps not surprising. But I am so proud that Adam and Michael intrinsically understood the value of good corporate governance in building their foundation. This led to the expertise and commitment they pulled together around our board table and gave GO such strong foundations.

It is testament to our strong foundations that ten years later, we are still committed to the highest levels of inclusion.

Inclusive corporate governance

I used to think that inclusivity in the boardroom meant more women or more multiculturalism around the table. Naively, I thought that inviting diversity to have a seat at the table was enough. My time at GO has shown me that inclusive governance can be so much deeper and so much more powerful.

The GO Foundation is committed to creating workplaces where Indigenous Australians can bring their authentic selves to work every day — workplaces where our students and families can be proud of who they are and of their heritage and where we can all share in the richness of our 60,000-year history. This extends to working with our partners to ensure that Indigenous culture is embedded in their organisation rather than a token gesture that is made during Reconciliation Week and NAIDOC Week.

Like most other boardrooms, our board meetings begin with an Acknowledgement of Country to show respect to the Traditional Custodians. We recognise that we live and work on land that always was and always will be Aboriginal land. Adam and Michael talk about how Elders on Gadigal land taught their children; they share stories of how learning was passed from generation to generation and they give thanks for the beauty of the land. They encourage the rest of us around the table to share the privilege of giving an Acknowledgement — not making it a tick-the-box exercise but instead making it a heartfelt recognition of who we are.

Our founders and Indigenous board members continue to guide us and give us a strong sense of who we are and how we are different to other organisations. Together with our Indigenous patron-in-chief, ambassadors and students, we are led by an Indigenous voice and I believe that we are far stronger for it.

Lived experience

When Adam and Michael established the GO scholarship program they wanted culture at its heart, a focus on public school education and a commitment to support students who lived at home, on country and in community. They wanted to expose students to Indigenous success stories and raise students' expectations of themselves. This 'wish list' was based on their own lived experience. Both eldest children of single mothers, Adam and Michael carried the weight of family expectations as they were growing up. Their gently persistent but relentless focus on inclusivity comes from the experience of being shut out and being told they weren't good enough.

In 2017, we commissioned KPMG Arrilla Indigenous Services to look into the correlation between further education and better outcomes for Indigenous students. What we found was fascinating. Further education has the potential to change so much — it can improve employment prospects, increase earnings potential, improve heath and wellbeing, reduce rates of obesity, reduce rates of suicide and incarceration and maybe even increase life expectancy for Indigenous Australians.

The research provided us with evidence for Adam and Michael's lived experience.

The future of corporate governance

I am so grateful for the trust that the board puts in me as a first-time CEO. Just as we are creating a safe space for our students to be themselves, the board created a space where I felt safe as the chief executive to create change, to listen to what the students wanted and to build a model of collaborative impact.

There is still a part of me that can't believe who I have the privilege to work with — visionary and committed founders, some of the most sought-after and experienced board directors in the country and GO Ecosystem (Ecosystem) partners who believe that our students will be tomorrow's leaders. Together, we have built an Ecosystem where there is deep understanding that good corporate governance does not exist without inclusive and respectful leadership.

We are all still learning at GO and we are always looking to improve what we do. We hold each other accountable in the GO boardroom and are prepared to admit when we could do it better. We have robust conversations that often take us to uncomfortable places — places that other boards might not go. But there is no doubt in my mind that there is immense benefit to an organisation and its beneficiaries when good directors and executives always have respectful inclusion front of mind.

The example that I live every day at GO gives me hope for the future of boards and management in Australia. It is my privilege to be the chief executive at GO but, as an Australian woman of Indian heritage, I am acutely aware that there are still not enough people who look like me in leadership teams or in boardrooms. If more organisations could truly embed the principles of diversity and inclusion, and ask themselves whether they are guided by these principles in everything they do, I think real change may be possible. If more boards can take our example and think in this way, our sons and daughters, regardless of cultural background or ethnicity, will all see themselves reflected in the faces of those who run corporate Australia.

Balancing purpose and profit through good governance

Tony Featherstone
24 August 2018, *Balancing purpose and profit through good governance*, Governance Leadership Centre, AICD.

B Corporation movement has implications for boards of emerging Australian companies.

Onya Life managing director Hayley Clarke was determined to achieve B Corp Certification for her venture. "There's so much 'greenwashing' these days from companies pretending to be environmentally friendly," she says. "We wanted independent certification to stand out."

Onya, a maker of reusable shopping bags, coffee cups and other alternatives for single-use plastics, embarked on B Corp Certification last year and achieved it in early 2018. "The certification process was incredibly rigorous, as it should be," says Clarke. "It forced us to think about every aspect of our business."

The Perth-based company is part of a new breed of Australian and overseas companies seeking B Corp Certification — a process that has implications for boards around corporate social responsibility and the delineation between commercial and social enterprises.

The B Corp movement began in 2006 in the United States through B Lab, a not-for-profit enterprise that certifies commercial organisations that meet high standards of verified social and environmental performance, public transparency and legal accountability.

B Corporation describes a B Corp Certified company as a new kind of business that balances purpose and profit, using business as a force for good.

B Corp companies are distinct from social enterprises, which intentionally tackle social problems. B Corps typically have a strong commercial imperative and social mission. They see no trade-off between these goals: high standards of corporate social responsibility are good for corporate profits, shareholders and the community.

B Corporation had certified 2,959 companies worldwide at August 2018, across 60 countries and 150 industries. The long-term goal is creating a connected global community of companies, business leaders and boards that help redefine the notion of business success. The B Corp movement, small in Australia, is growing quickly. The B Corporation website shows more than 80 certified Australian companies. Most are privately owned small or mid-size companies that typically have advisory rather than fiduciary boards of directors.

As B Corp develops greater awareness in Australia, it is likely that larger organisations will consider certification and that more boards will use it as a framework to better understand, maintain and govern corporate social responsibility standards.

Hayley Clarke says independent verification of Onya's approach is valuable. "Lots of companies say they do the right thing and are environmentally friendly, but how do you really know? Having our company's standards certified through a detailed process gives our customers, suppliers and staff peace of mind that we stand for something and do what we say we will."

Clarke says B Corp Certification has added to Onya's momentum. She and her partner bought Onya in 2015. At the time, the business was struggling. "We saw a huge unmet need for people to use responsible packaging in their daily life," says Clarke. "And an opportunity to build a profitable business that helps the community."

Onya's revenue has more than tripled under its new ownership. "We see no reason why you cannot become a large, profitable business, and do lots of good for the environment at the same time," say Clarke. That focus is absolutely fundamental to Onya's DNA."

Little Tokyo Two, a leading startup incubator, is also B Corp Certified. The Queensland for-profit venture is encouraging other firms in its rapidly growing community to consider B Corp Certification.

"Little Tokyo Two's ethos from the start has been about doing good for others," says founder and director Jock Fairweather. "We very much see ourselves as a commercial enterprise with a strong social mission. B Corp Certification is a way to put structure around that."

Launched in December 2014, Little Tokyo Two has grown to six sites and a community of hundreds of firms. Fairweather says: "B Corp is a really good fit for our community because we tend to attract fast-growing commercial ventures and social enterprises that believe that doing the right thing for stakeholders, the community and the planet is the future of business."

Little Tokyo Two began its B Corp Certification process last year. "It's not easy to get," says Fairweather. "We spent about a year working on our application and the certification process. We were already ticking a lot of the boxes, but the process made us think through our approach to corporate social responsibility (CSR) across all aspects of the business."

Fairweather says B Corp Certification provides useful CSR boundaries without being too prescriptive. "For example, it helps us put more structure around how we choose buildings that are energy efficient, our carbon footprint and what we give back to the community. In some ways, the certification sharpens your emphasis on long-term decision making and business sustainability."

Fairweather says the Little Tokyo Two advisory board, which consists of four directors and meets quarterly, supported the certification process. "If Little Tokyo Two can encourage other firms in its community to consider B Corp Certification, then we're helping the movement gain more traction in Australia and the B Corp community grow. That's a good thing."

Intrepid Group is among the larger Australian companies that have achieved B Corp Certification. The privately-owned travel group became B Corp Certified in August 2018.

Like others interviewed for this feature, Intrepid CEO James Thornton believes "greenwashing" is prevalent in his industry. "Lots of travel operators talk about the importance of responsible, sustainable business but do not always follow that up with their actions. Intrepid saw B Corp Certification as a way of demonstrating that our focus on responsible business is not just a marketing statement. It's something we live and breathe every day."

Thornton says Intrepid is using B Corp Certification as a continuous improvement process. "It took us three years to achieve the certification. During that journey, we introduced several initiatives: for example, an expanded parental-care policy and integrated financial report. The certification, in effect, became a health check for Intrepid that management and the board uses."

Organisation legacy is another benefit of B Corp Certification, says Thornton. "It helps secure Intrepid's long-term mission. If another CEO comes in tomorrow, Intrepid's corporate social responsibility focus will not change because we have the B Corp structures in place. We see the certification as a long-term investment in Intrepid's sustainability."

The hard work is paying off. Intrepid grew its revenue by 17 per cent to $341 million in 2017 and has 1,800 staff in 23 countries. The medium-term growth target is annual revenue of $400 million.

Intrepid intends to expand its fiduciary board to support future growth, adding two independent non-executive directors to its current three-member board (which includes two founders and Thornton). The board wants to add skills in digital marketing and finance.

Thornton says the board wants directors who understand the balance between commercial and social outcomes. "We really believe in business changing its focus from short-term profits to becoming a long-term force for good for customers, staff, the environment and shareholders. It's not enough for companies to say they are acting responsibly in their industry; they need to show it through independent verification and be accountable for it."

Good catch

Kath Walters
1 November 2018, "Good catch", *Company Director*, November 2018, AICD.

Culture change starts with new faces at the table and requires recognising the dangers of a win-at-all-costs mentality, argues newly elected Cricket NSW director Alex Blackwell MAICD.

In June, Alex Blackwell MAICD, the most capped player in Australian women's cricket, became the first woman elected to the board of Cricket NSW (CNSW) in its 159-year history. Just four months after ending a decorated 17-year sporting career, Blackwell transitioned to her new career in the boardroom.

Blackwell was the first woman director elected by members (until 2016, elected directors could only be drawn from a pool of 34 delegates, all but one of whom were male) and only the third female director in the board's history. The first was former player and manager, and current executive director of the Bradman Foundation, Rina Hore; the second, current CNSW director and executive director of the Sydney Business Chamber, Patricia Forsythe FAICD.

Blackwell, the kid from Wagga Wagga, got her start playing cricket with the boys from the age of six. "Sport was a big part of country life", she says. But it wasn't until her final two years of high school that she actually started playing *women's* cricket. Over the next 17 years, she would play first Women's National Cricket League, then internationally in the World Cup, Twenty20 (T20) and the Women's Ashes. All up, Blackwell has played 251 games for Australia and is a five-times world champion cricketer.

At 35, Blackwell comes to her new task well prepared and with a clear sense of the wider social need for culture change. Blackwell brings that strategic nous to the Cricket NSW board, together with the determination and leadership that she displayed coming out as gay in 2012. Even at her first board meeting, she says she felt comfortable and had opportunities to contribute.

All players can be themselves

In 2012, Blackwell became an ambassador for Athlete Ally, a human rights group fighting to end homophobia and transphobia in sports. "For a large part of my career, I felt like that characteristic of me was hidden," Blackwell says. "There was internalised homophobia because I didn't speak about that part of my life; I didn't feel it was something that would be celebrated."

As the face of diversity and inclusion at the Cricket NSW board, Blackwell is blunt. True diversity goes beyond tolerance, she says. Blackwell wants her sport to celebrate the participation of women, gay men, lesbians, bisexuals, transsexuals and intersex athletes as cricketers, fans and leaders. Cricket is ready for the change, according to recent research by Victoria University on behalf of Cricket Victoria and Cricket Australia on attitudes to LGBTI inclusion — surveying cricket employees, players, coaches, administrators and volunteers. Emma Staples, Cricket Victoria marketing and community engagement manager, says she's looking forward to working with Alex. "I look to Alex as a leader."

"Sport is set up in a binary way," Blackwell says. "It's girls' or boys' teams, or it's men's or women's. We have our trans brothers and sisters and intersex athletes. We need to not reject them."

Culture crisis

The Australian men's cricket team has faced the worst of times in 2018 with a ball-tampering scandal that interrupted the careers of men's captain Steve Smith, vice-captain David Warner and coach Darren Lehmann — although the latter was later cleared of any wrongdoing by a Cricket Australia inquiry. The governing body is now undergoing a review.

Blackwell says all cricketers must uphold the rules but believes the pressure to perform means that cricket takes over players' lives and they fail to see the big picture. "Not fully understanding how these actions will be viewed by the outside world was the part that was missing. It's about bringing diverse thinking to [cricketers] and being mindful of them developing and growing as people, not just as people who can hit the ball a long way. That win-at-all-costs mentality is extremely dangerous and I would hope that sports teams (and any team) measure winning in diverse ways."

She says this can include setting good examples of respect and inclusion to the rest of society, making a difference and leaving a positive mark on the places where the team travels — and inspiring more children to be active.

"This ties in with having a bold, ambitious and clear vision and purpose for the team that extends beyond winning trophies to something with greater depth," she says. "The All Blacks have done this well."

Change and diversity is more straightforward than directors might think, argues Blackwell. Just being at the board table will foster change, she believes. "I look different. I am a woman. I am younger. I'm from the high-performance cricket community," she says.

For directors struggling to respond to the demands for diversity, Blackwell advises opening the doors, so change happens naturally. "Once I'm sitting in that room, my presence creates a shift in mindset. It signals to directors that we have to consider women's premier cricket rather than just talking about men's premier cricket. I'm not always the one asking the questions about women and girls, or inclusion and diversity."

As Blackwell settles in to her new role, she has had some mentoring support from former CNSW director Rina Hore and current CEO Andrew Jones. Blackwell, who benefited from a Women Leaders in Sport grant, says Hore has been a great sounding board, while Jones had already suggested she position herself for board roles, for example by completing the AICD *Company Directors Course*. "It gave me confidence that I have what it takes to be an effective board member, even though I haven't sat on boards before."

Lessons from the field

Change isn't always comfortable, but Blackwell is prepared. "Success in cricket and in life requires an ability to seek out and be in discomfort," she says. "Two years ago, I was tapped on the shoulder by the Australian selectors, uncertain about my future in the T20 team. It was tough to hear, but I was able to embrace that feedback — it gave me absolute clarity as to what I needed to work on." Handling change depends on the story we tell ourselves about it, she adds. "What meaning am I placing on that feedback? Are they just picking on me? Do they want to see the back of me? That could have been the story. But my story was, wow, they've given me such clarity. I'm choosing discomfort by stepping up onto this board, something I've not done before. I choose to tell myself that this is an amazing expansion of my world and that I'm very excited about it."

Meanwhile, Blackwell is maintaining her cricketing skills, continuing to play in the Women's Big Bash League for Sydney Thunder. "I've had a remarkable career as a player and I'm more involved in the sport than ever before. I'm excited by that."

CHAPTER 14

Governance across jurisdictions: Navigating the challenges of operating across borders

Navigating overseas governance success: Woodside's Frank Cooper

Victoria Tilbury
21 December 2018, *Navigating overseas governance success: Woodside's Frank Cooper*, Australian Governance Summit Latest News, AICD.

Governing across overseas locations carries risk, so the right international mindset is critical. Hear advice on cross-border governance at the 2019 Australian Governance Summit from Frank Cooper AO FAICD, non-executive director of South32 Limited and Woodside Petroleum Limited, Division Council president of AICD WA and Chairman of the Insurance Commission of WA.

What are some major difficulties in managing overseas operations?

One of the first that comes to mind is the difficulty of operating in a different cultural and political environment. It is important to be aware of cultural differences and any political risk existing in the country, in terms of the fiscal regime, certainty of tenure, things like that.

Another that stands out is making sure you have the right people with the right experience working in these jurisdictions. Operating in a different country is not like having another office just down the road. Understanding the cultural differences and having the ability to work in that context while also meeting your corporate obligations takes experience. Having people with the knowledge of operating internationally — including regulatory requirements — is critical.

Then, there's simply the question of distance and the impact it has internally. People who are out of sight can be out of mind even within your own company. Breaching that distance to keep people engaged and making sure that the corporate culture is intact across boundaries and continents is easier said than done.

Can you give us an example of a cultural difference across borders that can pose a problem?

There is the possibility of increased exposure to bribery and corruption. I think it's important to have a single way of doing business and a single high standard that is applied consistently across your operations. That includes how you treat people in the various jurisdictions in which you operate.

Choosing not to engage in some of the practices that may be common in certain countries can make it more inconvenient, but I believe it ultimately makes more sense to stick to your standards and your values. Otherwise, it will inevitably unravel on you.

One of the challenges is how bribery and corruption can arise. Often it can be inadvertent. You might be dealing with someone who you think is a bona fide third party, but it turns out that they have some relationships you're unaware of. They might in turn indulge in some inappropriate behaviour that you can get swept up in because they were acting on your behalf. It can be quite a complex situation. Hence the importance of clear rules and zero tolerance.

How can mining and resources organisations develop trust within local communities?

In my opinion, I think the answer to this lies in the underlying philosophy of your organisation. If you take the view that the resources belong to the country and the people, and that you have been given the opportunity to extract those resources, that gives you a starting point for the nature of that relationship. It flows through to paying your appropriate royalties and fees and taxes and so on, but there is often a broader expectation that the benefits will be shared with local communities. This begs the question: how do you best go about sharing that value? There's not a simple answer. But, in my experience, it seems to work better where companies involve local communities in trying to determine how best to share that value. In the past there may have been an attitude that if you just hand over enough money then that is enough, but I think local communities are now looking for more investment into their sustainability as a community.

One challenge to doing this well is the increasing expectations of communities. In a world where there's less leadership from government, communities are often expecting companies to contribute and provide that leadership. Striking the balance between doing what you can within the bounds of what you can reasonably contribute is becoming increasingly difficult. It has to work for both parties. Unless it's economic and providing a reasonable return to the company, you won't be able to provide support to that community in the long term. That's why I think the quality, the openness of your engagement — and then effectively communicating your successes, too — is vital.

What must the board get right to succeed in overseas ventures?

For the board, it's essential to have clarity of purpose, and not only of the business side of things. It is important to understand that once you start to do business in another country, you are part of that country and that community. That brings with it some obligations and responsibilities. You need a clear view on how you factor those into doing business in that country in a way that ultimately works for both.

You must have processes in place to manage each of the risks posed by operating overseas that I've mentioned. Clear policies, effective training and support, and a system for ensuring you have people on board with the right experience is a good starting point.

Having a corporate culture that embraces the challenges of operating internationally is critical. Having a business-wide understanding of your responsibilities to the communities you work with and embracing them as part of how you do business is equally important.

Interestingly I think there is a lot we can learn about being better corporate citizens as a result of the experience of operating internationally.

What can Australia learn from global board models?

Christian Gergis MAICD
1 September 2018, "What can Australia learn from global board models?", *Company Director*, September 2018, AICD.

The Hayne Royal Commission has prompted increased scrutiny of Australian board governance models. AICD explores global jurisdictions and where we can take inspiration.

In recent months, there has been a lot of discussion about how Australian boards work and whether we should be looking overseas for inspiration. Everything from two-tier board structures to compulsory employee representatives to mandated renewal requirements have been floated in public debate.

The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Hayne Royal Commission) has helped prompt much of this introspection, although we must be mindful — as Justice Neville Owen who oversaw the Royal Commission into HIH Insurance commented in the July edition of Company Director — that the right response to every corporate crisis isn't just more regulation.

While direct comparisons can be difficult — each jurisdiction is a result of its own unique history, law and society — we shouldn't be afraid to look at how overseas models work. Equally, we shouldn't be afraid of standing up and saying Australia's system stands up well to scrutiny.

The reality is that Australia's corporate governance model is robust and well respected globally. The World Economic Forum 2017–18 Global Competitiveness report ranks Australia eighth out of 137 nations for "efficacy of corporate boards", while we come in at 11th place for the "ethical behaviour of firms".

The Asian Corporate Governance Association has also ranked Australia first in corporate governance practices compared to 11 other jurisdictions in Asia, including Singapore, Hong Kong, Japan and South Korea, in a 2017 study.

None of this is to say that we shouldn't be looking at other models and seeing whether there are things we can learn. Governance developments are increasingly happening on a global scale and there is always value in seeing what might be coming over the horizon. The reality is that no country has a monopoly on corporate scandal, nor can any particular governance model guarantee good outcomes, all of the time. The cases of HIH Insurance, Enron, Wells Fargo, Siemens and Volkswagen over recent decades show that.

So how are things done overseas?

Board structures

Broadly speaking, major Western economies are dominated by two main board models: the unitary model, and the two-tier (or 'dualistic') structure. In the Anglo-American tradition, followed in countries such as the UK, US, Canada and Australia, boards are responsible for supervising the affairs of the corporation, but generally delegate day-to-day management to an executive, which is led by the CEO. Under such models, the board's role is primarily one of oversight, with directors required to hold management to account and continually test their trust in the executive team.

This approach contrasts with many European countries, where authority is diffused between a management board and a separate supervisory board. In Germany, the supervisory board is banned from being involved in the day-to-day affairs of the company but has the power to appoint and remove the directors of the management board. The management board can ignore the supervisory board's opinion but must explain why.

Greater flexibility can be seen in other major European economies, such as France and Italy, where companies have the choice whether to adopt a unitary or dualistic model.

Board composition

A close look at comparative corporate governance models globally reveals one area with a high degree of uniformity: around independent directors. Varying independence requirements can be found in legislation or corporate governance codes in the UK, France, Italy, South Africa, Canada and, of course, Australia. Germany is an outlier, without such a rule. Interestingly, South Africa requires at least two executive directors.

In contrast, there is a clear point of divergence on employee representation. In France, larger companies (with more than 1000 employees) must include at least one director representing employees. The worker voice on the board is even stronger in Germany, where for companies with at least 500 (but fewer than 2000) employees, the employees elect one-third of the members of the supervisory board. That representation jumps to half of the supervisory board when employee numbers reach 2000.

Conversely, neither the UK, Canada, South Africa, Italy nor Australia reserve board seats for worker representatives.

There is a similar point of difference on board diversity, where there is a split between countries such as Germany, Italy and France — which have 30 per cent, 33 per cent and 40 per cent gender requirements, respectively (the latter two enforced via legislation) — and both Canada and the UK where, although there are diversity initiatives, no such targets exist. In Australia, the latest draft of the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations* (ASX Principles) looks to hard-code for the first time a 30 per cent gender target for ASX 300 boards.

Corporate governance codes

A review of international corporate governance codes demonstrates that the 'if not, why not' approach taken by the ASX Principles is common practice globally. In the UK, Canada, Germany, France, South Africa and Italy, implementation of the relevant code is required on a 'comply or explain basis'. South Africa is a market with one of the most stringent regimes, with the latest King IV code moving from an 'apply or explain' approach to an 'apply and explain' model. The Toronto Stock Exchange also mandates compliance with its own specific governance requirements.

So, what does all of this tell us?

Although there are some common threads, there is no universally accepted, best practice, corporate governance model. Ultimately, regulatory frameworks emerge out of the milieu of each individual country, and no law, however well enforced, can stop every failure. That would be too simple and fail to recognise the complexity of business and the human strengths and frailties upon which all structures rely.

CHAPTER 15

Joining a startup board? Understanding what your startup needs

So you want to join a startup board?

Sally-Ann Williams
Engineering Community and Outreach Manager, Google Australia

Startups are thriving in Australia right now. The number of startups and scaleups is on the rise with the increasing focus on innovation as a driver of the economy. As the role of startups and scaleups in the Australian economy continues to grow, it is important to consider the role of governance as a catalyst for growth. In Australia, startup and scaleup companies make the highest contribution to net job creation, yet the size and scale of these companies is still smaller than other OECD countries.[6] Could good corporate governance - appreciating the value of strategic advice, access to networks, and good leadership and culture setting - help startups grow further and faster? It's a conversation that's often overlooked in the startup ecosystem agenda but one we should add to the mix, alongside policy levers, access to capital and talent, and long-term strategies to encourage R&D.

We need to have a conversation around corporate governance and the role of the board in startups to educate founders, investors and board members/advisors. Getting the structure right from the start, and understanding how it changes over time, will help manage complex decision making as a startup grows from founders to funded.

In its simplest forms and in the early days of a startup, governance could be defined as the playbook between founders that identifies the roles, responsibilities, timing in key business decisions, scope of work, payment schemes and agreements on business practices. Founders who fail to consider the governance structure at the outset can find themselves in disagreement without the mechanisms for moving forward as the company grows.

[6] Office of the Chief Economist, 2015, *Australian Innovation System Report 2015*, Australian Government Department of Industry, Innovation and Science, https://www.industry.gov.au/sites/g/files/net3906/f/May%202018/document/pdf/australian_innovation_system_report_2015.pdf, (accessed 23 January 2019).

Clear, agreed upon governance structures in the founding group can mitigate this, yet are sometimes overlooked in the early stages.

For a startup with strong governance structures between the founders, outside council can be sought in the early days through informal mechanisms of mentors and advisors. Depending on the industry, formal advice in heavily regulated areas can be procured through professional services as required, while informal coaching and mentoring can fill in the gaps with strategic advice and access to networks. Pre-seed and seed funded startups will likely rely on a network of advisors acting informally to provide advice as they develop their MVP to launch.

The expansion of the startup ecosystem in Australia has resulted in a larger community of mentors and advisors acting informally through personal networks and engaging both formally and informally through incubator and accelerator programs, co-working spaces, angel networks and other growth and education programs. At an interim stage these networks can be a valuable resource for startups to hone their governance structures and establish foundations for growth.

Individuals with experience growing a business, growing a business to exit, or with a strong track record in startups are invaluable at this time as advisors and mentors as they typically combine both the skills needed in growing early stage companies with a passion to pay it forward. Australia is seeing a growing number of people willing to volunteer their time and expertise to early stage companies as the market matures and early stage employees at companies like Atlassian, Seek, carsales (to name a few) start to venture into investing and mentoring, along with Aussie diaspora returning from Silicon Valley.

Early stage funding is often the catalyst for formalising board structures in startups. Investors may hold some of the initial board seats which can present challenges should views on the strategic direction of the company change between founders and investors. In the early rounds some startups may shy away from independent board members due to funding constraints, and/or lack of suitable candidates, and instead draw advisors from their early mentor/advisor and funding networks. In the short-term alignment around risk appetite and growth can make this a good strategy for founders as they can receive more in-depth coaching as the board rolls up their sleeves and may dive in deep with the executive team to develop and grow the strategy and the organisation. The challenge for both founders and investors is to maintain alignment in growth strategy and risk tolerance to grow the business to strategic investment rounds, or possibly even pathway to IPO.

The greater the growth, the greater the need for good governance. As a startup matures in later stage rounds, or considers IPO, the governance needs grow. Board members and advisors who have been through this process are invaluable in helping guide and shape the strategy and culture and ensure that the good governance is in place.

A challenge for startups in Australia is finding board members and advisors who have the right experience at the right stage. The experience needed and risk appetite on startup boards changes with growth, in a similar trajectory to the founder's skills development and growth. As both need to expand in capability it is prudent to consider whether the board is still the right board to take the company to the next stages of growth, and critically if investors are on the board, are the long-term strategies still aligned. It is also critical to consider that the evolution of 'unicorns' — private tech companies valued at over $1 billion dollars — in driving a new conversation around the role of governance in startups.

Private financing has led to a longer pre-IPO cycle for companies such as Uber, Airbnb, SpaceX and many others creating a new quasi-public company (big enough in size, and importance, but without the scrutiny of public companies.) Ethical, compliance, internal cultural issues and public trust challenges arising in several unicorns in Silicon Valley over the past few years have raised questions around governance and the board composition (has it grown broader than the founders and investors to include independent directors), the boards regulatory and governance experience, and the complexity of stakeholders (employees as shareholders, investors and institutional investment, public scrutiny).

Engaging with startups as an advisor or board member can be personally rewarding. Being close to small, nimble companies with high growth potential, while exciting, requires a strong understanding of your risk appetite and how it aligns with the startup, flexibility of time and the willingness to dig in.

Directors with experience in fast growing companies can add tremendous value in helping to set the strategy, help founders build a company for future growth, and ensure long-term organisational sustainability.

Startup thinking for directors

Rick Baker
Co-Founder, Blackbird Ventures

I come from the world of venture capital investing. We invest right at the beginning of a startup' s life, sometimes when the product is just an idea. We take huge risks early on and we expect most startups will fail. In venture capital, 80 per cent of the returns come from just 5 per cent of the investments.

The trade-off is that when startups succeed they can create huge success and wealth. All of the top five public companies in the world by market capitalization at the end of 2018 were formed as venture capital backed startups.

Given this, venture capital has far more tolerance to risk than mature company investing and this applies to the way we approach our directorships. Startups are experimental, trying to change the way things are traditionally done. They often come with founders and leaders who have not run a business before and don't know what their compliance obligations are. They are under-resourced and under-funded.

At Blackbird we believe startup directors should approach their role as being a trusted mentor and advisor to the founding team: supporting them and helping them through a rollercoaster period, often pushing them to take more risks and increase their ambition.

Here are some tips for thinking like a startup director.

- Change your mindset: In an established company, especially a public company, the CEO and management follow the direction of the board. Because the success of a startup is so closely bound to the founders, we approach the relationship from a different point of view. The board's purpose is to support, coach and mentor the founder is his or her pursuit of a new business. This means effectively working for the founder, whist at the same time providing the governance required from the director position. Getting the balance right is important and sometimes difficult.
- Constantly challenge: A startup director's role is to constantly challenge the thinking of the founders. Make sure they are thinking about everything, testing their assumptions, often encouraging them to go faster. Perhaps we've seen a similar challenge at another portfolio company or can introduce them to someone who has been through the same issue in the recent past - introductions to other founders are often the best form of support.
- Founders know best: Challenge is important, but in the end the founders should make the calls on how to manage the business, not the directors. Often, it's the left-field ideas that trigger success. Other things are only learnt by doing and the best founders are often the stubborn ones!
- Treat your experience with scepticism: Directors are often asked to be on a startup board because they have years of experience from more established businesses. Be careful not to bring too much big company thinking to the table. What works in a big business doesn't necessarily translate to a startup.
- Ask for bad news first: Especially if you are representing investors, there's a strong tendency for founders to sugar coat things. I work hard to build trust with the founders, stressing to them that I want to hear the bad news first.
- Reduce the stress: When founders do call with bad news it's a director's job to help reduce the stress, not to increase it. Startups are roller coasters and because a I'm not living and breathing the business I can often help provide perspective to smooth out the ups and downs.
- Talk in between meetings: Being a good startup board member is so much more than the board meeting. The best conversations often happen in between board meetings.

- Demand board papers: We ask founders to prepare board papers in advance. It's a great discipline and means they come to the meeting with well thought out ideas. It also means the board meeting can be focussed on the core discussion points and the future, rather than reporting what happened in the past. Papers don't need to be complex - start by agreeing a standard list of topics and work from there.
- Don't run out of money: As an investor and director, it's a primary responsibility to make sure that startups don't run out of money. A startup is loss-making, so it doesn't matter how well everything else goes, if it runs out of money it's all over. Trading insolvent is one of the biggest risks for a director of a startup, so get this nailed. Always ask for a cash flow report with runway to zero cash as the first thing in the board report.
- Don't forget compliance: Often the founders have not run a business before and don't know much about their compliance obligations. It's important for startup directors to create a simple and clear process for meeting compliance obligations and make sure it is followed.

What don't startup boards need? It's all those things that it's so easy to slip into, especially when things aren't going all that well: a constant focus on short term metrics, showing disappointment and increasing stress, second-guessing founders and forcing opinions though, pushing for lower risk, lower ambition plans for the business.

It's a rollercoaster, but on the other hand, there is little more fulfilling than seeing a founding team and their business grow from nothing into something.

The startup board: Reaching agreement with the executive on what good oversight means

Belinda Gibson FAICD

A startup has a great concept and is searching for a successful business model. It must develop its offering simultaneously on many levels: the product, the distribution channel, pricing structures, staff resources and, in due course, the support structures. Its essence is agility, on limited resources.

As a sweeping generalisation, the startup lacks the funds or the commitment to build governance structures of the type we expect of the mature complex companies that inhabit the S&P/ASX 200 index. Indeed, a focus on some of these features can be an unwarranted diversion from the main game. Simply creating a sustainable business is very much the present concern. Successful startup entrepreneurs are rarely driven by risk and structured governance considerations.

The first order of business for a startup board is reaching agreement with the executive team on what good oversight means, and what governance structures will achieve that.

Next is to develop an understanding from the executives on where board members can add the value of expertise. One area is likely to be ensuring the foundations exist to scale the business in a sound way. Fundamental to any discussions is ensuring mutual trust and respect between the executives and the NEDs.

Governance settings

On every board there is a healthy tension about the content of board papers and NED information requirements. The executive needs time and space to get on with building an agile and sustainable business. What is sufficient for the board to oversight to the standards that independent shareholders can fairly expect?

This is particularly so in a startup. Expect a lively discussion on topics such as:

- board meeting schedules and agendas;
- board packs and minimum financial information;
- engagement with staff outside the board room;
- executive roles and remuneration arrangements;
- risk and compliance resourcing.

The boardroom discussions of 2018 about the need to understand the organisation's culture and finding space for more 'show me, don't just tell me' will get very pointed in the startup world. Though the business is simple the context — limited resources and the need for agility, is not.

The agreed governance settings will not be set and forget. Needs will evolve, though there will be always be a minimum base to work from. Some major projects will sit on a board agenda for a period then become standard operations. Most crises will pass. The best result will come from the NEDs and executive being comfortable with an open discussion about these topics. One that is open, not too frequent and definitely not protracted.

Adding value

The boardroom should have a good composition of experience and stakeholder connections. The wise executive team will use those resources to supplement the usual startup limitations of a thin team of experts. The executives must be the ones to identify the need and the capability. It cannot be imposed but might be suggested. The executive must feel at liberty to ask and are entitled to expect a generous response.

It is inevitable that the NEDs on a startup will get more engaged from time to time in bespoke aspects of the business than a traditional major ASX-listed company, with ample hired skilled resources to do the work, and a well-worn path to follow.

Startup executives are likely to need more coaching on the attributes of a successful company as it moves out of the startup mode into a business with an established business model with scale and depth. As the business gets traction the management systems to support that will need to evolve. That has a cost to it, in both money and executive time, and inevitably some loss of agility. Boards can bring experience to that transition.

There is a neat intersection between good governance and oversight and adding value at the point of establishing sound business foundations. Conversations can be rich around whether the management team has arranged the right resources to capitalise on the great concept to develop the successful business model. Does the business have:

- the necessary product development skills and adequate funding;
- the right people to build and operate an agile business, a complex mix of strategists and people to work with the customers;
- a sound digital strategy;
- a culture that facilitates collaboration and agility;
- a governance structure that can evolve with the business.

Mutual trust and respect

The startup leadership team, both NEDs and executives, will be a different mix of individuals than for an established ASX major company. The background experiences of the executive team will likely be very different. Nonetheless the goals will be the same — sustainable shareholder value, a generous workplace culture, and a good reputation to name a few.

Discussions about the appropriate governance settings and about harvesting the value that the NEDs can add can only occur in an environment of mutual trust and respect. That will be founded on a good common understanding of needs, resources and objectives — both for the short and longer term.

Be prepared to disrupt your own startup: Carsales CEO

Victoria Tilbury
20 December 2018, *Be prepared to disrupt your own startup: Carsales CEO*, Australian Governance Summit Latest News, AICD.

Cameron McIntyre, CEO and managing director of carsales.com, talks to us about what it takes to build a young business into one of Australia's largest online auto marketplaces, with operations across the Asia Pacific and Latin America.

How have you managed governance challenges in expanding overseas?

As we've grown into overseas markets, we've established corporate governance frameworks in those foreign jurisdictions. We have boards in each of the countries in which we operate and each has a similar framework to ours, each making their own minor adjustments to suit their particular market. They have risk registers and formal audit processes like ours, too. In order to manage the internationalisation of the business, the corporate governance frameworks have been replicated, and our overall risk framework has been expanded to include those offshore jurisdictions.

What are the challenges of running an online business?

One major problem to be aware of, for any online business, is that there are usually very low barriers to entry. Anyone can set up a website but the difficulty is how do you build an audience? How do you grow and then monetise your audience? There is a phrase, the 'virtuous cycle of online', which describes the cyclical process of a startup building inventory, then an audience, then transactions. He who has the most inventory tends to win over time but the challenge for us tends to be working on building, growing, improving that process in order to maintain what we have. We are a paranoid business. I'd say every business needs to be paranoid, particularly in today's digital economy. You're not just competing with locals, but with global competitors, and it's crucial to understand your market, where you fit into it, what are your competitive advantages and how you leverage them. This market is easy to enter but it's extremely hard to be successful.

When in a business's development from a startup does it become important to have formal corporate governance in place?

I think there are degrees of formal corporate governance, so from my point of view a business should have it in one way or another from the very start. When carsales started back in 1997 (a public unlisted company then, and between 2000 and 2009) we had degrees of formal corporate governance. We had a formal board and company secretary virtually from the get-go but we didn't have an audit committee. We introduced an audit committee later in 2007. If I look at all of our startups that we have begun at carsales over the past several years, or companies we have bought into, they've all had levels of formal corporate governance very early too. Our reasoning is that you have to set the business up properly from the start. If you get your corporate governance in place it becomes instinctive and natural. As the business grows you have that to scale with it and it is much less of a burden when the business gets to a point where it requires a formal governance structure because it's had it all along.

How does a young organisation's business model evolve as it grows?

With any startup or young organisation that's been invested in, the secret is to be nimble. You have to be prepared to pivot constantly and make micro-adjustments until you get things right. These changes will be different for each business, but you have to be making constant change to your business model as you grow and develop. You have to be conscious of what's happening in the market around you, changes in customer sentiment and technology, and potential competitive threats. Another thing I'd add is that you can't be overly attached to the way a business is functioning. You must be prepared to disrupt your own original business model.

For example, when we started carsales, we were a subscription-based model, like many classified companies around the world. Our customers would pay a particular monthly amount for the number of cars they had listed on the site. Three years into operations, however, our customers were telling us that the opportunities they were receiving through the site weren't of a very high quality, so we decided to change our business model. We made all searches through our site 'blind' (meaning potential buyers could search within a particular area, but they wouldn't know exactly where the car or dealership was located until they contacted the dealer) and we made the transition to a leads-based payment system. This was a significant change to make very early on, yet if we'd waited till now it would have been a much more difficult project.

Survival tips for startups

AICD

9 January 2018, "Survival tips for startups", *The Boardroom Report*, Volume 17, Issue 1, AICD.

Many startups fail due to pressures from funding and high growth. Marc Orchard, the Director of Startups with BDO in Brisbane, outlines how startups can maximise their chances for survival.

What is the 'trough of sorrow' and how do new startups survive it?

A startup is a new business with a business model that is designed to grow fast under conditions of extreme uncertainty. The 'trough of sorrow' is a term coined by Y Combinator founder Paul Graham to describe the period of struggle that follows the initial rush of starting a high growth company. During this time several difficult things happen, often at the same time:

- initial client feedback indicates that the startup doesn't have product/market fit;
- traction and growth aren't occurring as quickly as they hoped;
- the company is financially vulnerable;
- the team is small and often overwhelmed and/or burning out;
- there are no clear right answers or next steps.

These factors often then lead to the three things that typically kill a startup:

- running out of money;
- lack of product to market fit;
- founders giving up.

Reversing this, the teams that survive are the ones that find product/market fit, are resourceful/have access to capital and have the resilience and grit to stay the course.

For a founder looking to pursue a scaleup, what are the key governance questions they need to consider?

Often a founder of an early stage high growth company hasn't previously had much experience with corporate governance. Usually, it's not until a startup is looking for investment that founders get feedback on whether their internal governance is appropriate, often leaving them vulnerable during the negotiation stage of the funding process.

Main questions founders should consider include:

- What is corporate governance, and are we appropriately prepared for the stage our company is at?
- How do we create our own corporate governance playbook to make sure that we are always investible and sellable?
- Who do we go to for help to make sure we get this right?

If founders know what their corporate governance requirements are, create a playbook as part of their long-term business plan, and get the support they need when required, they make themselves far more attractive for investors and potential exit opportunities.

For a director joining the board of a startup, what kind of issues should they look out for?

For directors joining the board of a startup, the following important points should be considered:

- For many founders, this is their first time running a company. That means they often don't have the experience that would typically be expected of a CEO. Things such as corporate governance, financial and legal responsibilities, decision making, and strategic planning are all things on which directors may need to spend more time with a startup founder/CEO.
- A startup's mission is literally to find out whether they can create a high growth company as quickly as possible. That means that unlike a typical SME, revenue and profit are not usually the most important growth/traction metrics and should not always be treated as such
- Getting access to capital is one of the most important assets a startup can acquire, therefore having a personal network of angel and early stage investors, venture capital firms and high net worth individuals who are actively investing in these types of companies increases the value of directors as a board member.

What distinguishes those startups which become global facing companies, and those who fail?

In a nutshell, the most successful startups/scaleups get the right combination of the following factors:

- Timing: the macro market factors that provide the context for the opportunity and market push momentum in the startup's favour.
- Team/execution: the founders choose/attract the right team of talent and together they successfully execute the startup's creation, launch to market and scale.
- Idea: competitive advantage from uniqueness/capacity to protect the startup's key idea/main point of difference.
- Business model: how the startup makes money at scale.

- Access to funding: how the startup finances its operations (via a bootstrapping and/or investment).

Startups that have a great idea, a fantastic team, a business model that is profitable at scale, access to funding, and timing on their side do exceptionally well. Take any of these factors off the table, and it can ultimately lead to the failure of the company.

How can scaleups future-proof their organisation?

The short answer is that there is no way to completely future-proof your business, particularly if you are a scaling, high growth company. But perhaps a better question to ask is: How do we continue to grow? During the scaling stage, a company's goal is literally to grow as fast as possible. This hypergrowth, or 'blitzscaling' period, is deliberately high risk to maximise the financial return of the venture. Often, scaleup companies have a mandate to do this to justify a recent funding round and create long-term market value and return to their investors.

More broadly, there are two high level reasons why companies fail: they either only do more of the same or they only do what's new. To combat this, companies need to be self-aware about the following market opportunities:

- Core competencies: known company capacity; known client need/market
- Market opportunity: known company capacity; no known client need/market
- Market opportunity: no company capacity; known client need/market
- Moonshots[7]: no company capacity; no known client need/market

In order to stave off decline and expand their lifespan, one of the primary goals of any company should be to proactively convert market opportunities and moonshots into new core competencies.

[7] A moonshot, in a technology context, is an ambitious, exploratory and ground-breaking project undertaken without any expectation of near-term profitability or benefit and also, perhaps, without a full investigation of potential risks and benefits.

CHAPTER 16

Recent NFP governance reviews: The evolution of the for-purpose sector

The ACNC Review and three themes for discussion

Dr Matthew Turnour FAICD[8]
Chair, Neumann and Turnour Lawyers

With the debate over the existence of the Australian Charities and Not-for-profits Commission (ACNC) settled in favour of its continuance, it is the reasons for its existence that have become a primary focus of attention. This paper, written as a background piece for the 2019 Australian Governance Summit for the Australian Institute of Company Directors, sets out the context in which the issues are considered. It then introduces background to three themes that are likely to be developed in future discussions.

The legislative context

The three stated objects of the ACNC are:

a. to maintain, protect and enhance public trust and confidence in the Australian not-for-profit sector;

b. to support and sustain a robust, vibrant, independent and innovative Australian not-for-profit sector; and,

c. to promote the reduction of unnecessary regulatory obligations on the Australian not-for-profit sector.

The review, submissions and responses

The ACNC legislation had built into it a mandatory 5-year review. The first term of reference that the Review Panel was asked to examine was the extent to which the objects of the ACNC Acts continue to be relevant. The Review Panel responded to this by recommending no change.

This was contrary to the submission of the ACNC, which was that the Parliament consider adding two objects to the ACNC's mandate:

a. to promote the effective use of the resources of not-for-profit entities; and

b. to enhance the accountability of not-for-profit entities to donors, beneficiaries and the public.

[8] Dr Matthew Turnour FAICD was one of the panel members that undertook the review of the ACNC legislation.

In recommending no change the Review Panel noted before concluding that:

… maintaining the current objects without prioritisation provides the Commissioner with the flexibility to prioritise the most appropriate object at the relevant time. By maintaining the current structure of the objects, the Commissioner can prioritise the allocation of resources towards any of the current objects depending on the current environment, the needs of the sector and the resources available to the ACNC.[9]

At the time of writing (early January 2019) the government is yet to make its response to the recommendations of the Review Panel.

Stakeholders are positioning themselves for the debates to unfold and, in those debates, three themes may be expected to reappear frequently:

1. data for donors and government;
2. engagement and efficiency; and
3. litigation.

Data for donors and government

The ACNC's second commissioner Dr Gary Johns was appointed in December 2017. He delivered his first report in October 2018. The report[10] suggests that greater emphasis needs to be placed on the data and making it available in usable form. Describing the data as one of the ACNC's biggest assets and committing the ACNC to "make the information we collect more useful for donors, volunteers and the sector itself", Dr Johns explained the commitment of the ACNC to develop data utilisation tools. The tools are for "donors to understand the information [the ACNC] holds" and make it usable "so that donors can search for charities that do similar things, in similar locations".

Data maintenance and analysis is not an explicit object of the ACNC but may have been an intent. Emeritus Professor McGregor-Lowndes was the first to note publicly that the stated reasons for establishing a national regulator were not particularly compelling, and the real motivating force was a central repository of corporate information. He pointed not to donors, volunteers or the sector as needing data, but government.

We may expect the debates around data and its collection to shape the discussion of the ACNC's purposes in the years to come.

Engagement and efficiency

About two-thirds of Commonwealth government expenditures take place in contexts where charities are significant players. Historically, charities provided most of these services before government became a supplier. After greater government involvement, charities have often become a fee-for-service supplier on behalf of government. This is the case in areas of social security and welfare, health, education,

[9] P McClure, et al, 2018, *Strengthening for Purpose: Australian Charities and Not-for-profits Commission Legislation Review Report and Recommendations*, May, The Australian Government the Treasury, p 29, https://static.treasury.gov.au/uploads/sites/1/2018/08/p2018-t318031.pdf, (accessed 23 January 2019).

[10] Australian Charities and Not-for-profits Commission, 2018, *Annual Report 2017-2018*, October, https://www.acnc.gov.au/tools/reports/acnc-annual-report-2017-2018, (accessed 23 January 2019).

housing and community amenities, and recreation and culture.

If the government wishes to further strengthen services (or reduce fee-for-service funding) in any of these areas, then ideally charities would step into a greater role. For charities to step into this greater role there needs to be significant voluntary and donor engagement through charities. This need was translated into a legislative obligation imposed on the ACNC in all three of its objects but particularly the first two. The object to maintain, protect and enhance public trust and confidence in charities has been considered critical because before a person will donate or volunteer, a trust threshold must be crossed.

The ACNC has conducted three inquiries into public trust and confidence in Australian charities (2013, 2015 and 2017). The 2017 Report found a 13 per cent decline in trust and confidence in charities since 2013 and described this as significant. Charities have fallen from third most trusted institutions to fifth. Consistent with this trend, the percentage of Australians making donations fell by almost 10 per cent, from 87 per cent to 80.9 per cent from 2005 to 2016.[11]

The data shows that what affects trust in charities positively is engagement.[12]

The debate regarding engagement is likely to also encompass enhanced accountability.

Detailed analysis of the ACNC 2015 data by Furneaux and Wymer in November 2015[13] found, consistent with the 2017 report, that the public trust charities with which they are familiar, and which are transparent in their reporting. It seems that transparency and reputation do not result directly in donations and volunteering, but they do create trust and it is trust which then leads to donations and volunteering.

It will be recalled that the second additional object the ACNC sought to have included was to enhance the accountability of not-for-profit entities. It would be naïve to think that the issues regarding how trust is built, and the role of accountability, will not be included in the contested discussion in years to come.

Furneaux and Wymer did not discuss the critical distinction between compulsory and voluntary transparency and accountability by charities, but it should be expected that these possibly critical distinctions will also be ventilated in the debates.

[11] W Scaife and C Baker, 2017, "There's cause for celebration and concern in how Australians are giving to charity", 14 March, *The Conversation*, http://theconversation.com/theres-cause-for-celebration-and-concern-in-how-australians-are-giving-to-charity-72969, (accessed 23 January 2019).

[12] Kantar Public, 2017, *ACNC Public Trust and Confidence in Australian Charities 2017*, October, Australian Charities and Not-for-profits Commission, https://www.acnc.gov.au/tools/reports/public-trust-and-confidence-australian-charities-report-2017, (accessed 23 June 2019).

[13] C W Furneaux and W Wymer, 2015, "Public trust in Australian charities: Accounting for cause and effect", *Third Sector Review*, 21(2), pp 99-127, https://eprints.qut.edu.au/91136/, (accessed 23 January 2019).

The ACNC has not taken significant steps towards encouraging Australians to engage with charities or more generally participate in NFPs. If the logical consequences of the research are that that is how to best achieve the objects (a) and (b), expect greater scrutiny of both the research and the ACNC's engagement with it.

The other side of the engagement coin is efficiency. If there is to be less engagement, then greater efficiency is needed. The pressure on Commonwealth government expenditures in contexts where charities are significant players is not anticipated to decline. Given the request by the ACNC for an object directed to more effective use of the resources we may expect ongoing debates on these issues of both how engagement and efficiency are to be achieved.

Litigation

An extra $1 million was set aside for litigation by the ACNC as part of the 2018/19 Budget. The Review Panel recommended litigation supported by test case funding.

Should the ACNC prioritise the undertaking of litigation in the discharge of its objects? In the interim report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Hayne Royal Commission), Justice Hayne was critical of the proliferation of regulation without enforcement litigation in the banking sector. He said: "I do not accept that the appropriate response to the problem of allocating scarce resources is for a regulator to avoid compulsory enforcement action and instead attempt to settle all delinquencies by agreement".[14]

In its first six years the ACNC has not launched any litigation. Given the ACNC has been resourced expressly for litigation, now, expect discussion regarding why the ACNC has not litigated, whether it should, and the choice of future litigation targets.

Are charities who support vulnerable persons approaching the crossroads of a 'black swan' scenario?

Heather Watson MAICD
Non-executive director and consultant lawyer

The concept of a 'black swan' scenario in the context of organizational strategy and leadership was first coined by Nassim Nicholas Taleb in his book *The Black Swan: The Impact of the Highly Improbable* (2007). Based on his criteria, a black swan scenario occurs where:

- an event is a surprise to the observer;
- the event has a major effect; and

[14] K M Hayne, 2018, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Interim Report*. Vol 1, pp 286-287, https://financialservices.royalcommission.gov.au/Documents/interim-report/interim-report-volume-1.pdf, (accessed 23 January 2019).

- after the first recorded instance of the event, it is rationalized by hindsight as if it could have been expected (that is, data was available but unaccounted for in its risk management processes).

For charities who are in the business of providing support for and engaging with vulnerable persons, there have been emerging a number of 'events' that in isolation might be regarded as predictable and manageable through ordinary systemic responses. However, the timing and cumulative effect of a number of these events might together be the emergence of just such a black swan event that Taleb was talking about.

So, what are these emerging events and what might be the consequences of the convergence of them?

The increasing role of the Australian Charities and Not-for-profits Commission

Charities have historically been operating largely under the radar of broader public scrutiny and intervention. In Australia, charities have grown significantly in size and reach as a direct response to the inability of individuals themselves to manage complex vulnerabilities and combined with inadequate and under-resourced government responses to meet those needs satisfactorily.

The introduction of the Australian Charities and Not-for-profits Commission (ACNC) just over 5 years ago, was a step towards a more structured and deliberate approach to requiring a minimum standard of accountability and, in the process, giving guidance to charities as to what might be commonly expected from the community in that approach. While for many this minimum standard of accountability was thought to be quite low, there are various examples of charities whose conduct has been below expectation, becoming more public. As the ACNC goes about its work, there is an increasing awareness and expectation in the community that not every act or intervention of a charity has been necessarily at a standard expected of the community.

Royal Commission into Institutional Responses to Child Sexual Abuse

Charities that historically have been involved in the care and education of children have also been directly and indirectly impacted by the recent Royal Commission into Institutional Responses to Child Sexual Abuse. Church-based charities, many of whom have been involved in schools and institutional care for the most vulnerable of children in our community, have particularly had their historic inadequacies aired, and pragmatically are still to face the impact of the Commonwealth Redress Scheme, which is likely to identify and give rise to financial compensation in many more claims of abuse than have been documented or acknowledged by those institutions.

In the Royal Commission findings, failings by the leadership of these charities (both management and boards) have been identified where:

- Leaders did not take responsibility for their institution's failure to protect children against sexual abuse; and/or

- Gave priority to their own reputation (individually and that of their institution) over that of the victims and ultimately the truth.

In particular, in reflecting on the role of the board in these instances, there were often examples of the board having little information, or taking insufficient steps to enquire about issues of safety, policy and practice, ultimately leading to findings of inadequate 'line of sight' for the board members to have appropriately discharged their responsibilities.

Royal Commission into Aged Care Quality and Safety

The Royal Commission into Aged Care Quality and Safety kicks off in January 2019, and its remit is focused on another vulnerable cohort in our community, namely the elderly who receive forms of regulated care, either in a residential setting or at home or in a community setting. Some of the same organizations (churches, for example) who were front and centre with the Royal Commission into Institutional Responses to Child Sexual Abuse are having to gear up again to respond to this latest enquiry.

At one level, both enquiries potentially arise from a disconnect between community perception of adequacy of care and those that have or had been provided historically. There is a clear common theme here, that just having a mantra to 'do good' will not absolve charities from meeting an increasing and rising expectation of actions, behaviours and consequences.

Additionally, even before this Royal Commission has commenced, there has been substantive dialogue, emanating from both sides of politics, in support of yet another Royal Commission to commence within 12 months, this time focused on those vulnerable persons in our community who are living with a disability.

NDIS implementation and movement to client/customer-controlled forms of funding models

Beyond the regulatory compliance drivers indicated by these Royal Commission interventions, another perhaps less obvious shift has been occurring which arises from the fundamental shift in delivery and funding models occurring across many of the sectors that health and community service charities operate in. That shift represents a move away from government grant and block funding — where a cohort of beneficiaries are intended to receive services but largely at the discretion and priority of the provider — to a context that now puts individualized funding in the hands of those beneficiaries. By doing so, and in some contexts, consistent with government policy intent, a competitive market is created such that the individual beneficiary is able to choose:

- which provider;
- which service; and
- with what priority.

Examples of this movement is evident in the provision of residential aged care services: home and community services for the aged, National Disability Insurance Scheme (NDIS) and in some other aspects of community health provision.

The fundamental challenge for service provider organizations is that this shift to consumer or customer focused service provision creates new drivers for standards and priorities that are outside of the providers initiation, fundamentally challenging the previous and historic business models that have been business as usual for many decades. Whether or not these new approaches will be organizationally sustainable remains to be seen, and there are some geographies and cohorts emerging who will never have the luxury of choice of providers.

Nevertheless, for those charitable organizations that are facing this fundamental challenge, and for some across multiple business lines and impacting the majority of their budgeted income, it represents a disruption of potentially catastrophic proportions and challenges viability.

Conclusion

In reflecting on these recent examples of focus on distinct vulnerable cohorts within our communities, those organizations who have been significantly contribution of the provision of care services ought to be reasonably on notice as to the impact of changing expectations in the community.

They could well be indicators of a pending black swan scenario for such organizations. The significance of this recognition goes to the nature of the responses that boards and executives of such organizations ought to be developing.

In summary, a business as usual response is likely to be insufficient. Rather, a governance and operational response that recognizes the fundamentally disruptive nature of a black swan scenario, and its risk, to organizational stability and sustainability is required.

What the ACNC review means for directors

Lucas Ryan GAICD
12 September 2018, "What the ACNC review means for directors", *The Boardroom Report*, Volume 16, Issue 9, AICD.

The findings of the recent review into the Australian Charities and Not-for-profits Commission could change the way that charities are regulated and even impact the way directors' duties are applied. AICD Senior Policy Adviser Lucas Ryan GAICD explores how.

The final report of the statutory review of the Australian Charities and Not-for-profits Commission (ACNC) was made public on 22 August 2018. Its recommendations, if accepted by government, will shape the regulation of charities and could impact the responsibilities of directors.

About the review

In December of 2017, the ACNC completed its fifth year of operation, bringing a close to its 'establishment' phase as a regulator. This milestone triggered a statutory review (the Review) which was conducted between December 2017 and May 2018.

The government appointed an independent panel to undertake the Review chaired by Patrick McClure AO and including Su McCluskey MACID, Greg Hammond OAM MAICD and Dr Matthew Turnour FAICD.

The government has yet to respond to the findings of the review, many of which would require legislative changes.

Key findings

The Review affirmed the broad support of the ACNC among charities and its recommendations generally suggest only minor refinements to the regulatory framework rather than wholesale changes. Notably, the review did not recommend amendment to the objects or functions of the ACNC, despite this being a requested by the new charities commissioner the Hon. Dr Gary Johns through the ACNC's submission.

Key recommendations of the Review included:

- Significantly raising the reporting thresholds to less than $1 million for small charities, from $1 million to less than $5 million for medium charities and $5 million or more for large charities;
- Reviewing the ACNC's secrecy provisions to enable the ACNC Commissioner to disclose greater information about their regulatory activity and even investigations;
- Bringing certain tax exempt not-for-profits that are not registered charities under the ACNC regulatory framework; and
- Removing, subject to certain preconditions, the exemptions granted to 'basic religious charities'.

The Review also recommended the adoption of the '#fixfundraising' campaign's recommendations to improve the regulation of fundraising. It recommended that the Australian Consumer Law be amended to ensure its broad and clear application to fundraising, that state and territory regulatory regimes be repealed or amended, and that a mandatory code of conduct for fundraisers be developed.

The AICD has been an active participation in the #fixfundraising campaign and has welcomed this recommendation by the review.

Changes to directors' duties

One of the more surprising recommendations of the Review concerns the application of directors' duties for people who are directors of charities.

Under the ACNC's 'governance standards', charities are required to take reasonable steps to ensure that their directors are subject to and comply with a set of directors' duties modelled on those in the *Corporations Act 2001* (Cth) (the Corporations Act). It was intended that the governance standards would replace directors' duties for these directors by 'turning off' ss 180-183 and 191 of the Corporations Act.

However, the review observed that there was some uncertainty about whether and how this applied. Some have suggested that the duties have not been turned off for individual directors, but only for the company itself. Others make the case that it is uncertain, but the duties under the common law are sufficient to cover any gaps.

It has also been suggested that the governance standards themselves overreach the statutory limitations of the Commonwealth's power. The governance standards attempt to create a framework for directors' duties by requiring the charity to hold its directors to their duties. This is because the Commonwealth does not have the power to apply the duties directly to individuals. Whether this creative workaround is enforceable in practice has been questioned and would likely take a test case to resolve.

The Review recommended that the duties for directors of charities under the Corporations Act be 'turned on' to resolve any uncertainty.

Repealing the power dismiss directors

The ACNC Commissioner has the power to suspended or remove a director of a charity where they have engaged in certain misconduct. If this power is exercised, the ACNC Commissioner may also appoint one or more persons to act as a director of that charity for a period of time. This may be done without making an application to the court.

This is an unusual power for a charities regulator to have, however it has not been exercised by the ACNC thus far. The Review has recommended that this power be removed.

Basic Religious Charities are already exempt from this particular power. The rationale behind this is that a separation between church and state cannot be achieved if government regulators can unilaterally remove the leaders of religious communities from their role.

The Review has recommended that if this power is removed, and if the reporting thresholds are raised, that the exemptions available to Basic Religious Charities be removed.

What we need from the Aged Care Royal Commission: Kristy Muir MAICD

Shelley Dempsey
9 January 2019, "What we need from the Aged Care Royal Commission: Kristy Muir MAICD", *The Boardroom Report*, Volume 17, Issue 1, AICD.

As the Aged Care Royal Commission prepares to hold its first public preliminary hearing in Adelaide on January 18, Professor Kristy Muir MAICD, CEO of the Centre for Social Impact (CSI), outlines why it's important to govern for social outcomes.

I think there will be so many people with personal experiences with residential aged care — the good, the bad and the ugly — that the hearings for the Royal Commission into Aged Care Quality and Safety are going to be a real emotional roller coaster.

Are you looking to see a shake-up in the aged care sector?

The aged care sector is close to many of our personal experiences and hearts. It's a good example of a sector that exists for positive public good — the high-quality care of our older people that upholds care, dignity, respect and choice.

Most aged care providers are really clear on having a strong stated social purpose. But one of the key problems emerges when providers don't focus on how and whether they are achieving that purpose by measuring social outcomes. The implications can be frightening. While we have many residential aged care facilities passing required standards, on the flipside, we see coroner reports with horrific incidents. For example, a woman with dementia falling into an aged care fountain and drowning and an attempted cover up by the residential facility. At the end of the day, what we want for our grandparents, parents, ourselves who use this sector or are trying to make decisions about which organisation to use in the future, is for these agencies to live their purpose statements. For us to know if that's occurring, we need them to be measuring and reporting their social outcomes.

What outcomes would you like to see?

I think all organisations with a stated social purpose should measure the relevant social outcomes they are trying to achieve. Having a purpose statement is no longer enough. We have to know whether they're meeting that purpose. How, for example, can we make informed decisions about the services we use, where we put our funding, what is best or good practice and what needs changing?

The exact type of social outcome measured and reported will differ depending on what organisations are aiming to achieve. But, across the aged care sector, high quality care, dignity and respect and enabling choices are three critical things that the sector needs to grapple with.

There is much work to do to identify the most useful indicators to demonstrate that these things are occurring. It's not easy, but it is possible. We've seen this in the disability sector, for example.

What about governance questions?

Governance is key. The two roles of governance are performance and compliance. From a performance perspective: Are aged care providers meeting their social purpose? How does the board know? Many boards across the aged care sector have been, rightly struggling with financial sustainability. The business model often just does not stack up. But focusing too much on the financials has possibly distracted boards from turning to social performance and asking whether their organisations are living and demonstrating their purpose.

How important is social impact when you look at board performance?

I think it's critical. There is a growing push for organisations (whether for profit, not for profit or somewhere in-between) to be able to articulate and demonstrate how they contribute to the social benefit of society. Boards need to move beyond the idea of 'why' (their purpose), to demonstrating whether how and when they are meeting their 'why'. It's not enough to simply talk about doing good, we have to enact it, measure it and report on it — the successes and the failures. In an environment where the social purpose sector has been marketised and outcomes reporting is increasingly a funding requirement, understanding social impact has become a 'you can't afford not to' issue.

How should we measure board performance?

Like organisations, boards should be measured on their social performance. Financial metrics alone are not enough to demonstrate whether organisations are actually making a difference. This is especially the case in the not-for-profit sector, but it's also important for companies which need a social licence to operate. Overall, we need to add different kinds of metrics. For example, to what extent are you shifting outcomes for the people you are trying to help? Are you making people any happier? Any healthier? Are you improving their quality of life, wellbeing, housing, social and economic outcomes?

These things are not easy to measure. What is your initiative in this area?

Social outcome measurement is really tricky. I've been working in this field for almost 20 years and I've realised that if we're going to help organisations, boards and the sector lift social performance at scale, we need to be able to provide sophisticated and easy to use tools, guides and resources. Organisations and boards need to know how they are performing, how this benchmarks and whether and how they're making progress over time. To help facilitate this, the Centre for Social Impact has founded Amplify Social Impact™ — a $12 million project that aims to improve social impact through finding what works, what doesn't and supporting people to do more of it. Amplify has three parts:

1. Examine social problems and establish a robust evidence base
2. Bring together stakeholders in systems change events
3. Provide an online technology platform to support outcome measurement and decision making. Ultimately, this will help organisations better understand and track the difference they are making.

We are tackling five big social issues and we started with housing and homelessness last year. We are also finalising a procurement process with an IT company to do the technology build and will have the indicator engine part of the online tech platform released before the year is out. This indicator engine will help boards and organisations find validated metrics to measure if they are meeting their purpose. This year we will also release a Social Progress Index for Australia. CSI's main goal is to enable others to increase their social impact. Amplify Social Impact is one significant step in helping organisations measure their performance and know what difference they are making to society.

CHAPTER 17

The governance of government: Navigating the tensions of governing public sector organisations

Navigating the tensions of governing public sector organisations

Mark Scott AO FAICD
Secretary, NSW Department of Education

One of the advantages of watching the popular new television streaming services is that the best of broadcasting history is there for you to see once again. So, I am pleased to report that not only are all the old seasons of *Yes Minister* available for viewing but the comedy classic holds up well.

There was a story, perhaps apocryphal, of Malcolm Fraser, when he was prime minister watching episodes with his department head. They both laughed, but at different parts.

Perhaps more than any other part of cultural history, the series can define the tension that might be seen to exist between a politician with an eye to the electorate and an enduring public service that sees politicians come and go.

The Westminster model demonstrated in *Yes Minister* itself is somewhat dated, in an Australian context. There are few enduring mandarins like Sir Humphrey Appleby. Most heads of government departments are appointed on contract. Some may be public service lifers and others, like myself, recruited in for a particular role.

Given the plethora of punditry and opinions flourishing in a social media world, it is far too easy to fall into stereotypes about the public service. What is rarely appreciated is the level of complexity involved in decision making in the public service.

Take my current role as Secretary of the NSW Department of Education. On an operational level, the task is very significant: delivery of daily services educating 800,000 students in one of the world's largest public education systems. Add to it, the spending of over $6 billion in the next four years to meet demand for classrooms that comes with enrolment growth. Add to this again, the responsibility that comes with this service: not just keeping all students safe and engaged in learning today but equipping them for a rapidly changing world, where AI and machine learning will replace so many jobs and create so many new ones.

The job is operationally vast, involves wrestling with big strategic issues and has massive project delivery challenges — and the stakes are so high. The future of our children will shape the future of our nation.

Given so much depends on effective delivery, clarity around strategy and accountability for execution is vital. When recruited to this role in 2016 and trying to think through the modern relationship between a department head and a minister, I was encouraged to reflect on good corporate governance practice and find the similarities in the model. There are many.

To this end, it can be useful for the department head to think of the minister and the government as a governing board, with the voters as the shareholders. The government is ultimately responsible for strategy developed, decisions made and executed and accountable to those who own the institutions being led: in the government's case, the public. Accountability to these owners can be sharp and rigorous, reflected by voters' judgement at the ballot box.

A minister and a government will be accountable for all that goes on under their watch, so they rightly have a strong interest in the strategic settings of both the delivery of key reforms and the daily operational delivery of government services. A minister and a government pay the price if things go wrong, so they will decide on many of the biggest strategic issues. They are the ones who have made a political contract with the electorate on what will be delivered if they win office. Some of the commitments made by a government are specific, some more general; all have a sense that the public expects governance with an eye to efficiency and effectiveness, high standards of ethical leadership and sound judgement.

This much is clear but as with corporate boards and management teams, the detail of delivery can be more complex for a myriad of reasons. It is why the very best governance relationships in the public sector are built on mutual respect and trust, with a clear understanding of different roles and responsibilities.

The best public servants are not just order-takers. Many will bring deep policy experience and insight; they will know their area of operations very well. They will often have studied the history and the research, will have learned from previous failures and appreciate the execution gaps that have hindered delivery. They may provide the challenge to thinking beyond the short-term political pressures.

The best dynamics between senior public servants and their ministers should reflect what we see with the best boards and executive teams. Honest and at times robust, fact-based analysis. A shared confrontation with reality. Careful examination of opportunity and risk. An openness to new ideas and a challenge to conventional wisdom or group-think.

The dialectic can work well because public servants understand that final responsibility and accountability rests with the minister. It is a minister who has to decide and it is the role of the public service to implement the policy decision. It also works well if the minister is intently engaged with the advice provided by the public service: respecting the expertise behind it, questioning the assumptions that underpin it, respecting the professionalism with which it is offered.

This is how good practice should manifest between a minister and senior public servants: mutual respect and cooperation. Respect for political leadership and platforms, the legitimacy of mandates; the strength from electoral experience and the authority of accountability to voters. And then again, respect for detailed policy expertise and experience, the capacity to execute complex challenges, and the wisdom to give embryonic ideas policy shape to make them work in delivery.

How the CSIRO is governing for the future

Beverley Head

1 December 2018, "How the CSIRO is governing for the future", *Company Director*, December 2018, AICD.

Using science to solve real issues, the CSIRO works to shape the future, but how does the respected research institution future proof itself?

For 102 years, the Commonwealth Scientific and Industrial Research Organisation (CSIRO) has prepared scientists working in different disciplines for change. Now, in an era of data-driven and increasingly global collaborative research, how does Australia's national science agency operate while staying true to its founding principles? How does it future-proof itself?

How do you corral 5000 experts in 55 locations, keep track of around 3000 industry collaborations, 1800 patents, 150-plus spin-off companies and still stay focused and future-ready? With a CV steeped in startups, innovation and venture capital, Dr Larry Marshall brings a unique lens. CEO of CSIRO since 2015, with a PhD in physics and 25 years' experience as an international technology entrepreneur, he has founded six successful US companies in biotechnology, photonics, telecommunications and semiconductors. Marshall is a scientist, technology innovator and business leader.

"To future-proof any organisation, particularly a large, complex one, is hard, because you have to act more like a startup than a large corporate. You have to be willing to disrupt yourself before someone else does it to you," he says.

"How do you wrestle with 100 years of history, 100 years of culture? It's like the ABC — everyone has an opinion on how CSIRO should be run and it's hard to find two that agree." CSIRO chair, David Thodey AO FAICD, believes the question should be approached carefully and thoughtfully. With an extensive career, including six years as CEO of Telstra, and formerly CEO of IBM Australia New Zealand, Thodey believes relevance is a fundamental principle.

"This whole idea around future-proofing a government organisation comes back to relevance, which all organisations have to face. The only way I know to remain relevant is by having a focus on the customer — what you do and who you serve and being really good at what you do," says Thodey, adding that in the CSIRO context, the customer is any external party it works with.

"CSIRO has had 100 years of great science — agriculture, minerals, manufacturing, data, IT — but we need to keep reinventing ourselves because science doesn't stand still. That's why we spend a lot of time working out what we need to be focused on in the future."

After a rather rocky start to Marshall's tenure, following a 2016 decision to sack a cohort of climate researchers, there has been a gradual upturn in staff sentiment about the CSIRO's progress with its cultural transformation. He has taken a more consultative approach, holding regular meetings to canvas scientists' opinions and crowdsource the form of CSIRO's cultural transformation.

Thodey adds that CSIRO surveys employees each year, with a major investigation biennially. It measures progress on six areas of cultural transformation and is about halfway on that journey to make CSIRO not only nimbler and more responsive, but its scientists more empowered to act. The organisation also works directly with small to medium-sized enterprises (SMEs) to help accelerate their businesses (see opposite page). Marshall offers the examples of Medical Development International, which sells the Penthrox 'green whistle' pain-relief device, and with Energy Made Clean, which is building off-grid solar storage systems.

"Both those companies grew more than tenfold as a result of us working with them, because we were able to give them science and capability they could not have done on their own," says Marshall.

He stresses the cultural impact of CSIRO startups and spin-offs. "Look at Clayton or Lindfield — these are very old 'grey-cardigan' CSIRO sites, but you'll find dozens of startups living on those sites alongside the oldest grey-cardigan, grey-beard scientists we have."

Marshall is referring to two of CSIRO's older sites that have been revamped to house new research and startups. For example, Clayton is home to the Melbourne Centre for Nanofabrication and Australian Synchrotron. Lindfield, meanwhile, houses the Lindfield Collaboration Hub, an innovation incubator dedicated to working with SMEs in developing high-tech products.

"It's how we help them, but also how they reinvent us, says Marshall. "If you see a 40-year CSIRO grey-cardigan veteran after they've spent a month at Lindfield — they feel like students again."

Investment and innovation

As it strives to achieve real impact from its science, CSIRO has infused more data analytics and artificial intelligence (AI) into its research. For example, its preventive health and e-health team has used predictive analytics and machine learning to forecast the likely load a hospital emergency department might face on any particular day. It's now being rolled out in Queensland hospitals.

"It's first scientific proof of data actually saving lives in an ER," says Marshall. "It told us there was magic in AI we needed to understand. Not the AI on its own but coupled with clinical practitioners and our own health scientists."

CSIRO is also active in Australia's startup scene through its innovation fund, managed by Main Sequence Ventures and led by a team of seasoned entrepreneurs. In its first year it has raised $132m from investors including Hostplus, Temasek and Lockheed Martin, adding to the $100m stumped up by CSIRO and federal government.

Main Sequence Ventures invests in startups and spin-offs that come out of CSIRO, from Australian universities, Australian publicly funded research agencies — or SMEs that partner with one of these organisations. Nine companies have been funded to date, including real-time video specialist Coviu, satellite communications business Myriota and crop yield optimiser FluroSat.

One of the most recent investments is $1.25m into RapidAIM, a CSIRO spin-off in biosecurity that uses smart sensors to detect insects such as fruit fly, sends data via satellite to the cloud and, if needed, a warning to farmers via smartphone, helping to tackle a problem currently costing producers $300m a year.

This engagement with startups and spin-offs is essential to CSIRO's future-proofing, says Tim Kastelle, associate professor of innovation management and MBA director at the University of Queensland. Kastelle has worked with CSIRO to inculcate lean startup processes and help establish its ON accelerator initiative. At CSIRO, about 8000 such conversations have been initiated, and have proved "transformational", he says.

Sam Popovski, CSIRO Staff Association secretary, notes that "scientists are naturally sceptical of corporate systems and hierarchy". The Staff Association released the results of a survey of more than 1000 CSIRO scientists in October, revealing many CSIRO staff remain distinctly underwhelmed at the way the organisation is structured and the support provided to help scientists do their jobs.

Popovski, interviewed before the results of the survey were released, noted, "There was initial scepticism and confusion about the changes. In an organisation like the CSIRO, it's more important to do it properly than quickly."

Data-driven

Data61 CEO Adrian Turner wants things done properly, and quickly. A combination of the former National Information Communications

Technology Australia (NICTA) Centre of Excellence and CSIRO's own data sciences team, Data61 works on communications and IT issues, engaging with industry, academia and CSIRO scientists to support them with data-related challenges. Data61 has its own particular challenge.

"The half-life of data science is shorter than other disciplines," says Turner, which is why he negotiated with the CSIRO for more flexibility in how Data61 operates around speed, autonomy and ability to hire and retain talent. Getting the people right is critical.

Thodey agrees, "We need great individual contributions and great teams so we've embarked on a culture program across the company. We're trying to build mutual trust, moving away from hierarchies and bureaucracies to more collaborative networks; from a rigid planning process to greater agility, experimentation and managed risk; from quite controlling environments to more inclusive, participative ones."

He acknowledges the amount industry spends on its own R&D seems stubbornly fixed. Innovation and Science Australia released its *Australia 2030: Prosperity through Innovation* report in January 2018. Australia ranked 20th in the OECD for business R&D investment (one per cent of GDP) in 2015 compared to Israel (3.6 per cent), Germany and the US (2 per cent) and China (1.6 per cent).

"I'd like to see the number go up," says Thodey. "It is foundational for us creating differentiation in global markets." But he adds that he is seeing "enormous investment" across the private sector in AI, big data and applied innovation, which bodes well for industry future-proofing.

CSIRO is leveraging more information technology internally. One in five of Data61's 1100 staff is seconded to work with a team of CSIRO scientists, supporting them to use data and advanced IT such as AI or blockchain to advance their own research.

Turner says infusing data science and AI across the CSIRO means scientists can explore new ways of working based on data analytics and machine learning across massive, often global, data sets. "So, the system is effectively generating the hypothesis and bringing that back to the scientist for further investigation," he says. "That can potentially change parts of the scientific method that date back to the 17th century. For example, today we create a hypothesis about the properties of a new material, attempt to produce that material, then test it. In the future, we will build systems at the intersection of machine learning and computational modelling that allow us to define the attributes of a material and the system will automatically bring back the molecular models for new materials that have those properties."

While significant progress has been made, future-proofing the CSIRO will be a perpetual quest. The lesson for every enterprise, according to Marshall, is the same. "You've got to be willing to invest in changing the future or the future may not include you. That is my biggest fear."

Donald Challen AM FAICD: 2018 TAS Gold Medal Award Winner

Victoria Tilbury
25 October, "Donald Challen AM FAICD: 2018 TAS Gold Medal Award Winner", *Membership Update*, AICD.

Donald Challen AM FAICD traces the beginning of his distinguished career in academia, the public service and in corporate governance back to what he calls "a bit of an accident, really". When his initial plans for what he would do after high school fell through, a friend nudged him towards economics at the University of Tasmania.

"My father was a great believer in careful due diligence and he helped me find out a bit more about economics. It reinforced my thinking that it sounded worth having a crack at. So, I enrolled in economics at the university and — within a couple of months — it felt like someone had turned the lights on."

Challen believes that what he learned has had a far-reaching influence on his thinking throughout his career. "They say that economics changes your life — rewires your brain. I think that's right. Economists do tend to think a bit differently from the rest of society. I was introduced to a series of concepts that really resonated with me — it's been a part of my life ever since."

After graduating from the university with first-class Honours and a Master of Economics, Challen was 15 years an academic economist. In 1980, he was instrumental in obtaining government funding for the Centre for Regional Economic Analysis (CREA) where he was Founding Director. He also served as chair of CREA's board for a decade from 1993.

After a two-year stint at the Office of the Economic Planning Advisory Council in Canberra, Challen returned to Tasmania in 1986 as deputy under-treasurer at the Tasmanian Treasury. He was managing director of the Tasmanian Development Authority for two years and then appointed secretary of the Department of Treasury and Finance in 1993. He served as secretary for 17 years, working with six premiers and six treasurers of Liberal and Labor governments.

While he was in the public sector, particularly throughout his stint as head of the Treasury, he was asked to serve on several boards, both private and government. Challen says, "That really whetted my appetite for a career as a non-executive director…and what I've been able to do has been very rewarding. Initially, there were opportunities that were thrust on me, but it opened my eyes to the fascinating spectrum of activities that you can get involved in through a non-executive director role."

He is currently chair of the Motor Accidents Insurance Board and is deputy chair of the board of the Tasmanian Symphony Orchestra. In 2013 he was made a Member of the Order of Australia.

Looking to the future of Australian corporate governance, Challen notes that driving an appropriate and positive organisational culture will be a particular challenge. “Cultures are exceedingly difficult to change,” he says. “We tend to forget that human beings respond to the incentives presented to them. If you see behaviour that you don’t like in groups of people or in companies, the best way to cure it is to change the incentives for people. Regulation is a very blunt instrument.”

Organisational culture has been brought into the spotlight by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Hayne Royal Commission). In his interim report, Commissioner Kenneth Hayne AC QC posed that further regulation would add “an extra layer of complexity” to an already complex regulatory regime. Challen agrees. “Individuals respond to incentives and the cultures of companies are the amalgam of the behaviours of the individuals working in them. Thus, in a fairly direct way, a company’s culture is the result of the incentives provided to its employees.”

While Challen’s career path has veered to take him through such a variety of professional experiences, his changing roles allowed him the opportunity to contribute throughout the development of one of Tasmania’s largest infrastructure projects: the Basslink electricity connection. He was involved in the project’s conception as chair of the public service steering committee, and then sat on the Basslink Development Board, which found the private developer, National Grid PLC, to design, construct and operate the project. Later, as a member of the board of Hydro Tasmania, he had a hand in the negotiation of the contractual arrangements between Hydro Tasmania and National Grid, which were essential for the project to proceed.

As Hydro Tasmania’s Battery of the Nation initiative investigates future expansion of Tasmania’s clean energy capacity, this piece of infrastructure could further embed Tasmania’s place in supporting energy supply to mainland Australia.

“It was fantastic to be involved in developing a crucial piece of infrastructure, right from the beginning through to the party that celebrated the first electricity flowing across…it’s very satisfying to be not just involved, but to have been involved in every stage of its development.”

CHAPTER 18

Future trends: Preparing for the next cycle of change

The future: Now for something completely different

Nicholas Davis
Head of Society and Innovation, Member of the Executive Committee, World Economic Forum

What can boards really know about the future? And what should directors do when the future itself seems in flux?

In August 1939, two weeks before the outbreak of the Second World War, philosopher Hermann Randall reflected on the inevitable gap between what humans predict will happen and what actually occurs, saying "Just as the past was not what it has become, so the future is not what it will become."[15] Yogi Berra summed up this sentiment a few decades later in the rather snappier aphorism, "The future ain't what it used to be".

To many directors, that rings particularly true today. A decade ago, who would have predicted the deep uncertainty created by the combination of Brexit, a trade war between China and the US and a chilling of relations between Russia and the West? Or, closer to home, that the office of the Prime Minister of Australia would change hands five times between 2009 and 2019?

Of course, predictions are notoriously difficult to get right. Not only do we have a complete absence of data from the future, almost all humans suffer from chronic recency bias: what we expect from — and fear about — tomorrow tends to be heavily influenced by what happened yesterday.

More uncertainty, more complexity, more pressure

Ten years ago, the world was still reeling from the global financial crisis, and the critical questions for those trusted with organizational governance were around the stability of the financial system, how to manage financing needs and the timing of economic recovery.

While that was an extremely uncertain time, for a while that uncertainty was confined to a narrow set of topics. Today, as we enter the Fourth Industrial Revolution, both the

[15] J H Randall, Jr, 1939, "On understanding the history of philosophy", *The Journal of Philosophy*, Vol 36, No 17, 17 August, pp 460-474, https://www.jstor.org/stable/2018865?seq=1#page_scan_tab_contents, (accessed 17 January 2019).

complexity and range of topics that leaders need to be comfortable in discussing and making decisions about has increased. Greater numbers of complex, global issues are increasing the pressure on individual board members and making board composition more important than ever.

So what trends seem important today, and how are they different?

Geopolitics and the environment are driving — and sometimes eclipsing — economic concerns

The World Economic Forum's *Global Risks Report 2019*[16] asked more than 1000 global experts and decision makers to indicate which risks they see as most likely and impactful over the coming decade. This year's edition reflects the rising perception that geopolitical and environmental factors are critical to the business environment in the medium term.

Looking back at 2009, four of the top five most likely risk factors — and four of the top five most impactful ones — were economic.[17] Today, in 2019, environmental risks dominate both categories.

This is not to say that economic factors aren't still a major concern for boards. The AICD's Director Sentiment Index from second half 2018[18] revealed that directors are becoming less optimistic about the outlook for the Australian and global economies over the year ahead.

However, this caution isn't being driven as much from a sense of systemic weaknesses in the financial system as from recognition that a range of political — and geopolitical — uncertainties are at play. In Australia, directors report increasing pessimism around the federal government's impact on business, and in the Global Risks Report 2019, 90 per cent of respondents say that they expect further confrontation between major powers to negatively impact growth.

#MeToo, the role of culture and technology

Another recent trend influencing how directors see the future is the increased attention that citizens, customers and employees are paying to how individuals and groups behave within organisations.

Corporate culture is being recognised as a critical driver of bad behaviour — from sexual harassment to fraudulent dealing — that creates significant risks for boards and organisations in addition to the direct harm it does to people. PwC's *2018 Annual Corporate Directors Survey*[19] reveals that directors blame the tone set by both the executive team and middle management for

[16] World Economic Forum, 2019, *The Global Risks Report 2019*, 14th edition, https://www.weforum.org/reports/the-global-risks-report-2019, (accessed 17 January 2019).

[17] Ibid fig iv.

[18] Australian Institute of Company Directors, 2018, *Director Sentiment Index: Research Summary Second Half 2018*, August, https://aicd.companydirectors.com.au/advocacy/research/director-sentiment-index-second-half-2018, (accessed 17 January 2019).

[19] PwC, 2018, *2018 Annual Corporate Directors Survey: The evolving boardroom: Signs of change*, PwC United States, https://www.pwc.com/us/en/services/governance-insights-center/library/annual-corporate-directors-survey.html, (accessed 17 January 2019).

damaging environments — yet 64 per cent of respondents say they tend to use their “gut feeling” to understand and gauge culture, despite on 32 per cent of directors thinking this would be useful.

Technological issues are also part of any future-oriented board agenda. The Global Risks Report places cyber-attacks and data fraud and theft as the fourth and fifth most likely risks globally in 2019, and PwC’s survey shows that 84 per cent of boards report discussing management’s plans to respond to a cyber security crisis. However only a third of boards say their organisation has staged a drill, and less than half have a written policy to guide management should a crisis occur.

From confidently predicting to modestly preparing

Whilst it is impossible to know exactly what the future holds — especially when things are being driven by events and decisions far out of our control — it is often useful for boards to acknowledge this fact, and to resist the urge to make big bets or ignore weaknesses on the assumption that “I don’t see that happening”.

Analysis of trends, forces, drivers, risks and scenarios tends to rest on what Randall called “the envisaged future”: that which the authors of pontificating reports can themselves understand, make sense of and create a plausible narrative around. The same holds for directors in the board room. Yet the ability to tell a good story doesn’t make one more accurate in forecasting.

The challenge here is for directors to be able to say “I have some thoughts on this. But if I am profoundly wrong, where would we be, and how might we prepare accordingly?”

From seeking consensus to pursuing maximum divergence

Another useful strategy for creating resilience to the future is to increase board diversity: actively seeking board members — or invited guests, where more appropriate — who bring completely different data sets, experiences and world views into the discussion.

Perhaps the most successful and useful future-oriented activity is to develop widely divergent scenarios and carefully consider their implications. In this process it’s often advised to seek out ‘remarkable people’ — individuals with viewpoints so challenging that their input stretches the boundaries of what is plausible for decision-makers, thereby making any subsequent plans both richer and more resilient.

And often, diversity means simply ensuring there is at least one person in the room with direct experience of the topic under question.

In discussing cyber security, for example, it’s useful to bring in someone to talk about how they dealt with a cyber attack at a different organisation. And if there’s a sure bet for 2019, it’s that you’ll be discussing cyber security at some point. The rate at which both system vulnerabilities and rewards for criminal actors are expanding means that every board can assume that their organisation will be targeted — and likely penetrated — at some point in the near future. It may well have happened: a 2018 survey by US firm First Data found that 34 per cent of respondents had had their personal information compromised in the last year.[20]

Changing the future for the better

Finally, just because the world is complex and uncertain doesn't mean that boards lack the ability to make positive changes. Directors, both individually and collectively, have significant power to influence their organisations, the stakeholders they serve and the wider world.

Because, in a way, the future we can envisage defines the problems that face us today.

So, perhaps the most important task for directors is to shape the future by deciding what it *should* look like, not just what it *might* be.

And then to look for every opportunity to set a positive example by successfully discharging duties in ways that help to reduce the complexity and uncertainty for everyone else.

Future trends: Preparing for the next cycle of change

Dr Catherine Ball MAICD

The future is already here, it's just not evenly distributed — William Gibson.

If you weren't already aware, we are in the midst of a paradigm shift called the fourth industrial revolution. Some of us already have a better grip on it than others but all of us are going to be directly affected, globally. Physics teaches us that for every action there is an equal and opposite reaction and the digital world is not immune to this. Accordingly, the most effective way to understand this revolution is to regard it as an ecosystem rather than as a range of isolated and individual tools that we need to master. There are certainly challenges as well as opportunities for directors when it comes to emerging technologies. The good news, and the bad news, is that we aren't alone in this challenge. Every part of society is likely to change in the next few years in a manner that we have not experienced before.

A major concern for all companies (and directors) right now should be the question: Are we future fit?

To be future fit doesn't just mean you have a grasp of cybersecurity principles, have hired some consultants and feel confident with your smart devices. Being future fit means the need to be more prescient about the way your company is operating, and predictive about the technologies that are emerging and

[20] BusinessWire, 2018, *First Data Releases Cybersecurity Study on Personally Identifiable Information (PII)*, 17 October, https://www.businesswire.com/news/home/20181017005273/en/Data-Releases-Cybersecurity-Study-Personally-Identifiable-Information/?feedref=JjAwJuNHiystnCoBq_hl-Q-tiwWZwkcswR1UZtV7eGe24xL9TZOyQUMS3J72mJlQ7fxFuNFTHSunhvli30RlBNXya2izy9YOgHlBiZQk2LOzmn6JePCpHPCiYGaEx4DL1Rq8pNwkf3AarimpDzQGuQ==, (accessed 17 January 2019).

the positive and negative issues that may arise. This is not just about risk management around the known quantities but also about risk prediction around things that don't even exist yet.

Let's take the drone world for example; hundreds of lives are saved each year because companies and governments have adopted drones to reduce health and safety risk. Yet drones are also perceived as a nuisance and even a danger to society (which is deftly summarised by the hashtag #GatwickGate[21]). How can we provide enough freedom for these emerging and exponential technologies to be the best they can be and conversely also protect ourselves from the nefarious and negative use potential? It's a one answer question: Education.

In this new era of convergence, we find that technologies we could once deal with in a traditional linear framework are now intermingled and cannot be separated. You can't unscramble eggs and you can't talk about cyber without talking about data. Subsequently, you can't address data concerns without mentioning internet connectivity and internet connectivity turns to conversations about the internet of things, which can then lead to thoughts on all of the platform technologies that are going to be using and generating data in brand new ways. Smart phones, drones, autonomous buses and trains, driverless cars, and even rail-free trams are all starting to talk to each other without humans in the loop.

Are you ready?

There's an increasing need for people who may not have been born a digital native (also known as a 'digital immigrant') to be able to immerse themselves in technology in ways that were not included in their traditional education pathway from a few decades ago. As directors, we need to be able to create strategies for our companies in an increasingly evolving technology-infused business ecosystem. We can't do this on our own, and therefore using experts and consultants, and adding directors to the board who are from younger generations (and therefore who are digital natives), is becoming a necessity to maintain currency. Using the skills-based approach to director appointments assists in identifying gaps in knowledge and confidence traps. For example, when it comes to health and safety, recognising relevant risks and seeking relevant solutions increasingly needs people who are fully conversant in the opportunities allowed by such new robotics advances as exoskeletons to dramatically reduce injury risk.[22]

[21] Refer to *Gatwick Airport drone incident*, https://en.wikipedia.org/wiki/Gatwick_Airport_drone_incident, (accessed 21 January 2019).

[22] A Burton, 2018, *Expecting exoskeletons for more than spinal cord injury*, The Lancet Neurology, 13 February, https://www.thelancet.com/journals/laneur/article/PIIS1474-4422(18)30074-7/fulltext, (accessed 21 January 2019).

Every new technology is creating and using data in quantities beyond most corporate IT systems. It has been calculated that over 90 per cent of the current data in the world was created in the last three years.[23] Read that sentence again. We are drinking from a data firehose. Traditional servers are filling fast as businesses are required to meet the data archiving and storage requirements of companies by both law and insurance edicts. Increasingly, companies are turning to cloud-based solutions without fully understanding the risks of doing so.

So, if you're new to all of this, where do you start? Smart people surround themselves with people who are smarter than them in different ways: foster an innovation mindset in your board, get the culture right to ask questions, and identify threats and opportunities in your company with terms of reference around new, emerging, and exponential technologies.

The best stratagem to handle changing and changeable times is to be open to being vulnerable and to admit where there are opportunities to improve learning and understanding. Look at sector-based training and education. Work with academics and government in cross-industry collaborations. Find people who are doing things well and collaborate on projects together. Get in and amongst it when it comes to industry sector conferences and congresses. Put yourself on the *learning* edge and soon, by osmosis, you will be on the *leading* edge.

[23] B Marr, 2018, *How much data do we create every day? The mind-blowing stats everyone should read*, 21 May, Forbes, https://www.forbes.com/sites/bernardmarr/2018/05/21/how-much-data-do-we-create-every-day-the-mind-blowing-stats-everyone-should-read/#1c433dbb60ba, (accessed 21 January 2019).

CHAPTER 19

Governance 4.0: Operating in the evolving governance landscape

Directors' duties: Addressing changing community expectations of corporate purpose and responsibility

Professor Pamela Hanrahan
UNSW Business School and advisor to the Hayne Royal Commission

Never has Peter Drucker been more correct: Culture eats strategy for breakfast.

In January 2019, Blackrock chair and CEO Larry Fink observed that, "society is increasingly looking to companies, both public and private, to address pressing social and economic issues. These issues range from protecting the environment to retirement to gender and racial inequality, among others." As a result, he said, "stakeholders are pushing companies to wade into sensitive social and political issues — especially as they see governments failing to do so effectively".

The question this raises for directors is: Ought their corporation take a stand on these issues and, if so, what should inform that stand? What if taking a stand impacts on the bottom line, or advantages one group of stakeholders over another?

In corporate law, boards are given powers to manage or direct the management of the business of the corporation. The board's powers are exercised collegially, or may be delegated to board committees, management or others. By operation of s 181(1)(a) of the *Corporations Act 2001* (Cth), individual directors (and their delegates) must exercise their powers and discharge their duties in good faith in the best interests of the corporation, and for a proper purpose. This means that the board's decision to take a position on any of these issues, as with any other decision, must be motivated by the interests of the corporation, rather than any private enthusiasm or other conflicting loyalty.

In the Australian legislation, the focus is placed firmly on the corporation's interest. This is not necessarily the case elsewhere. For example, the Indian Companies Act 2013 provides, in s 166(2), that a director "shall act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of environment". In the United Kingdom, s 172 of the Companies Act 2006 points to the primacy of shareholders' interests, stating that a director "must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole" and in doing so "have regard (amongst other matters) to" considerations including the likely consequences of any decision in the long term, the impact of the company's operations on the community and the environment, and the desirability of the company maintaining a reputation for high standards of business conduct.

The challenge for directors in the Australian context is discerning where the interests of the corporation lie. The corporation's interests are not necessarily to be equated with the immediate interests of the current body of shareholders. In 2006, the Corporations and Markets Advisory Committee (CAMAC) was asked to consider whether a change to the statutory duty, along the lines of s 172 of the UK legislation, was necessary to ensure that directors could look beyond maximising short-term financial performance in their decision making. It concluded that Australian directors "have considerable discretion concerning the interests they may take into account in corporate decision making, provided their purpose is to act in the interests of the company as a whole, interpreted as the financial well-being of the shareholders as a general body". On this basis, CAMAC took the view that "the environmental and social matters referred to in the debate on corporate social responsibility are really factors that directors should already be taking into account in determining what is in the best interests of their corporation in its particular circumstances".

In mid-2018, the ASX Corporate Governance Council proposed various changes to its influential *Corporate Governance Principles and Recommendations*. ASX-listed entities are required to report on whether their governance practices reflect the Council's recommendations on an 'if not, why not' basis. Among the proposed changes was replacing existing Principle 3 — that a listed entity should act ethically and responsibly — with a new principle that it "should instil and continually reinforce a culture across the organisation of acting lawfully, ethically and in a socially responsible manner". Examples given by the Council of acting in a socially responsible manner included "respecting the human rights of its employees, including by paying a 'living wage' to employees", "offering employment to people with disability or from socially disadvantaged groups in society", "not engaging in aggressive tax minimisation strategies", and "acting responsibly towards the environment".

In *Australian Competition and Consumer Commission v Australia and New Zealand Banking Group Ltd (2016)* 118 ACSR 124; [2016] FCA 1516 at [123], Wigney J adopted the parties' joint submission that: "The Australian public is entitled to expect that Australia's major corporations act as exemplary corporate citizens wherever in the world they may operate." The misconduct exposed in 2018 by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Hayne Royal Commission) suggests this expectation is not always being met. But this is a separate question from whether a corporation must, or should, step in to advance proactively the interests of the communities in which it operates, particularly (as Fink suggests) if governments are no longer willing or able to do so.

In most cases, a board decision to commit the corporation to a course of action that advances a generally accepted social good can be justified on the basis of what CAMAC called 'enlightened self-interest' — that is, that being and being seen to be a corporation with a strong moral compass is ultimately good for the sustainability and prosperity of the business. This in turn benefits the shareholders as a whole over the medium to long term. But there will be instances where social goals conflict with corporate goals. Marriage equality does not affect the corporate bottom line, but wage equality would. Balancing and reconciling these competing goals in the interests of the corporation is the ultimate responsibility of the directors.

There is an ongoing debate over whether corporations, and large corporations in particular, must pursue social advancement in return for the 'social licence' described by the ASX Corporate Governance Council as being one of a listed entity's 'most valuable assets'. In future, boards will be increasingly called upon to articulate the corporation's purpose and values, to demonstrate the manner in which those values inform their decision-making, and to be transparent about the goals they believe the corporation should pursue. For some, this will be confronting. Unless the law is changed, directors must continue to exercise their powers in the best interests of the corporation. This clearly includes deciding how to address community expectations about the ends that corporate activity and influence should serve.

CHAPTER 20

Reflecting on the royal commissions

Leaders under scrutiny: Lessons from recent royal commissions

Robert Fitzgerald AM
Former Commissioner, Royal Commission into Institutional Responses to Child Sexual Abuse

Australia has had 136 federal royal commissions since 1900 and whilst many have touched on institutional concerns three of the most recent have put the spotlight directly on institutions, their governance and their conduct. The royal commissions into trade unions, into institutional responses to child sexual abuse and, currently, into banks, superannuation and financial services all raise serious, systemic issues that demand the attention of boards and organisational leaders.

At a relatively superficial level three things should leap out at institutional leaders.

First, *there are no such things as secrets*. Someone always knows and someone will always tell. All the commissions have shown that what you do or fail to do may ultimately be exposed, sometimes through the brutal, public examination by a body such as a royal commission, with wide inquisitorial powers and where the normal rules of evidence are largely suspended. Further, the more closed and secretive the institution, the less transparent and accountable, the more likely bad conduct will develop and persist, but also the greater the damage that will be done when ultimately the veil of secrecy is lifted.

Second, *the corporate 'fish' does rot from the head*. Case studies in the various commissions demonstrate that much of the conduct that has shocked the nation, if not sanctioned by the leadership, existed within a culture where the leadership failed to enforce the values and standards that they espouse. At worst, they have themselves created a permissive culture of pushing ethical and good conduct boundaries to the point of breaking or beyond. Whilst many may not have had direct knowledge of wrongdoing it is clear that many either did not ask enough of the right questions or failed to put in place safeguards against such practices or conduct occurring. They certainly appeared to have no means to know whether their proclaimed institutional values and standards were being applied throughout the organisational substructures.

Third, *that misconduct is not just a case of a few rotten apples*. The various royal commissions have demonstrated deep systemic issues that have permitted, facilitated or even encouraged poor or unlawful conduct, or led to weak, indifferent responses and sometimes responses that are themselves unlawful. The dismissal of institutional misconduct as only being the actions of a few aberrant individuals has been exposed as simply denialism. Whilst no organisation is immune from personal misconduct from time to time what has been exposed is institutional misconduct.

What factors permit such systemic wrongdoing and a failure to respond appropriately are many. Reasons found by various commissions include institutional greed, indifference to the best interests of members or consumers, conflicts of interest, protecting the reputation of favoured individuals or institutions, ethically compromised legal and other advice, poor systems and processes and weak feedback mechanisms to detect and report misconduct. But universally it boils down to poor governance, a poor commitment to ethical conduct and values, and a flawed culture.

Whilst the regulatory environment has also been found wanting in many of the inquiries, it has not generally been regulatory failure that that has been the main culprit.

For example, practices revealed in the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Hayne Royal Commission) would appear to often be deliberately developed to disadvantage or exploit consumers (even dead ones) notwithstanding the very strong provisions of Australia's consumer laws. One can ask why anyone would believe such practices were ever acceptable, irrespective of the law.

In the case of sexual abuse of children in institutions much of the misconduct was always unlawful, yet some institutions responded as if these offences were only moral lapses and did not respond as the law or justice would demand. One can ask why we should need stronger laws to deal with conduct that is so reprehensible that most observers would expect institutions to act decisively in the interests of protecting children, irrespective of the law.

Good quality regulation and the diligent, proportionate enforcement of law does matter. Good regulation and good regulators do make a difference. But it is only part of the answer. The real solution rests in the internal governance and culture of organisations.

Put very simply, and drawing from a political slogan used in the recent Victorian state election, isn't good leadership about 'living your values, keeping your promises and delivering the goods responsibly'. Leaders of organisations do need to live the values that they claim for their organisations. They do need to keep the promises they make to customers and other stakeholders. And they need to deliver the products or services in a responsible manner consistent with the laws and social norms of our society.

Yet, unpacking a few issues may be helpful. Each of the commissions has identified some clear areas of weakness in institutional leadership and governance. One of the clearest has been the broad notion of conflicts of interest. This has many layers and takes many forms.

In some cases, it goes to the very essence of 'in whose interest' directors are acting. The conflict between the short-term interests of investors, the personal interests of directors and senior staff, and the interests of consumers seems unresolved. The notion that the interests of the organisations, its investors and the customers need to be aligned seems to have been abandoned in many circumstances. Some say that so called short termism acts against the long-term alignment of these interests. What is certain is that the long-term interests of an organisation require a clear framework to create an alignment of interests between its stakeholders or at the very least a means to deal ethically and fairly with potential conflict.

Another level is in whose interests boards and leaders will act when misconduct is identified. Too often the interests of the abused such as affected children or vulnerable customers are subjugated to those of the interests of favoured individuals or the corporate reputation. Too often we have seen offending union officials, church leaders, senior business managers or fellow directors, not dealt with appropriately to protect them or the organisation. Organisations need clear processes that allow for the thorough objective investigation, reporting and rectifying of all wrongdoing.

These are issues that affect all organisations — commercial, private or public, faith-based, membership-based, clubs and associations — operating in all sectors of our economy and society. The lessons must be learnt by all organisational leaders. The public calls for greater accountability, transparency, ethical conduct, fair dealing and regulatory oversight will only grow.

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