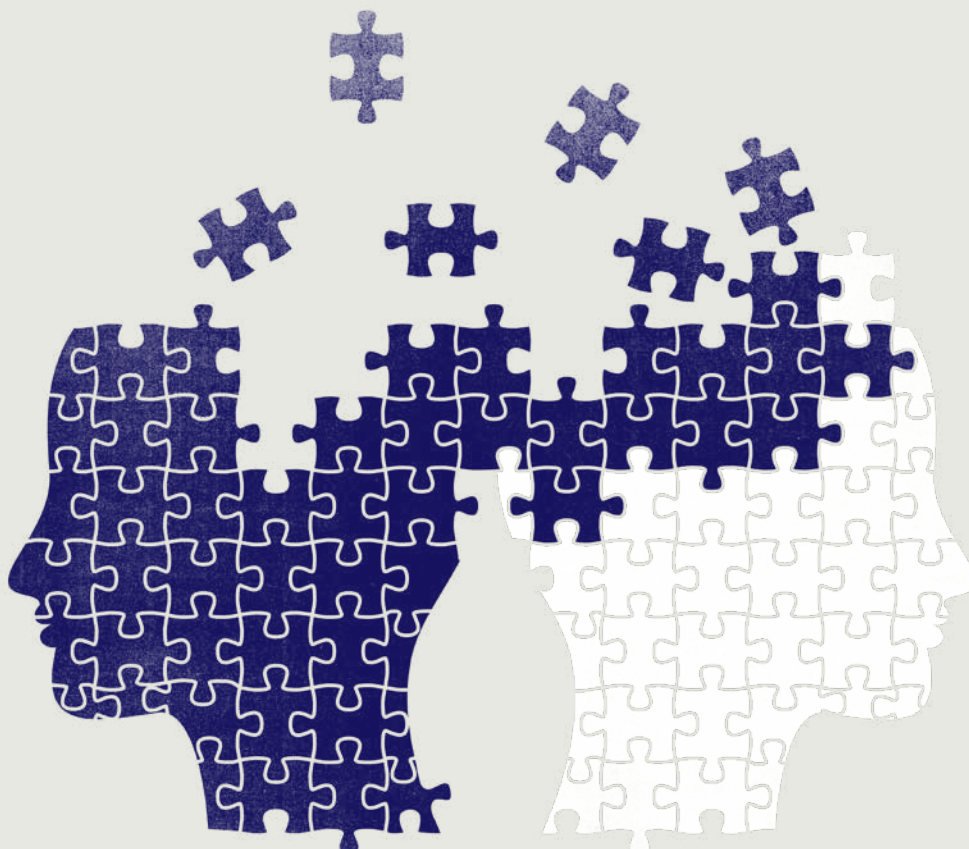


# Creating value and **balancing** stakeholder needs

*The Board's role*





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## Foreword



*Launching into 2019, Commissioner Kenneth Hayne’s words loom large in directors’ minds. From the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the “Hayne Royal Commission”) Final Report, “In almost every case, the conduct in issue was driven not only by the relevant entity’s pursuit of profit but also by individuals’ pursuit of gain, whether in the form of remuneration for the individual or profit for the individual’s business. Providing a service to customers was relegated to second place.” There is a clear reciprocal relationship between customer and company, and that relationship should be safeguarded by diligent and ethical directors. Yet somehow, some of our most venerable institutions lost of sight of this tenet.*

It is clear that directors must consider more than financial returns to shareholders in exercising their legal duty to act in the best interests of the corporation. But pursuit of the best interests of a corporation – as Commissioner Hayne made clear – is also not a binary choice between customers and shareholders. We know that acting in a responsible and ethical manner towards a range of stakeholder groups – including employees and the community – is necessary for the promotion of the interests of the company and its sustainability.

Beyond the legal context it is important for us to recognise that evidence of misconduct has the community rightly asking if this interpretation of duties is applied in practice. Boards need to clearly demonstrate that they aren’t putting profits ahead of people, or they will be held accountable.

This was made clear in a turbulent Annual General Meeting season, where the Australian Securities and Investments Commission found, “Strikes appeared to be driven by a number of factors, including: negative shareholder

sentiment towards executive pay and accountability, arising from concerns highlighted by the [Hayne Royal Commission].”

It is heartening then to see the responses from this research, where Australian Institute of Company Directors (AICD) members identified customer satisfaction as a critical issue impacting their organisation, followed by employee satisfaction and internal culture/conduct. In almost every question, customers – and employees – were a top priority in directors’ eyes, ahead of other stakeholders or issues. The survey covered the listed, private, not-for-profit and public sectors.

We support the efforts of the director community to take stock and ensure their activities meet the high standards set for us by those that matter most. We look forward to leading the discourse on these important points.

We thank KPMG for their partnership on this vital piece of research at a pivotal moment for governance practice.

**Angus Armour FAICD**  
Managing Director & CEO  
Australian Institute of Company Directors



*Corporate Australia is responding to challenging times; good corporate governance is leading the way to better outcomes for all stakeholders.*

*Conduct and trust are in the spotlight with the light being shone from many directions. It is therefore positive that the responses from this year's KPMG survey of more than 600 members of the AICD indicate that people must be put first.*

In almost every survey response, customers – and employees – emerged as the top priority for directors. They were rated ahead of all other stakeholders or issues. This indicates the acceptance that not only is inclusion of people paramount but that boards have a vital role to play in driving change to create and ensure equity.

While business has not always considered people as its first-order priority the findings of this year's survey indicate that this is changing. Customers are speaking out strongly, taking action, and communicating expectations. Organisations, and their leaders, are listening to customers and employees – and they are responding.

The prioritisation of people by surveyed directors raises some important questions for boards and their organisations.

How can they create value for shareholders while also balancing different stakeholder priorities? Is the organisation sufficiently robust to attract millennial customers and employees alike who readily transfer allegiances on perceived alignment to their personal values?

What of the need to satisfy shareholder expectations – a group of key stakeholders which remains very important. It is now widely accepted that the focus on governance and culture, post GFC, was too narrow, focusing only on financial soundness and stability. The report shows directors

see the need to prioritise customer and employee outcomes over short term financial performance. The Final Report of the *Hayne Royal Commission* also recognises culture as a vitally important area which must be supervised to ensure positive outcomes for customers.

The pace of change also appears to be challenging. There was a sizeable number of respondents who were only relatively confident or less so, that they were able to handle dealing simultaneously with – and possibly mitigating – past mistakes while at the same time focusing on plans for future growth and investment. Post-Hayne, this is an important area for many, not just those in the financial sector.

Yet the overall picture seen in the responses to this year's survey indicates these challenges are being recognised and also acted upon. The conversation in boardrooms is changing and decisions are already being made through the lens of what the community will think. Strategies to address the challenges are being developed and delivered. Australian boards are not only ready for the task; indeed they will rise to the moment.

A handwritten signature in black ink, appearing to read 'Alison Kitchen'. The signature is fluid and cursive.

**Alison Kitchen**  
Chairman, KPMG Australia

## The board's role in creating value and balancing stakeholder needs

*In 2019, the customer is at the core of boards' thinking, according to the latest KPMG and AICD survey of company directors.*

A great deal has been said recently about the board's role, and whether it is sufficient for directors to look after shareholder/owners' interests, or if there is a need for them to engage more broadly and embrace societal accountabilities.

The Corporations Act<sup>1</sup> clearly articulates what is expected of directors – the key accountability being to “act in the best interests of the entity”. This is a simple statement, yet one which is inherently and increasingly more complex to fulfil.

Key questions arise: How do directors define the “best interests of the entity”? Is it just financial performance? Ultimately this would not seem to be the case unless it is the long-term financial viability of the entity and its ability to compete successfully in their market.

As we have seen through many recent public reports and investigations, non-financial pressures are impacting on entities' growth potential, reputation and market share.

Sally Freeman, Partner and Head of Board Advisory Services, KPMG, says: “There are some key questions that directors are asking in today's dynamic environment, including;

- How to take into account the varying needs of shareholders – some seeking short-term return, others looking for a longer-term investment; but almost all expecting organisations to demonstrate ethical behaviour?
  - How to communicate a clear sense of purpose that engages today's employees?
  - What is the entity's role in social engagement issues, and is the entity sufficiently robust to attract millennial customers and employees alike, who readily transfer allegiances based on perceived alignment to their personal values?”
- KPMG and the AICD undertook a survey to seek insight from directors about some of the issues that they feel are shaping the way they govern their organisations, including the elements they vary to create value, and the challenges they must balance to satisfy different stakeholder priorities.
- While the survey was carried out in December 2018, before the final report of *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry Final Report* (the “Hayne Royal Commission”) was released, many of the issues identified by directors in the survey were subsequently also highlighted in the Final Report in February 2019.
- How to balance the myriad of stakeholders' (employees, the community, owners and customer) competing needs?

<sup>1</sup> Corporations Act 2011 (Cth)

## Survey approach and respondent profile

AICD members were invited to participate in the survey, with a total of 612 respondents taking part. The spread across sectors was evenly balanced, with 55% from listed and private entities, and the balance from the public and Not-for-Profit (NFP) sectors.

Of the respondents, 87% were aged 45 and over, and this is reflective of AICD membership and the average age profile of the director community.

Responses were received from entities of various sizes, as outlined in the table below.

Sector	Value					Don't know/ Prefer not to say	NULL	Grand Total
	Less than \$10m	\$10m– \$49m	\$50m+ \$99m	\$50m– \$99m	\$100m– \$499m			
Private	101	74	24	16	32	12	1	<b>258</b>
Listed	13	5	38	4	17	2	1	<b>80</b>
Not-for-Profit	69	39	17	17	10	6	1	<b>159</b>
Public Sector	16	13	11	9	11	2		<b>61</b>
(Blank)	23	8	6	9	4	4	1	<b>55</b>
<b>Grand Total</b>	<b>222</b>	<b>139</b>	<b>95</b>	<b>55</b>	<b>74</b>	<b>26</b>	<b>4</b>	<b>612</b>

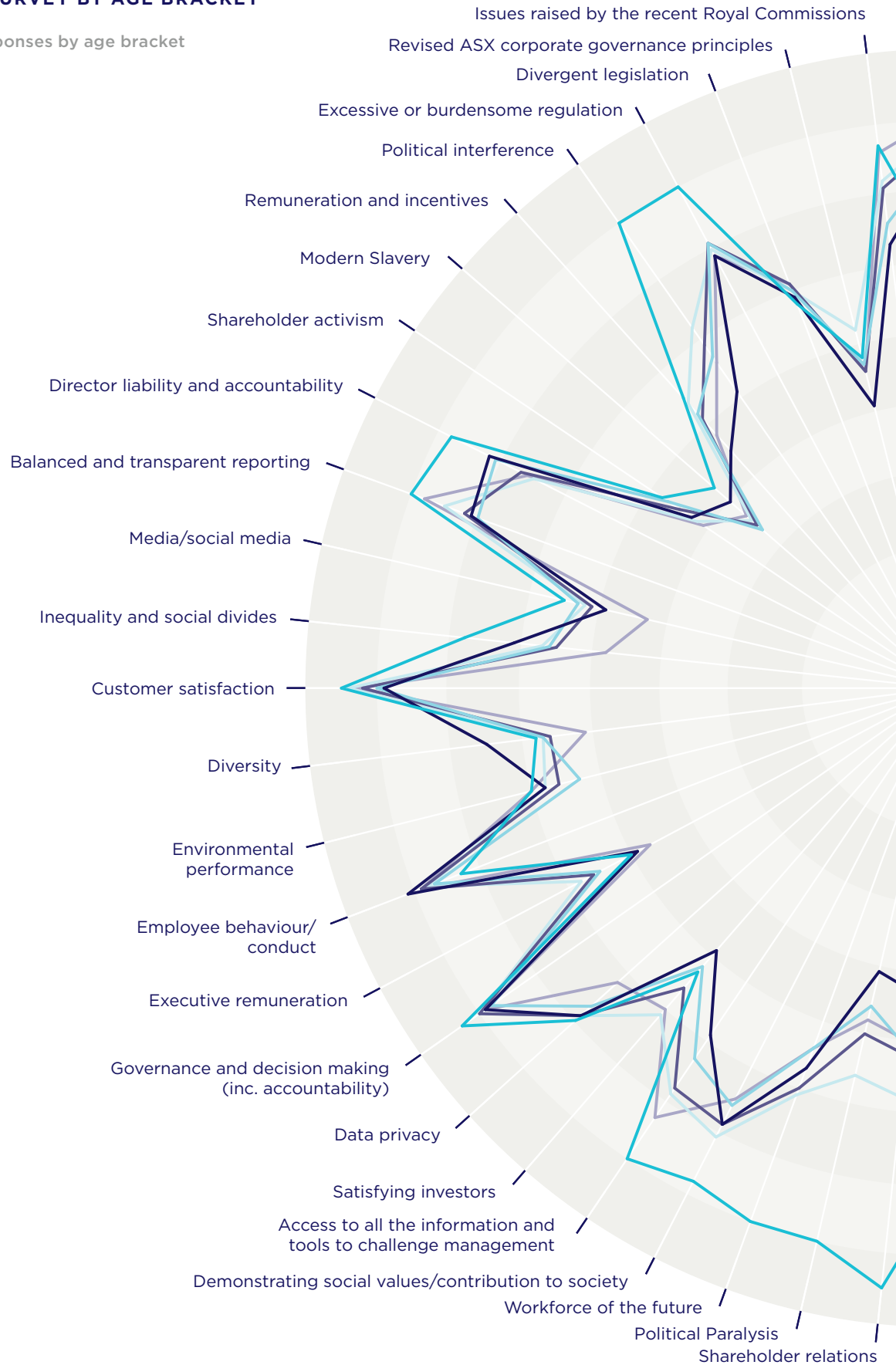
Each respondent was asked to rate answers to eight questions, using a scale of 1-9, where 1 represented 'least significant' and 9 was 'most significant'. Each response was not discrete, meaning that a respondent could rate more than one factor as a 9 (most significant). This allowed respondents to weight issues that they felt could be of equal significance. The results focus on key themes rather than pinpointing specific issues as operating in isolation, as that would be unrealistic in our complex and highly networked world.

Of note in the overall results is the contrast in answers based on the age of the respondent. It is evident that the younger directors (aged 18 – 34) are much more passionate about the potential impact of cybersecurity, innovation and disruption, digital transformation, cost competitiveness and the workforce of the future. It is also surprising that the nearest group to the younger directors in sharing those views are those aged 75 and over.

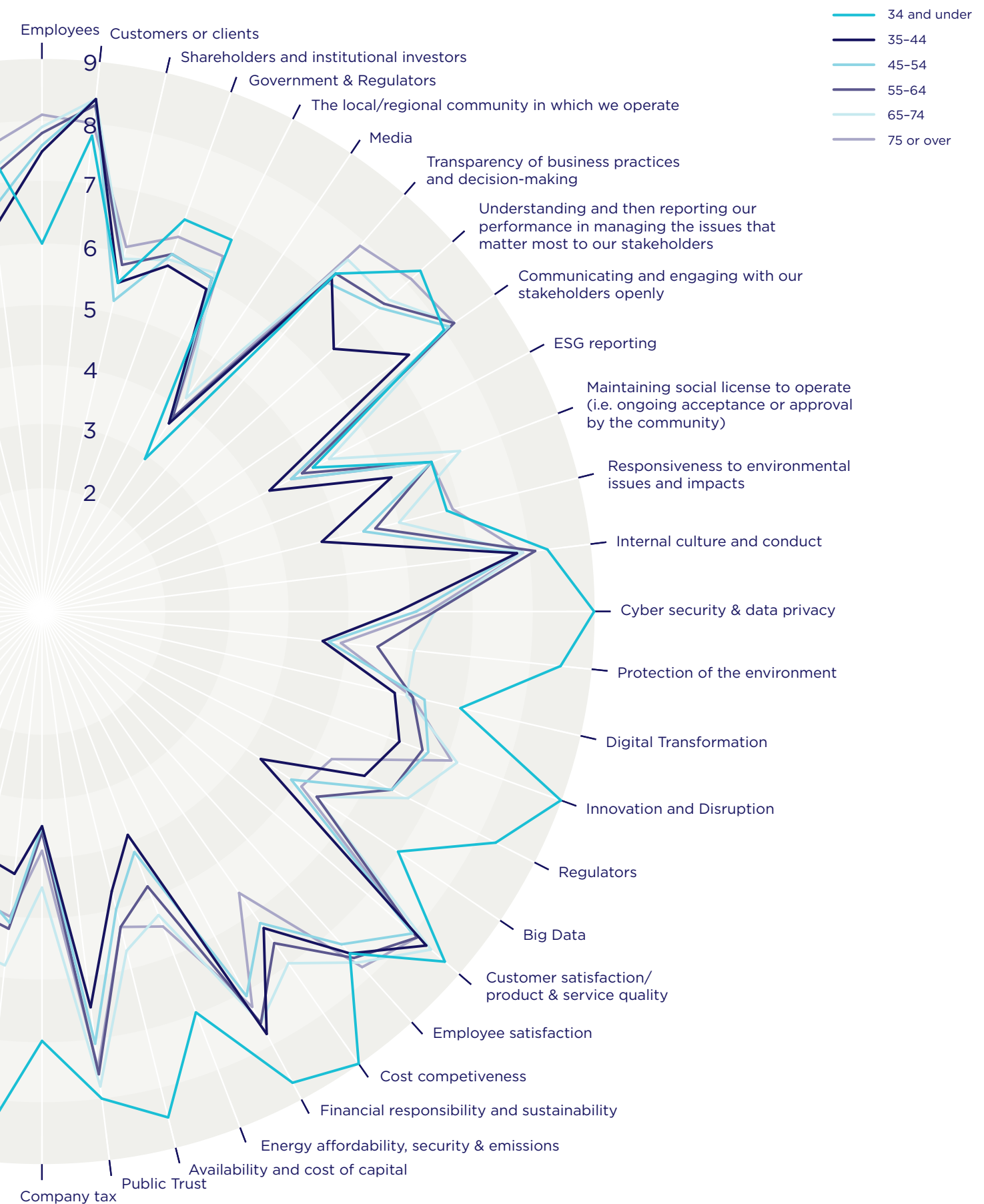
See graph on the following page.

**AICD & KPMG ENTIRE SURVEY BY AGE BRACKET**

Figure 1: Entire survey – responses by age bracket







Winning back community trust

“After 12 months of the Hayne Royal Commission and what it exposed, perhaps it is not surprising that the survey found that treating customers well is top of mind for directors. Organisations are finally embracing the idea of the customer being king, and are now truly putting customer at the centre of their thinking.”

Alison Kitchen, Chairman, KPMG

We know that trust in all sectors has diminished and that directors are focused on building back the confidence that enhances the speed of transacting and the ease of delivering value. The *Edelman Trust Barometer*<sup>2</sup>, released in February 2019, notes that globally the “trust gap” has widened. The trust gap measures the difference in levels of trust of the informed public (those aged 25-64, college educated, in the top 25% of household income and report significant media consumption) and the mass population (all respondents less the informed public, 84% of the total global population) has widened. This is also referred to as “trust inequality”. The global trust gap is outlined in the table below.

TRUST INEQUALITY RETURNS TO RECORD HIGHS  
TRUST INDEX (23-MARKET AVERAGE)

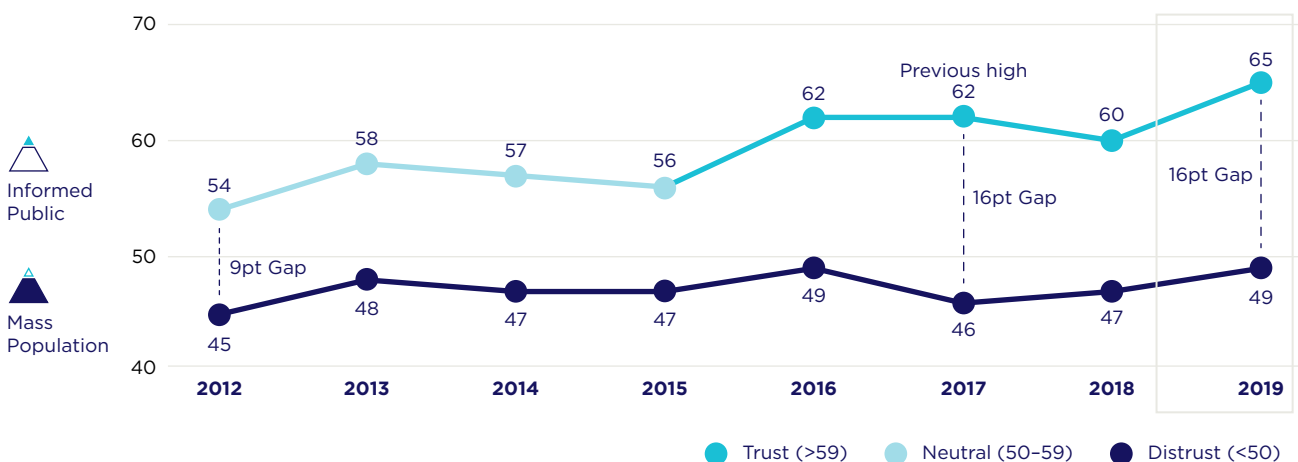


Figure 2: Global trust inequality. Source The Edelman Trust Barometer, 2019. Available at: [www.edelman.com](http://www.edelman.com)

<sup>2</sup> <http://www.edelman.com.au/>

Some particular points for directors from the 2019 Edelman Trust Barometer include:

- The global trust gap between informed public and mass population is at a record high. A consequence that we see playing out in many countries is the rise of populism.
- Fears of job loss remain high, with 59% of those surveyed fearing job loss due to not having the right training or skills.
- People are increasingly looking to business to lead – 76% (up 11 percentage points) and say CEOs should take the lead on change rather than wait for governments to impose it.

- People are turning to their employer and fellow employees as their most trusted relationship, and are looking to them as a trustworthy source of information about social issues and topics on which there is not general agreement. Employees are also increasingly turning to their employers to allay fears and insecurity in the fast-moving uncertain world.

In Australia, we are still in a state of distrust, despite a slight uptick in our all-time low trust measure of last year (2018). However, Australia’s trust gap, uniquely, is not increasing, due largely to declining trust among the informed public, particularly women, meaning that, in Australia, the informed public are moving closer to the levels of distrust felt by the mass population.

**TRUST INEQUALITY FALLING IN AUSTRALIA**

**TRUST INDEX**

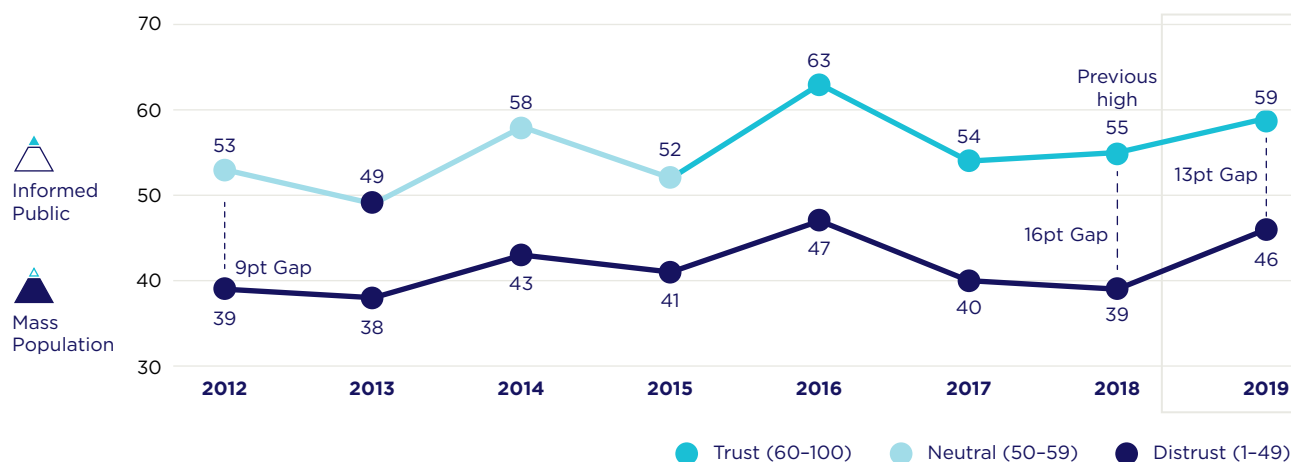


Figure 3: Trust Inequality in Australia: Source: Edelman Trust Barometer 2019. <http://www.edelman.com.au/trust2019/>

While CEOs are the least trusted, a level of distrust also remains with our politicians, businesses, NFPs, and even government entities. Those charged with regulating our institutions have also been found lacking, unable to maintain their integrity as a result of a range of investigations, perceived lack of enforcement actions, scandals and of course, Royal Commissions.

**Rebuilding culture**

A key factor in the loss of trust by companies and institutions is the breakdown of culture, which opens the way for misconduct and the poor treatment of customers.

This was identified in the *Hayne Royal Commission*.

In the *Hayne Royal Commission*, Commissioner Hayne highlighted four key areas of underlying cause of misconduct:

1. Misconduct and behaviour was motivated by profit (incentives were not rewarding good conduct)
2. Misconduct occurred because it could (there was an imbalance of power between the entity and the consumer)
3. The use of intermediaries created conflicts of interest that did not work in the favour of the customer
4. There was a lack of accountability when the law was broken.

The recommendations echoed the findings of the Australian Prudential Regulatory Authority (APRA) report into CBA (May 2018)<sup>3</sup>. The key themes of that report highlighted significant governance and organisational deficiencies including:

- Ineffective oversight
- A culture of complacency
- Ineffective escalation of issues
- Lack of accountability of the board and senior management
- No ‘voice of risk’, nor an adequate ‘voice of the customer’.

Add to this the findings from other investigations – including the Royal Commissions into Institutional Child Abuse and into Quality and Safety in Aged Care – and it is evident that culture, conduct and behaviours have in large part led to poor or sub-standard outcomes for customers, clients or recipients of institutional care. Systems and processes in place were thought to be adequate but were found not to be robust, allowing for complacency, judgment reflective of ‘group think’ and incentives, and ultimately a poor culture.

The findings of all these investigations has impacted the role of boards and directors. Some directors have already lost their jobs because they failed to adequately fulfil their duties and meet the expectations of the shareholders – but more importantly – of the community. It is the pressure of community expectations that has probably been felt most.

“Boards should consider how they can communicate a clear sense of purpose that engages employees through alignment to their personal values. The broader community and customers are also increasingly looking to business to demonstrate a sense of purpose and values.”

.....

Angus Armour, CEO, AICD

<sup>3</sup> Australian Prudential Regulatory Authority, Prudential Inquiry into the Commonwealth Bank of Australia, April 2018. Available at: [www.apra.gov.au](http://www.apra.gov.au)

# 1. Stakeholders

## Who are the critical stakeholders for board directors?

Directors predominantly consider customers and clients as the most critical stakeholders, with 360 of the 612 respondents rating them as the 'most significant' stakeholder (i.e. rating them a "9") with respect to maintaining the relevance and viability of their organisations. This was closely followed by employees, with 234 respondents rating them as 'most significant' for the same criteria. Both elements achieved an overall average score of 8 out of 9.

Shareholders & Institutional Investors, Government & Regulators and the local community were behind, averaging a rating of 6 out of 9.

Given a blended mix of respondents, including NFP and government, there is a partial rationale for the relatively low rating of shareholders. However we would still expect that shareholders and owners, an important stakeholder group, would have ranked higher given the focus of private and listed respondents.

### CRITICAL STAKEHOLDERS

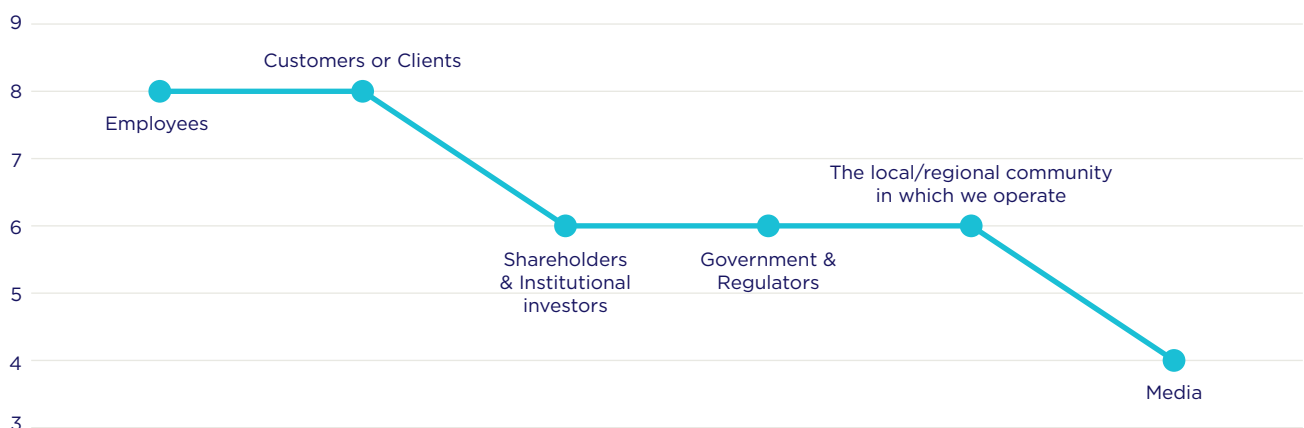


Figure 4: Question 1 - To maintain the relevance and viability of my organisation, the most critical stakeholders are... (rated on a scale of 1-9 where 9 is "most critical" and 1 is "least critical")

We are seeing these results play out in corporate boardrooms, with a greater focus on how the organisation engages with employees, customers and clients rather than purely focusing on keeping shareholders happy.

“Shareholder benefits are a function of customer and client engagement, who judge the entity based on the company’s product relevance, their value for money and good service pre, during and after sales.”

.....

Sally Freeman, Partner and Head of Board Advisory Services, KPMG

### 1.1 How to build stakeholder engagement

Asked about the most critical factors for building stakeholder engagement, directors rated ‘communicating and engaging with stakeholders openly’ as the most significant.

Next most highly rated were ‘transparency of business practices and decision making’, and ‘maintaining social licence to operate’.

Notably, these three factors are all closely related, with a focus on how information about the organisation, its performance and its practices are communicated to its stakeholders.

The least critical factor for building stakeholder engagement was ‘Environmental, Social and Governance (ESG) reporting’. ‘Responsiveness to environmental issues and impacts’ also rated poorly. This suggests that reactive and arm’s length engagement (such as published annual reports) is not considered to be an effective means of engaging meaningfully with stakeholders.

In the context of customers and employees, this resonates through stakeholders wanting – and sometimes demanding – to understand the culture of the organisation, which in turn influences how they perceive the future value of the organisation. As many directors pointed out, ‘getting it right’ with customers and employees is critical to maintaining the organisation’s ability to operate, and to ultimately ensure its financial performance and ongoing viability.

## CRITICAL FACTORS FOR STAKEHOLDER ENGAGEMENT

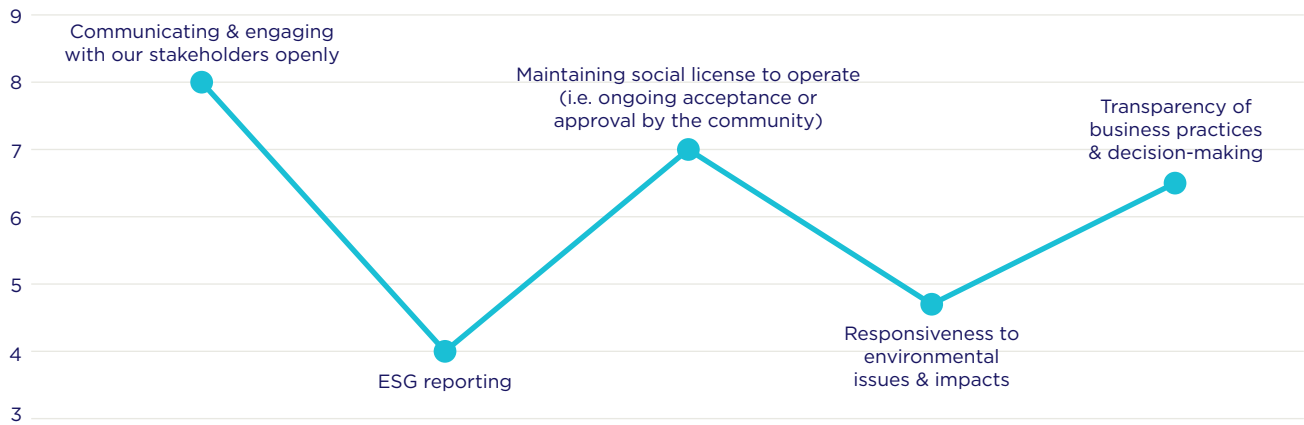


Figure 5: Question 2 - The most critical factors for building stakeholder engagement in my organisation are... (rated 1-9 where 9 is "most critical" and 1 is "least critical")

Comments from directors highlighted several critical factors for building stakeholder engagement, such as delivering on the strategy and objectives, quality of service to customers, and meeting stakeholder targets and expectations. However, in the end it is customer engagement, culture, and how these factors are communicated, that will build integrity, trust and brand value.

The board's role in overseeing an entities' culture was emphasised by Commissioner Hayne in the *Hayne Royal Commission*, where he states that directors should measure and monitor their organisation's culture and governance, identify any problems, rectify the problems, and finally, determine that the problems have indeed been rectified.<sup>4</sup>

<sup>4</sup> Hayne Royal Commission into the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Volume 1, Recommendation 5.6, page 36.

## 2. Value

### 2.1 Creating value for the future

Directors were asked to assess 19 issues that are likely to impact their organisation, and its ability to create value for the future. We have categorised these issues into six key themes:

1. Financial – availability of cost and capital; company tax; cost competitiveness; financial responsibility and sustainability
2. Environmental – protection of the environment; energy affordability, security and emissions
3. Trust and external relations – customer satisfaction/ product service and quality; public trust; shareholder relations
4. Politics and regulatory – regulators; political paralysis
5. Technology and security – innovation and disruption; digital transformation; cybersecurity and data privacy; big data
6. People, conduct and culture – Demonstrating social values; employee satisfaction; internal conduct and culture; workforce of the future.

#### KEY ISSUES THAT COULD IMPACT SUCCESS

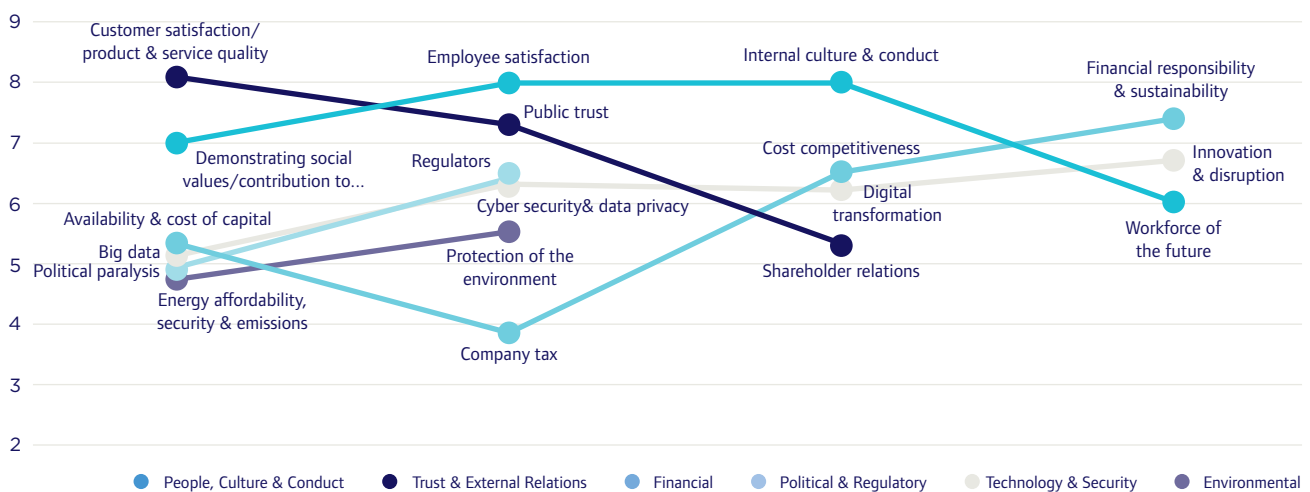


Figure 6: Question 3 – The critical issues impacting my organisation are: (rated on a scale of 1-9 where 9 is “most significant” and 1 is “least significant”)



Many respondents noted that all of the named factors in the survey were relevant to creating value – and so they tried to focus on those they felt had the greatest impact on the organisation’s ability to sustain its core business. Respondents also highlighted the challenges of trying to balance these sometimes competing influences.

Overall, the elements that were weighted most heavily as ‘very significant’ were ‘customer satisfaction/product and service quality’, ‘internal culture and conduct’, and ‘employee satisfaction’ – each being equally rated as an 8.

This tells us that directors are seeing the need to focus on improving outcomes for employee and customer satisfaction over short term financial performance and shareholder returns. These elements are seen to be critical to maintaining corporate reputation.

These results are part of a growing perception that the focus of governance and culture activities in the wake of the global financial crisis was too narrow, focusing only on financial soundness and stability.

Cultural initiatives, often focusing on values, have failed to consistently lead to good outcomes for customers. With the release of the *Hayne Royal Commission*, and in echoing the APRA Inquiry into CBA, it continues to be clear that supervision must extend to include non-financial risks and must include culture, governance and remuneration.

“KPMG believes directors see the need to focus on improving outcomes for employee and customer satisfaction over short term financial performance and shareholder returns. The critical issues in running a business are the customers. Without customer satisfaction you quickly lose the trust of the public and your employees. From there, it’s a hard road back.”

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Stefanie Bradley, Partner, People and Change,  
KPMG

## Culture starts with leadership

Following the *Hayne Royal Commission*, many boards have been considering how to address the issue of culture as it applies to conduct and non-financial risks. Many note that governance and remuneration systems are tangible, whereas ‘culture’ is complex, an outcome of context and many other factors.

It is tempting to conflate tangible systems, regulation and culture, whilst neglecting the single most important issue – leadership. All of these big organisational conduct and culture issues begin and end with leadership at the director, executive and board level. That is not to say that tangible systems, like remuneration and incentives can be ignored; remuneration and incentives, especially variable remuneration programs, tell staff what the organisation values. Remuneration both affects and reflects culture.

Recommendation 5.6 of the *Hayne Royal Commission, Changing culture and governance*, is a centrepiece of the report and a lens through which all other recommendations should be read. As noted earlier, Commissioner Hayne has directed that financial services entities are to take proper steps to assess the entities’ culture and governance, identify any problems, deal with those problems and thereafter determine whether the changes made have been effective.

This recommendation seems straightforward, and on the surface may not appear as though much has changed – after all, Prudential Standard CPS220 Risk Management and equivalents have requirements around risk culture already. However, it is important to note the additional expectation – that an organisation “*determine whether the changes it has made have been effective*”.

For many organisations, conducting a risk assessment and outlining remedial actions are already part of their ongoing activities. However, risk culture is a nebulous concept, and difficult to measure in any quantitative way outside of one-dimensional risk surveys.

Demonstrating genuine effectiveness of culture change to the board will be a challenge for many. Measuring the effectiveness of changes is made more challenging as an organisation’s culture is built over time, and is only changed slowly.

APRA has been directed to re-establish its culture supervisory capabilities, and to take a more active role in the supervision of culture in including “assess(ing) the cultural drivers of misconduct in entities”<sup>5</sup>. Organisations wanting to avoid close cultural scrutiny from APRA would do well to take steps to understand and deal with their cultural problems as the recommendation suggests a “risk based approach” given cultural work can be resource intensive, and therefore needs to be focused.

Our AICD/KPMG director survey, also found the second most weighted group of issues likely to impact the organisation was ‘trust and financial responsibility’, and ‘sustainability’, with a strong rating for ‘cost competitiveness’. This was particularly evident amongst public sector and NFP entities which rated public trust and demonstrating social values as the most relevant.

Private sector and listed entities, were more financially focused, rating ‘company tax’, ‘shareholder relations’ and ‘innovation and disruption’ as the most significant.

<sup>5</sup> Hayne, Kenneth Hayne Royal Commission – Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Volume 1, 1 February 2019, Recommendation 5.7, available at: <https://financialservices.royalcommission.gov.au/Pages/reports.aspx#final>

## 2.2 What elements of performance are most important in measuring long-term value?

So how does an organisation measure performance in this environment?

Again, respondents indicated a move away from measurements of long-term profit towards more customer and employee-centric analysis.

Some 30% of directors rated 'customer satisfaction' as a key metric for measuring the organisation's ability to deliver value. Following this were 'values' (effective leadership and workforce alignment to company values) and 'employee engagement and innovation' came in at 18% and 17% respectively.

### MEASURING PERFORMANCE

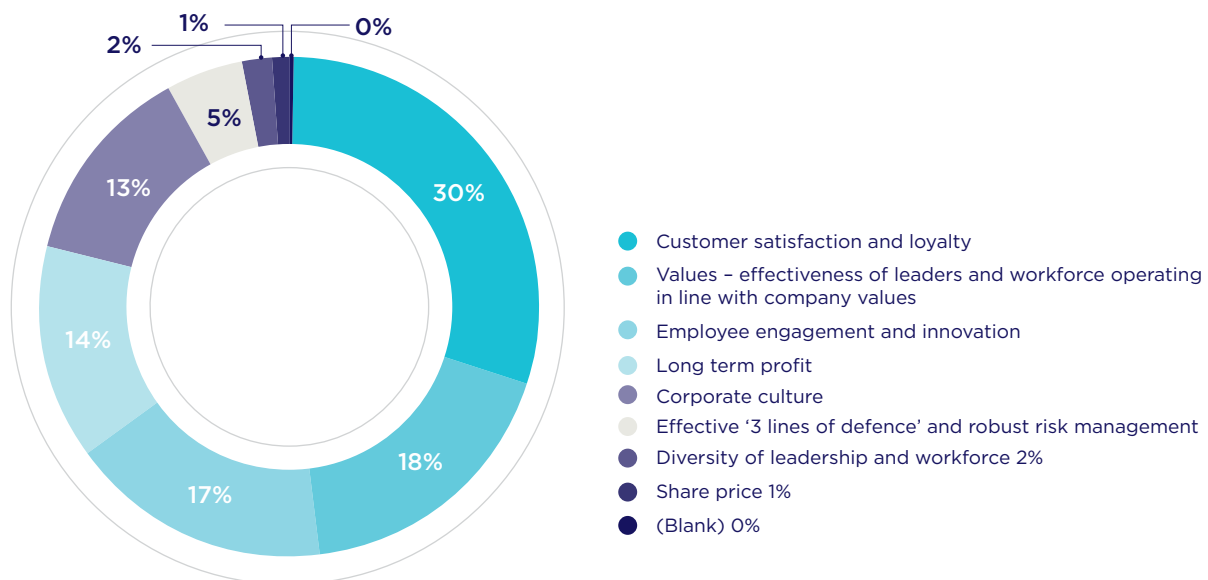


Figure 7: Question 4 - What elements of performance are most important in measuring your organisation's ability to deliver value?

### 2.3 Do directors’ have the right tools and information to actively and efficiently challenge management?

A crucial part of the director’s role is to hold management to account. Some 50% of respondents felt that they had access to all the information and tools needed to challenge management on issues that had the potential to undermine stakeholder value (answered 7 or above). Of concern is the 35% of directors who were less confident in the information that the board was receiving and whether it was less sufficient to facilitate rigours debate and challenge (rating 5 or ‘rather not say’).

#### RELEVANCE OF BOARD REPORTING AND INFORMATION

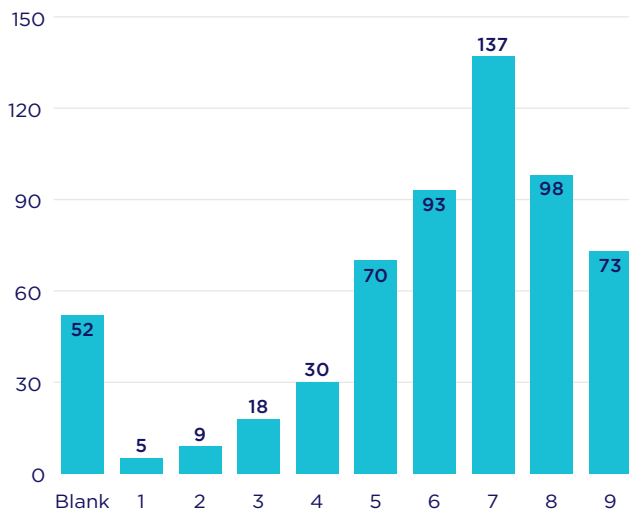


Figure 8: Question 5 – My board has access to all the information and tools it needs to challenge management on how the organisation responds to issues that can undermine stakeholder confidence and erode value – and does so actively and effectively (rate out of 9 and give

Directors are recognising the need for enhanced scrutiny of board papers, lifting the level of challenge, and looking for the ‘canary in the coal mine’ which will alert them to emerging issues that warrant further board inquiry.

The *Hayne Royal Commission* noted that boards cannot operate without the right information and that it must be sufficient to enable directors to challenge management on issues such as breaches of the law and standards of conduct.

Proper governance requires setting priorities which may mean the choice between conflicting goals or courses of action.

Early intervention is critical for boards that wish to stay ahead of the curve and definitely ahead of the enhanced and robust regulators.

“No longer is the reporting of historical averages going to satisfy directors. They are looking for key risk indicators that highlight issues where future value may be eroded.”

.....

Sally Freeman, Partner and Head of Board Advisory Services, KPMG

### 3. Post-Royal Commission **issues** for directors

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It is not surprising to see issues of ‘accountability’, ‘trust’, ‘conduct’ and ‘transparency’ being rated most highly as being critical to maintaining corporate reputation – issues which were subsequently highlighted in the *Hayne Royal Commission*.

Based on the data already discussed, the Hayne Royal Commission served to enhance the focus that was already emerging – customer centricity and ethical conduct moving onto the board’s agenda and strategies.

“It is the entities, their boards and senior executives who bear primary responsibility for what has happened, close attention must be given to their culture, their governance and their remuneration practices.”

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Hayne Royal Commission – Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, February 2019

The case studies examined during the Hayne Royal Commission are well known to not only those customers who made the submissions, but to the regulators, public and corporate community at large. There can be no doubt that the impacts on the corporate reputations of the financial institutions – and individual directors and executives – who took the stand during the Royal Commission have been significant. These lessons are not lost on directors on non-financial services entities.

Directors surveyed consistently rated ‘customer satisfaction’ as the most critical factor for maintaining corporate reputation, with ‘governance and decision-making (accountability)’ and ‘employee behaviour/ conduct’ also rating highly. Corporate reputation is – and should be – an important consideration of all organisations, with directors keeping a watchful eye on how to maintain this valuable organisational asset in a complex social landscape.

**MAINTAINING AND ENHANCING CORPORATE REPUTATION**

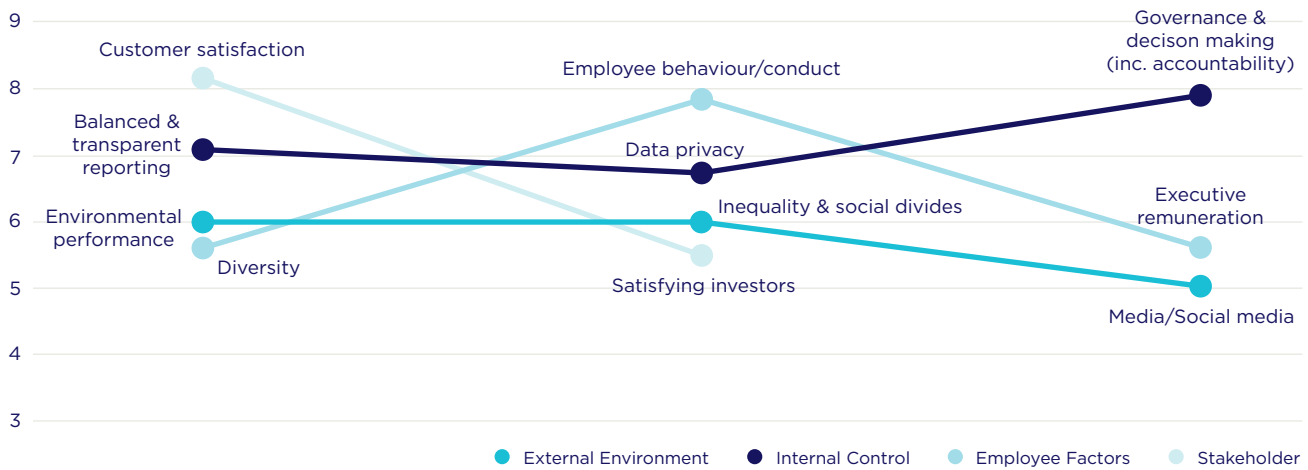


Figure 9: Question 6 - In an era of declining trust and greater scrutiny of business, what issues do you see as critical in terms of maintaining/enhancing corporate reputation (rated on a scale of 1-9 where 9 is “most critical” and 1 is “least critical”)

Directors felt that the Royal Commission – which had yet to hand down the *Hayne Royal Commission* when our December 2018 survey was carried out – had sharpened the focus on director liability and accountability and increased the likelihood of excessive or burdensome legislation. (This was particularly felt by directors of

larger organisations >\$500m revenue). We now know that in the *Hayne Royal Commission*, Commissioner Hayne has in fact encouraged less burdensome regulation, and yet we note the increased likelihood of enforcement action in courts and penalties.

#### DIRECTORS' AREAS OF CONCERN POST HAYNE ROYAL COMMISSION

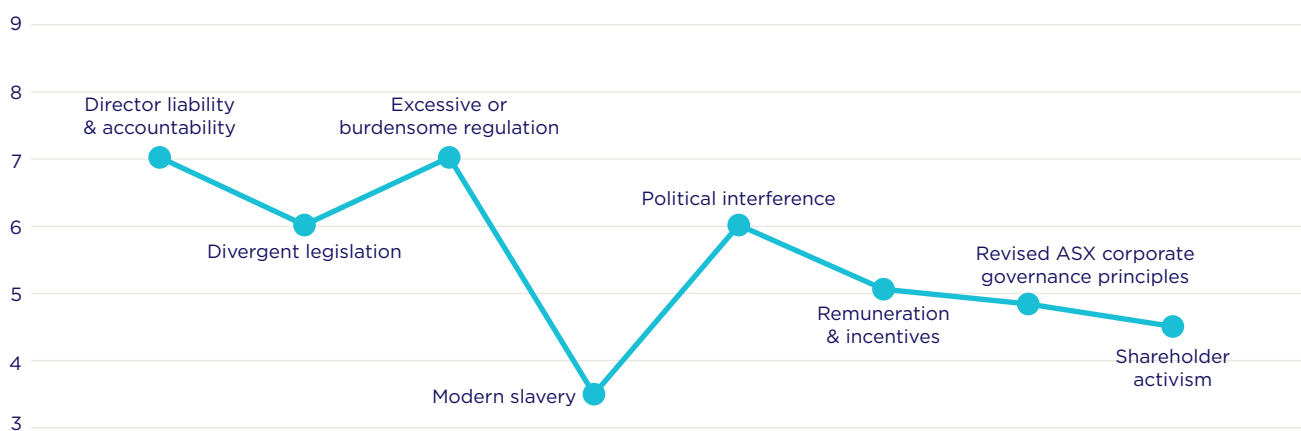


Figure 10: Question 7 - With enhanced regulatory oversight expected post Hayne, I am most concerned about “...” (rated on a scale of 1-9, where a 9 is “most significant” and 1 is “least significant”)

In an environment where customers and employees have emerged as most significant to the relevance and viability of the business (whether pre or post the *Hayne Royal Commission*), 60% of directors surveyed still felt relatively confident that their organisations were able to simultaneously deal with – and possibly mitigate – past mistakes while also focusing on plans for future growth and investment (rated 7 or above). However 30% were less confident in this respect, and felt addressing the errors of the past could be a distraction from focussing on future plans.

**BALANCING THE MISTAKES OF THE PAST AND THE NEEDS OF THE FUTURE**

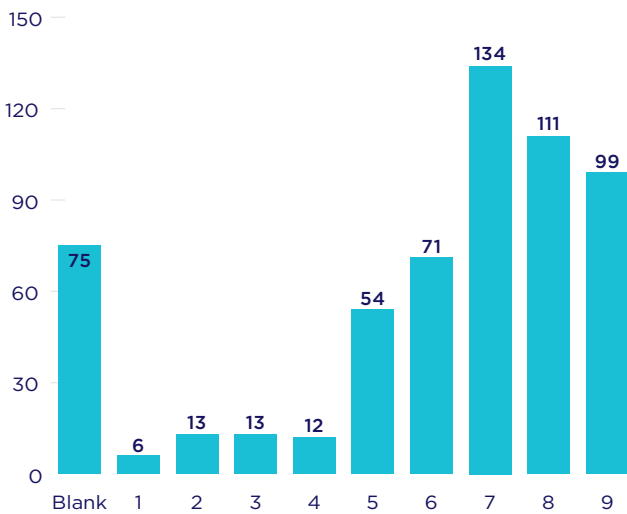


Figure 11: Question 8 – Given the issues raised by the recent Royal Commissions, my board and executive management are able to balance dealing with, and if necessary mitigating, past mistakes and business issues while still focusing on the our plans for future investment and growth (rated on a scale on 1-9 where 9 is “strongly agree” and 1 is “strongly disagree”)

Further to this, the *Hayne Royal Commission* reiterated that directors must exercise their powers and discharge their duties in good faith in the best interests of the corporation, and for a proper purpose. This reinforces that it is the corporation (and not the shareholders) that must be the key focus of director duties.

The *Hayne Royal Commission* also stressed the equal importance of non-financial risks including compliance risk, conduct risk, regulatory risk and operational risk as the types of risk that are more often associated with misconduct and which are more difficult to measure than financial risk.

The current landscape is forcing many directors to focus on how they guide their boards and organisations to maintain a higher level of public trust, demonstrate social values, and contribution to society, and to stay on top of the impacts of innovation and digital disruption. Without success in this critical role, organisational integrity is eroded and detrimental financial impacts ultimately follow.



## 4. What are the practical steps for directors in 2019?

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Directors should expect further game-changing implications from technology/digital innovation; greater scrutiny of corporate culture; growing demands to address environmental and social issues; rigorous regulators in all sectors; and investor expectations for greater board engagement, diversity, and long-term value creation.

Additionally, there are growing concerns about mounting trade tensions, resurging debt, high valuations, and political swings in Australia, the US and the UK.

The result is that the year ahead will require a careful balance of near-term focus, agility, and long-term thinking.

Drawing on insights from our survey and interactions with directors and business leaders over the past 12 months, we've highlighted seven items for boards to consider as they focus their 2019 agendas on the critical challenges at hand and on the road ahead:

1. Look at the talent in the boardroom. Is it diverse and aligned with the company's strategy and future needs?
2. Recognise that connecting digital disruption with risk management and strategy is more important — and more challenging — than ever.
3. Help focus the company on long term value creation and understand the views of all key stakeholders.
4. Make CEO succession and talent development throughout the organisation a priority.
5. Assess, monitor, and reinforce culture as a strategic asset and critical risk.
6. Continue to refine boardroom discussions about cybersecurity and data privacy as risk management issues.
7. Reassess and reposition the entity's focus on customer.

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