Good governance about practices, principles and outcomes

Organisations and governing bodies.

Language of IIRC Framework, Dec 2013

Language of King IV, Nov 2016

Protocol for governance for SOE’s in SA
Governance about practices, principles, and outcomes

Enterprise - strategic

Risk for reward – business judgment calls

Good governance and BJ call errors

Acceptable with quality of governance

Bad governance - error - scandal

Not acceptable
THE GOVERNANCE EQUATION

Governance

UNIFIED

Governance principles, best practices and outcomes

BJR

Enterprise and business judgment calls (strategy)
INCAPACITATED PERSON

- Young healthy individual, soul and heart in the body
- Incapacitated of mind
- Artificial person no heart, mind or soul
- Directors become the heart, mind and soul
- Content to a director’s duties of good faith, care, skill and diligence
An individual with immortality lacks a soul to be punished by the Almighty,
Lacks a body to be punished
Is a person without a conscience

“No soul to be damned and no body to be kicked.” Lord Thurlow 1844

Negative reaction by society to a person not being a creature of the Almighty
“OWNERSHIP” – A SOCIAL CONSEQUENCE

- Wealthy families provided the equity capital
- Members of the families directors
- Seen as “owners” of the organisation
- Primacy of the shareholder developed
- Public discourse of shareholders’ “ownership”
- Short term profit for shareholders even at a cost to society and the environment
- Free economy subsidized monetary gain
- Focus on financial capital
The Primaçy of Shareholders Reinforced

- The Dodge Brothers vs Henry Ford 1919 – minority shareholder
- Ford wanted to use profits to pay better wages
- Court ordered Ford to discharge its primary duty to shareholders and pay a special dividend
- So thinking was directors had to act in the best interests of the shareholders - primacy
- Corporate success was equated with share price
- There was a focus on the AFS
- The financial manager became known as the CFO
OWNERSHIP?

Shareholders are “the owners of the business” and the responsibility of the corporate executive is to “conduct the business in accordance with their designs, which generally will be to make as much money as possible while conforming to the basic rules of society …. There is one and only one responsibility of business – to use its resources and engage in activities designed to increase its profits as long as it stays within the rules of the game ....” Friedman

- Tacit – company not part of society
- Principal (shareholders) agent (directors and managers)
OWNERSHIP MYTH DEBUNKED

- Shareholders no rights:
  - To possess the company’s assets
  - To use the company’s assets
  - To manage the business of the company
  - To the income of the company
- Shareholders have no duty or responsibility to the company
- Representative shareholder duty of RI to their ultimate beneficiary hence UNPRI
- Practising RI a driver of quality governance
THE ERROR OF CORPORATE LEADERS

- Duty to the organisation not shareholders
- Agency theory requires directors to obey
- Independence of mind fettered
- An organisation’s health not its shareholder’s wealth
- Time has come to challenge maximising shareholder value
- Distracts boards from building the organisation’s health
- Professors Stout (Cornell) and Paine (Harvard)
UNTIL THE END OF THE 20\textsuperscript{TH} CENTURY

- Organisation and its activities seen through a financial lens
- Corporate reporting was only financial
- Backward looking
- In automotive terms a car with rear view mirrors and no windscreen
All organizations depend on a variety of resources and relationships for their success. These resources and relationships can be conceived as different forms of “capital”.

Source: Incite  *Sustainability 2.0: A Guide to Competing in a Changing World*
COMPONENTS OF MARKET VALUE

Source: OCEAN TOMO LLC
January 1, 2015
INTANGIBLE ASSETS

- Ecological overshoot and population explosion
- Strategy – long term value creation
- Reputation – perceptions of stakeholders
- Supply chain – legitimacy of operations
- Human rights – child labour
- Stakeholder relationships – civil society
- Positive and negative impacts on triple context
- The quality of governance of the organisation
- How does the organisation make its money?
INNOVATIONS IN CORPORATE REPORTING AT BEGINNING OF 21ST CENTURY

- Enhanced business reporting
- Balanced score cards
- Triple bottom line – theory - context
- Sustainability reporting
- Each trying to communicate value creation
BEYOND FINANCIAL REPORTING

- Reporting in monetary terms
- FR critical but not sufficient
- SR critical but not sufficient
- The two in silos divorced from reality
- Triple context – dimensions – SDG’s
DRivers of change (1)

- Global financial crises
- Climate change crisis
- Ecological overshoot
- Radical transparency
- Greater expectations from stakeholders
- Stranded assets
DRIVERS OF CHANGE (2)

- Responsible investment
- Population growth
- Digital and net generation era - fourth Industrial revolution
- Cannot carry on business as usual
- Have to learn to make more but with less
FROM PROFIT TO VALUE

- From Friedman’s “free” economy profits
- 21st century value creation by a company
- Historically book value – the difference between total assets and total liabilities
- Book value greater or less than the market value
- Book value equals market value
- Value of money – the present value of discounted future cash flows
- All through a financial lens
How does the organisation make its money?
The positive and negative impacts on the triple aspects of the organisation’s business model and output – financial, social and environmental
Enhancing the positives, eradicating or ameliorating the negatives
Embedding sustainability issues into strategy
As water is critical to the beverage manufacturer
Now value is seen through a sustainable lens in a resource deprived world
In the long term better interests of shareholders
THE SIX CAPITALS

- Financial
- Manufactured
- Human
- Intellectual
- Natural
- Social
At Coca-Cola, we believe active lifestyles lead to happier lives. That's why we are committed to creating awareness around choice and movement, to help people make the most informed decisions for themselves and their families. Coca-Cola commits to:

1. Offer low- or no-calorie beverage options in every market.
2. Provide transparent nutrition information, featuring calories on the front of all of our packages.
3. Help get people moving by supporting physical activity programs in every country where we do business.
4. Market responsibly, including no advertising to children under 12 anywhere in the world.
INTEGRATED THINKING

- Understanding, knowing and then planning:
- How the organisation makes its money/achieves its purpose?
- How the organisation will sustain value creation in the long term?
- Board should determine, inputs, how, outputs and outcomes
Every organisation dependent on relationships and sources of value creation

Mindset change at board & senior management level, including the CFO

Symphony of resources and relationships

Knowledge of stakeholders’ legitimate NIE’s

Greater stakeholder expectations

Agenda items: Inputs to outcomes stakeholder relationships
Board decides how, affects and strategy
To generate long term value
For its business, society and the environment
Success depends on internal and external outcomes:
  • internal financial return
  • external social, environmental and economic results
To be accountable you have to be understandable

“If I had more time...”
INTEGRATED REPORT

[Cartoon image of two men sitting on stools labeled 'Social', 'Financial', and 'Environmental'. One man is stable, while the other is falling off his stool labeled 'Financial'.]
1. **Connecting departments** – one of the most mentioned benefits of Integrated Reporting is the opportunity it provides to connect teams from across an organisation, breaking down silos and leading to more integrated thinking.

2. **Improved internal processes leading to a better understanding of the business** – changes to systems driven by Integrated Reporting requirements are providing greater visibility across business activities and helping to improve understanding of how organisations create value in the broadest sense.
3. Increased focus and awareness of senior management – a shift to Integrated Reporting is increasing the interest and engagement of senior management in issues around the long-term sustainability of the business, which is helping them to gain a more holistic understanding of their organisation.

4. Better articulation of the strategy and business model – better understanding of organisational activities is enabling companies to establish a holistic business model and helping to streamline communications.

5. Creating value for stakeholders – organisations are starting to identify ways to measure the value to stakeholders of managing and reporting on sustainability issues.

(Black Sun)
THE THREE SHIFTS

From ‘Financial Capital Market System’ to ‘Inclusive Capital Market System’

From ‘Silo Reporting’ to ‘Integrated Reporting’

From ‘Short-term Capital Markets’ to ‘Sustainable Capital Markets’
Strategy no longer stops at output
Board needs to be informed of stakeholder relationships, sources of value creation and how the organisation makes its money or achieves its purpose
Board needs an informed oversight
Hence agenda items of inputs to outcomes and stakeholder relationships
“CFO” working with C-suite on an integrated strategy – guardian of values - CVO
IFAC

- G20 meeting in China, September 2016
- IFAC proposals at meeting
- Promoted IR for adoption
- Called for global adoption of IR Framework
- 6 December, 2016 ICGN only value creation
- 11 January 2017 – supports IR for global corporate reporting cohesion
- SEBI – Indian top 500 companies on Bombay SE
- Only value creation used in framework – not profit
- 2017 IFAC promotes IR for SME’s
CHANGING TIMES

- The world - not what it used to be
- Strategy – not what it used to be
- Taxation – not what it used to be
- Stakeholders – not what they used to be
- Transparency – not what it used to be
- Value – not what it used to be
- Raising capital – not what it used to be
- Reporting – not what it used to be
CHANGING APPROACHES

- Mindset changes
- Capitals and stakeholder relationships
- Population growth and diminishing natural assets
- Greater stakeholder expectations
- Responsible investment – UNPRI
- Financial capital to inclusive capital
- Short term capital to sustainable capital
- Outcomes based approach to governance and reporting
What are common sense principles of good governance in this changed corporate world?

- **I C R A F T**
- It must be organisation centric – its best interests
- Has to be in the context of value creation in a sustainable manner – the health of the organisation
- It has to be mindful and a value add with positive outcomes for the organisation
- Cannot be a mindless check list approach
- SDG’s “indivisible and integrated”
Inclusive organisation centric model

16 basic good governance principles – King IV

To achieve four outcomes

Regimen of apply and explain

Equal consideration to the sources of value creation and stakeholder relationships in the decision making process in the best interests of the organisation

(King IV)
FOUR OUTCOMES

- Ethical culture and effective leadership
- Value creation in a sustainable manner
- Adequate and effective controls/informed oversight
- Trust and confidence in the organisation and legitimacy of operations
QUALITY VS QUANTITY

- Quality governance needs to be mindful
- Quality governance needs to be a value add
- Needs to achieve the four outcomes
- If basic principles are practised and the four outcomes are achieved, an organisation has practised good governance
“Action without vision is only passing time, vision without action is merely daydreaming, but vision with action can change the world.”
CONCLUSION

- The vision must be to have an organisation-centric governance model which moves away from yesterday’s primacy of the shareholder. It needs to be implemented mindfully to achieve the four outcomes of effective leadership, value creation, adequate controls and legitimacy of operations.
- We don’t have to grope in the dark.
- We have the light – the IIRC Framework of December 2013 and outcomes-based governance, King IV.
THANK YOU

Prof Mervyn E King SC