GEOFF NUNN & ASSOCIATES
Governance and Board Advisors

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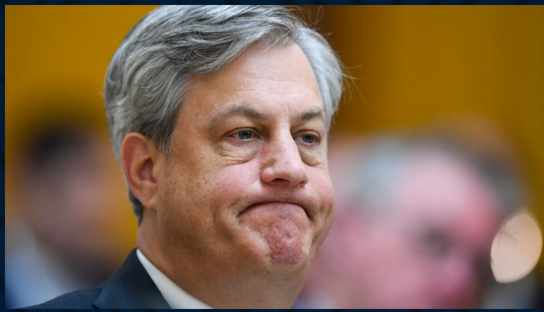
2020 The End of an Era?



Brian Hartzer, Image SMH 26-11-2019

In this Newsletter we review events of 2020 from a macro governance perspective and get out the crystal ball and have a look at what 2021 might hold. We talk about the wisdom of replacement of organisational leadership when a significant breach of legal or governance requirements takes place. In particular the decision by David Murray to step down as Chair of the AMP (under pressure from institutional investors) in the wake of the Bo Pahari scandal. See Pages 2-3.

2020 A Tumultuous Year in Corporate Governance

When 2019 was drawing to a close many of us had a sense that it had been a big year in corporate governance. And it had. We'd seen Westpac Chair and CEO Lindsay Maxted and Brian Hartzer step down in the wash up of the Austrac money laundering scandal. APRA had released a draft standard (CPS 511) effectively imposing tough conditions around executive remuneration in major financial institutions. The fall out from the Banking Royal Commission continued to reverberate across the corporate sector as many boards moved to improved governance oversight and take a broader view of stakeholder relations. Some commentators questioned the profit driven ethos of most private sector businesses and there were calls to change the Corporations Act along UK lines. The UK Companies Act requires boards to take into account the interests of broader stakeholder groups. Not just focus on the interests of shareholders.

As 2020 commenced we had little idea of the challenges that would unfold. There were signs of an outbreak of what appeared to be a variant of the SARS virus in Wuhan. But few anticipated the global pandemic that was to follow. Strategic navigation quickly became the imperative for boards and executive teams throughout the world as they sought to ensure operational continuity, workforce safety and community engagement. TSR and ROE plummeted for many corporates and are just recovering for some.

By any measure most boards and executives in Australia's corporate and government sectors have done an extraordinary job of keeping their organizations functioning over the last ten months There have been relatively few disasters. Virgin Airlines was perhaps the biggest calamity. With $7b worth of debt and most of its fleet grounded administration was inevitable. The new owners, Bain Capital, are moving quickly to rationalize services and re-build the business.

Governments of all persuasions have supported businesses with various grants and allowances. SMEs have been hard hit and many have not survived. Others have shifted focus and managed to hang on by a slim thread. Some are thriving.

Continued Page 2

Geoff Nunn & Associates

Geoff Nunn & Associates was established in 1993 as an independent provider of services to the government and corporate sectors. We specialise in working with Boards and CEOs in the areas of corporate governance, board dynamics and renewal, governance structures and executive remuneration strategy.

Our Services

- Board Advisory Services
- Board Governance Advice
- Facilitated Boardroom Dialogue
- Focused Board Renewal
- SME Strategic Navigation
- Board & Executive Remuneration Strategy

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2021 The Crystal Ball

2021 - A New Governance Paradigm

In early 2020 Geoff Nunn & Associates produced a series of short videos on what the governance landscape might look like as the year unfolded. By February it was clear that the content of these videos had been overtaken by events. Not that it was irrelevant. Just that priorities had shifted. So let's revisit and update them for 2021 in the light of the last 12 months' experience:

1. **Stakeholder Engagement:** Boards are increasingly being called upon by regulators, governments, investors, clients and the general public to consider the interests of a broad range of stakeholders in their strategy development and decision making. Many are doing this already but there is a long way to go.
2. **Workforce Deployment:** The workplace landscape has changed forever. Flexibility in working arrangements has become the norm. But working remotely can never replace the deep bonds and collegiate engagement that permeates a mature work group, whether it's a board of directors or frontline maintenance team.
3. **Technological Innovation:** continues to transform every aspect of business and government. Video conferencing has reduced the need for travel. Remote working has reduced demand for office space. The pursuit of hydrogen technologies will ramp up in parallel with solar and wind.
4. **Executive Remuneration:** There is downward pressure on executive remuneration, particularly at the top end of listed companies in Australia. The general public and regulators are frustrated by the gap between the highest paid executives and those on the shop floor. A quick review of the annual remuneration reports of the top ten listed financial institutions indicates that not much has changed since the Banking Royal commission handed down its findings almost 2 years ago. There is a long way to go in this area.
5. **Corporate Culture:** Boards and executive teams continue to struggle with the notion of corporate culture. They will see culture as the phenomenon that can be measured by employee engagement surveys and other self-report instruments. Thus re-enforcing the current management paradigm that suggests that if it can't be measured it does not exist. Few will undertake the deeper level of analysis required to truly understanded the embedded and contextual nature of their corporate culture.
6. **Ethics and Ethos:** The ethical dimensions of board decision making will be ever present on the agenda. The Banking Royal commission brought home just how far ethical standards has slipped over the last 25 years in the pursuit of profit.

APRA Chair Wayne Byres

7. **The Governance Conundrum:** The rigidity and prescriptive nature of governance regulations in Australia perpetuates the "Governance Conundrum" where directors struggle to balance compliance and procedural requirements on the one hand and strategy and innovation on the other. Some have embraced the need for "De-regulated Dialogue" amongst directors, and with the CEO and executive team.
8. **China Relations:** The Australian Government will continue to struggle to maintain positive diplomatic and commercial relations with China. Mutual respect and equanimity seem absent. Somehow Australia needs to embrace the commercial reality of dealing China whilst diversifying its export market base. As a signatory to the UN Charter of Human Rights (1948) Australia needs to be an exemplar of the principles enshrined therein. This has not always been the case over the last 70 years. We've got work to do to get our house in order. That's not to say we should not call out breaches by other nations. We need to continue to do this openly and with integrity.

Strategic Navigation

Boards across most industry sectors have embraced the lessons of the past year. They have placed strategy as the centrepiece of their governance platform. This will continue for 2021 and beyond as we see a deeper and more connected governance paradigm continue to evolve. One that balances a fair return for investors with community presence and ethical conduct.

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2020-2021 The Governance & Leadership Landscape

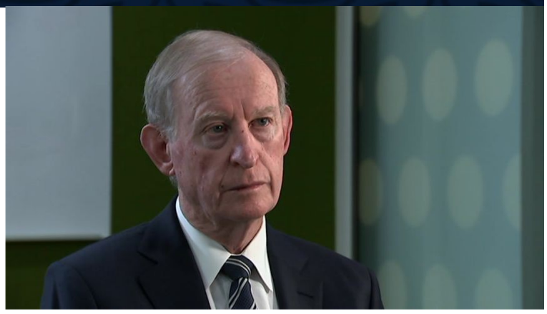

Image ABC 31.10.2018

Replacement as a Governance Strategy

Back in 2018, in the wake of the disastrous findings of the Hayne Royal Commission, David Murray seemed the ideal choice to lead the board of the AMP out of the morass it found itself in. During his 13 years as CEO of the Commonwealth Bank he steered the company from a market capitalisation of $6b in 1992 to $49b in 2013 with an average TSR of over 23 percent. He was inaugural chair of the Future Fund and is former chair of the International Forum of Sovereign Wealth Funds. Who better than to lead the AMP back to prosperity and credibility. Investors were hurting bad. The share price has dropped from a high of $5.89 in November 2015 to just $1.62 at the beginning of September 2020.

Murray should have been the right person for the job. With Francesco di Ferrari as the new CEO, a highly credentialed board and executive team all the ingredients should have been set to turn the ship around. So what went wrong ? Forget the Bo Pahari story. Maybe it was a bad call but not enough to sink the ship. Some asserted that institutional investors were disillusioned with some of the business decisions the board had made. Including the decision to sell the insurance arm of the business at what appeared to be a discounted price of $3.3 billion. They felt there was a lack of consultation on key issues.

There is a tendency in governance to locate the problem with an individual and, of course, the chair, board and CEO are ultimately accountable for the conduct of their organisations. It seems that someone needs to take the fall for justice to be satisfied. Sometimes this is a symbolic gesture. But frequently, when a significant breach occurs, the underlying issues are deeply systemic, cultural and accountability far more widely distributed than holding a single individual accountable would suggest. Organisations may be letting go individuals who literally are the best person for the job. The loss of expertise and cost of replacement can be considerable.

We've seen lots of examples over the last two years. Who can forget Ken Henry and Andrew Thorburn as Chair and CEO of the NAB in the wash-up of the Banking Royal Commission. Lindsay Maxted and Brian Hartzer of Westpac as a result of the Austrac money laundering scandal. Jean-Sebastien Jacques and Chris Salisbury stepped aside as CEO and head of Iron Ore for Rio Tinto following the Juukan Gorge rock shelters debacle. There have been many more.

Organisations conduct an internal investigation when a significant breach occurs. Sometimes an independent investigation is warranted either by a regulator or auditor.

A significant breach requires action. It might be the tip of the proverbial iceberg with significant systemic issues sitting below the surface. These need to be uncovered and worked with. Sometime the language used in a particular organisation can be a guide as to what the underlying issues might be. It reflects the culture. For instance if the language is strongly focused on the competitive nature of the business that the company is in or the need to generate returns, this might be paramount in the mind of the board and executive team to the detriment of social and environmental considerations. This may well have been the case in the Rio Tinto Juukan Gorge rock shelters incident. The incident also reflects the imbalance in the power dynamic where a major multi-national has so much more influence on governments than a marginalized local indigenous community.

The process of bringing these underlying issues into awareness can be painful. It needs to occur outside of the prevailing functionalist and KPI metric driven leadership paradigm. Sometimes the wisdom of letting go the chair, CEO, directors or executives is questionable. Particularly when they have demonstrated outstanding leadership, professional and governance capabilities.

It requires deep reflection and a willingness to discuss the undiscussable. Another governance conundrum.

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