



INSTITUTE OF DIRECTORS
SOUTHERN AFRICA

Governance issues for boards to consider in 2016

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Introduction

Boards of today have the difficult task of steering their organisations, while maintaining proper governance, through these complicated times. With growing unrest globally, fluctuating markets and the matters of internal organisational management, there is a lot to stay abreast of. Boards need to ensure that they stay focused and have clear strategic plans around many potential sink-holes. In this paper the Corporate Governance Network has highlighted some of the dominant governance issues that boards should consider during 2016.

Subsequent to Davos 2016 in a World Economic Forum paper titled

“Why aren't business leaders getting the governance message?”

is was said: “Business and government leaders worry about a multitude of issues these days. Climate change, weapons of mass destruction, water scarcity, migration, and energy are the greatest threats we face, according to the 750 experts surveyed for the World Economic Forum’s Global Risk Report 2016...” yet in the same paper it was pointed out that “...none of the risks highlighted in the WEF report caused the recent spike in debt crises or the wave of scandals that engulfed – just in the last year – Volkswagen, Toshiba, Valeant, and FIFA.” All of which flow from Corporate Governance – boards needs to maintain good Corporate Governance especially around the key governance issues mentioned in this paper.

The below is set out in no order of priority or seniority as each item may be of more or less importance to an organisation and board. However each bear merit in been on the list and should be considered. Furthermore this list is not exhaustive, but is rather the dominant themes which have been highlighted in today’s current times.

Cyber security

Cyber security is a formidable challenge, because of the number of cybersecurity threats and the fact that the sophistication of these attacks is increasing. With the risk of cybersecurity attacks increasing, directors need to increase their understanding and focus on the potential impact and implications thereof.

The Centre for Strategic and International Studies estimated in their report titled

“Net Losses: Estimating the Global Cost of Cybercrime”

that the annual global cost of cybercrime could be as high as \$575 billion. What is clear is that this risk is increasing and due to the demand for information regarding security and prevention, it is clear that

organisations are alive to the jeopardy and danger that looms and it is key for boards to have this as a priority. Finding solutions to mitigate against these risks and putting preventative measures is critical.

In South Africa, we have the draft Cybercrimes and Cybersecurity Bill which was out for comment and we are currently waiting for the next step to progress in its development.

Nick Shutte who is the Head of Financial Lines, Zurich South Africa stated at the IRMSA Risk Lab of 2015 that “the 5 top targets for cyber crimes are smart appliances, social networks, the cloud, androids and Java”. Since the majority of these are utilised in daily business operations, proper protection, information storage and sharing is critical. A clear understanding within the board at a strategic level ensures the proper steps are taken to protect the organisation.

In 2016, we recommend that boards a) understand the cyber security risks facing the organisation; b) obtain assurance over areas of the organisation which are vulnerable for an attack, c) ensure proper controls are implemented to protect the vulnerable areas and d) understand the legal implications for their organisations.

The IoDSA’s Corporate Governance Network is currently working on a paper on cyber security which will be available on the website once issued: <http://www.iodsa.co.za/?page=ForumCGN>

Emerging technologies

The influence of emerging technologies and digital developments continues to grow and have an impact on organisational strategy. Directors are increasingly recognising the importance of considering digital enablement as an inevitable and essential consideration.

For most organisations, these technological and digital developments are impacting on the customer experience as well as the method of delivering their products and services. Communication with customers as well as the methods for sharing of information regarding the organisations’ products and services have significantly changed and the use of technology is obviously the approach of today. Boards need to be attentive to this in order to ensure they utilise this to their organisation’s advantage.

Rapid changes to technology, combined with the expectations of customers to utilise technology to engage in transactions and communications brings a lot of complexity and risk.

“Internet of Things”

is one such technology that brings about a new strategic and information management dimension and a whole lot of possibilities for organisations.

Organisational assets can now connect and share data in ways that were never thought of before, thereby creating an integrated and enterprise wide view of information and operations. "Internet of Things" brings about operational efficiency yet it introduces many risks. Boards now face the challenge of either becoming progressive and adapting to the new landscape or finding themselves left behind.

After Davos 2016 the World Economic Forum released a paper titled "5 Lessons for international security from Davos 2016" and it stated that:

"We are not prepared to manage the security risks coming from technological change."

From the International arena to the boardroom technological developments are coming up as a growing concern.

This has been a difficult time for organisations and we anticipate it will continue into 2016 - changing business processes to keep up with the high speed of the technology evolution is demanding and high risk. While boards may recognise this is unavoidable, making hastened decisions that turn out to be the wrong decisions can destroy the organisation altogether. It's a risk and one that boards must be very alive to when making decisions and deciding strategy in the year ahead.

Board skills, composition and diversity

Board skills, composition and diversity has been top of mind for boards in the last several years and its becoming increasingly important globally. The Global Network of Director Institutes ("GNDI") has recently released a paper around board renewal and these particular points are crucial elements of that process. The paper will be available on their website once issued: <http://www.gndi.org/>.

Having the appropriate skills set within your board is a key motivator to effective board leadership and functioning. A diversified skills set brings different perspectives and input when the board is considering and directing its strategy and decisions. This is crucial for its growth and progression by taking many elements into account.

Current board composition and succession planning is crucial in the strategic effectiveness and planning of the board. A board that is more diverse in its composition and that is planning for its future is progressive and forward thinking. In South Africa, gender and race are prominent themes for a diverse board and there are

benefits to having a gender and race diverse board, both in terms of organisational performance and enhancing the organisation's attractiveness to investors.

Good governance further requires a board with a level of independence, particularly with having independent non-executive directors.

Shareholder activism

Shareholder activism is the method by which shareholders can influence and impact an organisation in the shareholder exercising their rights as owners. There are differing views around whether shareholder activism is positive as it ensures the board and management take cognisance of what the shareholders require and have to say; or whether it is negative in that the board and management are required to comply with the demands of the interfering shareholder.

If the board looks at shareholder activism holistically and for its intended purpose, the outcome should be favourable.

Critical to managing this is ensuring an open-pathway to high quality communication between the shareholders and its boards and management. In addition, executive management need to invite closed group dialogue with shareholders and become more transparent.

Corporate and integrated reporting

In South Africa, the King III Report on Corporate Governance introduced the concept of an integrated report. It provides that by issuing integrated reports, a company increases the trust and confidence of its stakeholders and the legitimacy of its operations. The use of and need for integrated reporting is growing fundamentally due to its inclusive approach.

In 2013, the International Integrated Reporting Council released the Integrated Reporting Framework with the intention of providing a concise global guidance document around how organisations should be developing and creating their integrated reporting approach. This document provided critical necessary guidance to organisations and boards on this new method of reporting.

In 2016, we expect an increasing focus by a range of stakeholders on the integrated report and whether management/the board makes decisions in an

integrated manner. Directors should be aware of key developments in this area.

Compensation and the pay gap

This is an area that has received a considerable amount of attention of late. South Africa has one of the worst gini coefficients in the world and in 2014 the Human Science Research Council ranked South Africa the fourth most unequal society in the world. It has been said that

“Better and more efficient public services, as well as higher economic growth...”

are needed in improve South Africa's overall ranking.

Key for boards is considering the growing pay gap from a sustainability, fairness and inclusive stakeholder point of view and the extent of disclosure regarding the pay gap. Boards are usually assisted by Remuneration Committees on this.

Value creation and strategy

The most successful organisations understand that the purpose of any business is to create value for its stakeholders. A board with its finger on the pulse knows that any and all strategic approaches for 2016 and beyond needs to be linked to the businesses value creation within its market. Good boards are ensuring strategic approaches that are engaged, focused, results-oriented and disciplined. Agendas and committee structures are being revised to focus on strategic primacy and value creation.

The board should provide realistic expectations when testing the organisation's strategic approach and therefore they need to take into account all material factors, global standing, market status and the organisation's capabilities. If the expectation is too high, the board would be setting its management up for failure and if the expectation is too low then the management is not accountable and pushing the envelope for progression and achievement.

In order to avoid these pitfalls of improbable and unworkable expectations around strategy, a clear strategic plan must be created by the management and then stress-tested by the board. Good boards also set out their objectives on an annual basis.

Risk oversight

Risk oversight continues to be a top priority for directors. It is critical that boards evaluate and challenge the organisation's risks thoroughly, remembering that the biggest risks are those that no one anticipates.

Boards should focus on overseeing the organisation's most critical risks and agreeing on the organisation's overall risk appetite. A healthy board risk appetite is needed for the positive movement of an organisation. Boards are becoming risk averse due to the volatile economic conditions and the financial crisis however if we are to progress forward, informed and strategic risks need to be taken for growth and developmental purposes. This is imperative for the board to understand.

Very important is to also focus on the opportunity side of risk, which will have an increased focus in the anticipated King IV Report on Corporate Governance.

Crisis management

A cyber breach is just one type of crisis that an organisation may face. Natural disasters, significant product failures, reputational damage, national financial meltdown, or even sudden changes in leadership are other potential crises examples. How an organisation responds to a crisis is critical since it can have significant implications, particularly on the organisation's reputation.

Ensuring the organisation is ready and capable to deal with these potential crises is something a board needs to have assurance on.

While an organisation cannot prepare for every eventuality, strategic planning should allow for crisis scenarios to be anticipated or pre-empted in the planning process. A detailed crisis management plan is required and the board should be obtain assurance from management on the robustness thereof.

Over legislated and regulated landscape

An over legislated and regulated landscape – leads to organisations ticking the box without proper understanding of obligations and without real buy-in.

This is a dominant theme found in papers and particularly in the USA due to its over-regulation. In South Africa we are heading in that direction too. Many organisations see legal compliance as a tick-box exercise whereby they check their legal compliance because they have to and to avoid penalties and legal repercussions

Boards need to ensure and maintain that an organisations' growth cannot be a welcomed achievement unless it is done in a sustainable, supported and justifiable manner.

("Keeping the CEO out of jail").

That is one of the concerns regarding compliance. Boards need to ensure that the organisation fully understands that legal compliance should not merely be a tick-box exercise but rather one that moulds an organisation in its holistic and strategic thinking. This is particularly the case for applying the King III Report on Corporate Governance. Corporate Governance is a value enhancement for an organisation and is highly beneficial for the growth and progression of an organisation.

Social Media

Throughout January in South Africa we saw the adverse impact of social media on Government, on businesses and particularly on individual reputation. Social media can positively be used as a tool within an organisation to promote and communicate the constructive and progressive developments that an organisation is achieving. However it may negatively impact the reputation and character of the organisation when it is adversely used or held against the organisation.

The organisation must have a strategic risk management plan around the use and impact of both positive and negative social media when a crisis hits as well as a plan around effective communication with stakeholders through social media and both must be on the Boards Agenda in 2016.

Sustainability

As stated in the King III Report on Corporate Governance

"Sustainability is the primary moral and economic imperative of the 21st century. It is one of the most important sources of both opportunities and risks for businesses."

This has never been more prevailing than in today's turbulent times. A complementary balance between nature, society and business needs to be ensured and boards need to ensure they strive and progress towards upholding a balance between these three interconnected and complex arenas.

Notes

Dotted lines for note-taking.



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