Breaking the Deadlock – Roundtable #1
A Breakthrough in Investor Performance

Australian Institute of Performance Sciences

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Introduction

Recent breakthrough Australian research has identified governance practices that lead to sustained highly-effective value-creation in large scale organisations and across public networks. Preliminary evidence demonstrates the potential for significant social and economic benefits for Australia. These includes sustained wage growth and stimulation of an estimated $100Bn additional annual corporate investment in innovation, productivity and exports.

The research also indicates an assessment practice that can be used to measure the quality of an organisation's long-term value-creation practices. This answers the calls from Global fiduciaries, and elements of Australia's Superannuation Investment market for increased focus on long-term perspectives of shareholder and stakeholder value – within climate, sustainability, societal and broader contexts.

Additionally, these enhanced governance practices can be applied to increase transparency and enhancing communication with stakeholders on the organisation's future direction. This serves to provide a counter to the erosion of public trust, and may serve to increase stakeholder (including staff) participation, and increase the value of their contributed effort.

A Breakthrough in Long-Term Investor Performance

Danny Davis, Executive Director of the Australian Institute of Performance Sciences, kicked off the session noting the unequivocal messages coming from an increasing segment of global financial markets, including; large-scale investors such as Blackrock and Vanguard, leaders amongst Australia's superannuation sector, and a range of global agencies. He identified that the call is for increasing focus on long-term perspectives of shareholder and stakeholder value in the context of climate, sustainability, social and broader contexts.

John Stanhope, Vice Chair of the International Integrated Reporting Council, Chair of Australia Post, Bionics Institute and Director at AGL provided an informed background briefing on both movement on the world stage, and the context of making day-to-day and strategic commercial decisions in large-scale Australian organisations. John positioned Governance of Value Creation as a logical extension of Integrated Thinking.

Danny outlined the concepts and supporting research behind Governance of Value Creation as an integrated multi-disciplinary governance model for sustained value creation in large scale organisations. Also, as a future-orientated equivalent to financial governance, how it enables leaders to assure the 'Future Fiduciary' question 'Are we optimally invested in our own future'. He described how, in practical application, this enables consistently enhanced decision-making throughout an organisation in continuous support and optimisation of better future outcomes.

Danny disclosed how Governance of Value Creation provides an accounting-style understanding of the future value (risk and uncertainty mitigated) of all of the work of an organisation, a collaborative network, or a market sector - leveraging the ongoing development of leading practice within all of the supporting professions (risk management, project management, etc.). Danny described the Institute's 'Letter to Fiduciaries' initiative proposing further collaborative development towards the creation of an investible global disclosure framework.

Measurement of Future Value

Implications of Australia Taking a Leadership Role?

Danny Davis asked participants what they saw as the implications of Australia taking a global lead in this area of quantitatively assessing the certainty of an organisation's future prospects. The concept of the future value of opportunities was explored.

One participant commented that the traceability of progress and results is what builds confidence and will also assist in freeing up additional investment capital.

Another participant commented that old-style assurance mechanisms still don't detect that projects are doomed to failure from the outset. Also that projects which no longer have relevant future value, are not stopped.

An industry participant agreed, noting that there was "no problem with availability of capital in Australia"; however, culturally, Australians cannot accept the high rate of failure, which can be as high as 70%, and should be expected.

A couple of the participants noted that there appeared to be a common cause underlying both the poor outcomes of innovation and the lack of confidence in corporates and government. This is that people see the wastage of resources (financial, human, etc.) on projects that fail to deliver the desired outcomes. It was suggested that organisations blindly pursue these initiatives, failing to acknowledge that they are no longer relevant or beneficial, because executives have 'staked their reputation on its completion'. It was also pointed out that these also result in a disinclination to heavily invest in new opportunities.

There was discussion about the research finding which identified that increased corporate and investor confidence in innovation activities, as a result of the broad application of the Governance of Value Creation, has the potential to stimulate an additional A$100Bn of corporate investment in Australia. Upon back-testing with domain experts, these projections were viewed as a conservative forecast.

What Should Australian Super Funds Demand?

A number of participants noted that a number of the Superannuation Funds undertaking Integrated Reporting was a great first step, and a springboard for other companies to follow. It was acknowledged that you could not expect companies that you invest in, to undertake this type of reporting if you don't do it yourself.

The focus on short versus long term returns was also mentioned and comment was made that there was a desire for both, but in the absence of any quantifiable long term measures, the short term performance was the one primarily focused on.

An industry participant outlined a possible implementation approach to solve the problem. This was to first identify the scale of intangible value across the ASX100. With the development of formal auditable mechanisms to measure this value, it would be possible to hold Directors accountable for value-creation through the ASX Corporate Governance Principles.

Another participant suggested that the Australian Superannuation sector could take an exemplar lead in assessing the quality of an organisation's future prospects (as proposed in the Letter to Fiduciaries) by sponsoring its application across the larger organisations in their own investment portfolio. It was suggested this would send a strong message to all Australian CEOs about the need for improving their own long-term sustainability orientation.

Comment was made as to an upcoming release of upgraded ASX Corporate Governance Principles that would see Integrated Reporting applied on an "if not, why not" basis, following the approach taken in other economies.

One participant Commented that Australia had a propensity to follow, rather than lead.

This was countered by several others who used JORC as an example (JORC is a reporting standard for Mining organisations to report the level of certainty around their as yet un-mined resources); this reporting standard was developed systemically in Australia and now mandated by ASX and ASIC for all mining companies listed in Australia, as well as being adopted in over a dozen jurisdictions globally.

Another participant contributed the observation, based on experience, that there is a gap between Australian Superannuation organisations' rhetoric on sustainability and their action, and that regulatory leadership might be the only thing that prompts change.

C-Suite Remuneration Model Implications'?

The perverse incentives inside organisations, including those resulting from KPI, remuneration and incentive packages was discussed, in particular their tendency to focus attention towards the short-term. There was discussion around the application of a risk-adjusted value of future outcomes in the setting of targets for CEOs and CxOs.

It was observed that an incoming CEO could be provided with a statement that the starting value of the future outcomes was $x and their role is to increase it by y% at a minimum and that improvements over a certain amount would attract a bonus. Comment was also made on the trickle-down effect within the organisation, and the resultant impact that it could have on achieving a sharper focus on initiatives and in driving a greater balance between short and long term outcomes.

One group also reflected on the potential for development of a self-assessment tool to provide Chairs with a perspective on the efficacy and adequacy of the organisation's existing future-orientated governance processes, as they apply to executive incentives and other issues.

The following observations arising from research were noted: Incentive plans designed to balance priorities towards the long-term were not working; No one in the organisation, outside of the CEO, is accountable for the RATE of value-creation performance of the CEO; That this outcome was not on the CEO's KPIs, and that being disciplined individuals, they were not engaging with it; and, that several Chairs of large-scale Australian listed organisations reported being 'unable' to raise discussions about these new concepts with their CEOs.

Productivity and Economic Challenges

One participant noted that the money was smart in Australia leading to a lack of willing investors. This outcome is understandable given the poor conversion of investments into tangible outcomes achieved in Australia. According to INSEAD, Australia invests at number 12 globally, by value; however, its rate of value creation is ranked at number 73 globally – just behind Pakistan & Zambia.

It was suggested that Investors and Boards are not investing in optimising their potential to address growing global opportunity and threat, as they have no confidence they can get a return.

It was widely agreed that there is a perception of significant value destruction in the majority of large-scale organisations. It was suggested there was low-hanging fruit in better execution practices, as well as in better strategic selection (both doing things right, and doing the right things). It was suggested that it is difficult to get focus on doing things right, if people feel they are working on the wrong priorities. i.e.: strategic consideration is pre-requisite to improved execution. Both are required.

This was identified as being in great part due to knowing when to call a halt to programs that will no longer deliver the levels of outcomes initially envisaged, or those outcomes are no longer relevant.

Several participants commented that people have lost trust in government because of continuous stream of Press Releases that do not provide clear communication of their context, strategic intent, progress and an updated view of future value. An improved ability to communicate long term vision is vital to addressing the erosion of trust in government. It was suggested that better communication of shared long-term objectives might even motivate increased public participation in pursuing community outcomes.

John Stanhope provided a perspective on economic performance and the rise of integrated reporting, commenting that ***Integrated Reporting*** is an outcome of Integrated Thinking… but that it is ***Integrated Thinking*** that is the objective.

He pointed out that Integrated Reporting has different labels in different jurisdictions (in the UK it is referred to as the Strategic Report); but they are all designed to provide stakeholders with a holistic view of an organisation's performance. It focuses on consideration of an organisation's performance and creation of value over multiple time horizons and measures.

Several participants noted that it is important for organisations to consider all stakeholders, including employees, when developing their future strategic direction. Some cogent examples were provided of organisations taking this approach and the subsequent benefits that they have achieved as a result.

Key Outcomes

It was agreed that the ability to be able to quantify and value a company's future opportunities in an assurable manner would be of great interest to its key investors.

Participants acknowledged that there was Global interest from large-scale investors, and a raft of agencies involved in enhancing the sustainability of the global economic infrastructure. There is a clear systemic gap, and need for this capability.

It was agreed development of this type of capability could deliver significant generational value both to Australia and also globally.

Participants confirmed that there were clear precedents for a disclosure framework of this nature delivering significant value to both the Australian economy and to the Global economy.

There was confirmation that the collaborative development of supporting standards was the optimal approach, notwithstanding any potential strategic benefit to any one organisation. It was noted that, if Australia decided to take the lead, it could establish Australia as a beacon of enhanced business practice for the 21st century.