



Australian Institute of Performance Sciences

SUSTAINED VALUE-CREATION OUT-PERFORMANCE

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Hon Kenneth Hayne AC QC
Commissioner
The Royal Commission into Misconduct in the Banking,
Superannuation and Financial Services Industry

By email: fsrscenquiries@royalcommission.gov.au

**Expert Submission – addendum to our submission 1 August 2018
on Governance and its Systemic Impact
on Ethical Conduct and Sustained Performance**

To the Commission:

The Australian Institute of Performance Sciences welcomes the Royal Commission's interim report. We particularly note the context set by the commission in its call for submissions "Why did it happen? What can be done to avoid it happening again? These are now the key questions."

The Commission rightly points out that, more often than not, the issues identified were contrary to existing laws. And, it asks, whether these laws should be administered or enforced differently, or simplified. The Commissioner states agreement with Treasury opinion that three matters go to the heart of the conduct identified. These being;

- the culture and governance of financial (and other firms)
- the capability and effectiveness of regulators to identify and address misconduct, and
- conflicted remuneration and integrated business models.

AIPS' original submission and this addendum provide new perspective to these questions.

We identify the core issue being that well intentioned, otherwise competent, corporate leaders and regulators are relying on practices that are insufficient to enable them to assure performance against a wide range of emerging issues that are fundamental to the future of healthy organisations, economies and societies. We observe;

- Current forms of governance practice in widespread use are insufficient to enable management and boards to engage conduct risk, and other emerging issues including social licence, culture, digital disruption, cyber-security, sustainability and climate change.
- A breakthrough fit-for-purpose enhanced 'Governance of Value Creation' practice, and related assessment methodology for leadership and investor use has been developed through 2018 Australian research.

Whilst there is global interest, and growing momentum in advances in this space, it does not immediately follow that these issues will 'sort themselves out' without significant further harm being done to the Australian public.

The original AIPS submission and this addendum seek to focus the Commission's attention to the primacy of the need for collective action in an agenda to change behaviours across complex systems. We call on the commission to use its mandate to advance this agenda.

Enhanced integrated governance is required to engage, lead and perform within the complexity of the modern organisation, and the flow of emerging issues. This is 'Integrated Governance', where governance is used as in the term 'Financial Governance'. As with accounting, it involves a framework of decision-making and assurance that enables players at all levels (including shopfloor, management, executives, boards, investors, and regulators – including within public and community organisations) to take appropriate action to optimise sustained performance of complex outcomes. Unlike accounting, it is future-oriented, and multi-outcome in nature.

There are real-world examples of Australian organisations demonstrating good practice. However, the majority of Australian organisations, including those studied by the Commission are not using, and not working towards, available better practices. The Finance industry again provides the precedent of the collective action required to drive development and uptake of better systemic practice. As highlighted in the summarised history of the pathway to maturity of global accounting and audit, in 'The Auditor, Quo Vadis?', 2018 by Mervyn King and Linda de Beer.

A recent speech from RBA Assistant Governor Luci Ellis (11 Oct 2018), looking through the lens of productivity and growth, further identifies the need for collective action.

"The evidence both in Australia and abroad is that productivity varies widely across firms, even within the same narrowly-defined industry. Firms that are highly productive – so-called 'superstar firms' – tend to grow faster, grow employment faster, and pay better than firms that are a long way from the frontier of productivity.... Must laggard firms always lag? Could they instead catch up to today's superstars? ... Perhaps this dispersion has something to do with the distribution of management ability. If so, it's not set in concrete, either at the firm level or more generally. (That said, raising the bar on management skills in an organisation can be difficult and isn't always successful.)"

And, she goes on to say

All of this comes back to the question of where growth comes from, and the answer is it comes from all of us. Growth is not something that is bestowed upon a nation by external forces. And though domestic institutions matter, neither is growth in the long run something that governments can bestow upon society. Instead it's about the myriad of individual decisions within firms and other organisations to find better ways of doing things. An important question is how we as a society support and enable those decisions. But more important is whether we actually make them.

Additionally, we would like to draw the Commission's attention to respected South African and UK-based academic and author Bob Garratt, who has made some of the clearer recommendations for structural reform options to drive improvements in Governance practice and adoption (see 'Stop The Rot', 2017). On page 265 he recommends:

1. Broadening the scope of organisations for whom directors' duties apply (noting UK context)
2. That corporate governance regulation is broken out as an autonomous Council akin to the Financial Reporting Council (noting the UK context, but relevant in AUS).
3. That government establish a national forum for the continuous learning, development and regulation of effective corporate governance. (noting that he specifically precludes the IOD UK's equivalent of the AICD as being conflicted in this role, see page 250)

Garratt proposes a five-role system of National governance oversight comprising; a director's forum, an owners' forum, a regulators' forum, a legislators' forum and a public oversight standing commission.

The AIPS is proposed as a feasible contribution in the Australian-context. It represents a broad cross-industry collaborative approach to Garratt's call for continuous development and learning of effective corporate governance.

The AIPS has operated on the assumption that Australia is not ready for a structural response along the lines that Garratt has recommended. However, if the Commissioner sees merit in such an approach, we would be delighted to participate in the provision of further advice.

Rather, the AIPS has been modelled on the precedents of the collaborative approach to the development and maintenance of accounting and audit practice – albeit with a more urgent timeframe. The AIPS has been designed to contribute independently of any changes (which may or may not occur) to legislation or regulation.

Initial research work by the AIPS suggests that benefits would accrue to all participating stakeholders: in ameliorating conduct risk (as observed by the Commission), in improved corporate and investor performance, in an enhanced ability to respond to a range of emerging risks, and in the contribution of organisations can make to broader sustainable and societal outcomes including those identified in the UN Sustainable Development Goals (SDGs). Additionally, we propose that the AIPS' contributions in upgrading the maturity of systemic practice will enable government to advance with more feasible, affordable, effective and palatable regulation at a time of its choosing.

In summary, we call on the Commission to highlight broad collaborative action on systemic practice improvement as the only viable and sustainable solution to systemic issues.

We call on the Commission to i) identify Governance of Value Creation as an emergent contribution from which enhanced systemic practice may be developed, ii) identify pathways to secure broad participation in collaborative development and adoption of enhanced practice, and iii) to put in place appropriate timelines and accountability for corporate, investor and government participation in such action.

We remain available to assist the Commission in any way.

Yours,

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