GEOFF NUNN & ASSOCIATES
Governance and Board Advisors

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2020 - Scenario Planning in Turbulent Times

2020-2021 The Governance & Leadership Landscape

Corporate Responsiveness and the McKinsey Report 13.4.2020

Last week McKinsey and Company released its latest business update on the Covid-19 pandemic response. The first part of the report looks at how countries have responded to the virus and the effectiveness of actions taken. The second part looks at the economic impact and the fallout for companies and government entities large and small. In particular the changes in consumer behaviour and consequences for different industry segments. What will the depth of the disruption be? How long will it last and what will the shape of any recovery look like? A number of key workforce imperatives for companies and governments have emerged:

- The degree to which the Covid-19 response permanently shifts the nature of work and how the workforce is deployed.
- Workplace safety and how it might be managed in this shifting environment (including mental health impacts).
- What will the new normal look like for the workforce in diversified organisations?
- What the full extent of the financial impact of this shift likely to be for organisations and its employees?

The Nerve Centre

The Report introduces the idea that companies and government entities, most dramatically affected by the virus, consider of developing a "Nerve Centre". It's role is to ensure operational sustainability, formulate strategy and undertake scenario planning. The Centre could be made up of four teams:

1. **The Deliver Team:** is focused on delivering key operational and customer priorities.
2. **The Decide Team:** is tasked with determining the next strategic move and ensuring delivery is proceeding according to plan.
3. **The Discover Team:** evaluates short and long term scenarios and allocates priorities.
4. **The Design Team:** develops strategic action plans with clear decision points.

Continued Page 2

In this Newsletter we talk about the latest McKinsey Briefing, Global Health and Crisis Response 13 April 2020. It contains insights and for directors and executives. We continue our review of the global pandemic's impact on board and executive remuneration. See Pages 2-3.

A Word From Di Percy

How is your organisation coping with the crisis? As you expected? Why are some people stepping up while others struggle? To what extent is it a cultural factor? Find out in the *DNA of Culture: for Directors and CEOs*. Out soon.

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
- Board & Executive Remuneration Strategy

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2020-2021 The Challenges Ahead

Corporate Responsiveness and the McKinsey Report 13.4.2020 (Cntd)

Team design would vary between organisations and strategic priorities. Balancing operational and customer needs with strategy and future scenario planning is paramount. See the McKinsey Report here: https://www.mckinsey.com/business-functions/risk/our-insights/covid-19-implications-for-business

The Evolving Scoreboard

Corporate scoreboards have typically reflected financial, operational, customer, stakeholder and people priorities. The recent APRA move to cap weighting on financial metrics to 50.0% in STI and LTI Plans has met with a mixed response. But that was before the Covid-19. Clearly financial metrics will now need to shift as will other non-financial measures. It's early days but here are some thoughts:

a) **Operating Cashflow**, Revenue, EBIT, TSR measures will need to be adjusted. Tightening revenue in response to reduced sales in some sectors will flow through to most financial metrics. Managing debt and liquidity will become even more important.

b) **Operational Continuity** and responsiveness measures need to be re-configured. For some companies the need to re-design the supply and delivery chain will be challenging.

c) **Customer Measures** will need to be re-defined. NPS and sare less important in the current environment. Supply across multiple platforms plus timing and delivery channels are critical.

d) **Stakeholder Engagement** has never been more important. Limited cooperation between competitors to ensure supply has been flagged as temporarily acceptable by the ACCC. Government and regulator engagement has taken on a new meaning.

e) **People & Safety** measures present some challenges. If a significant proportion of your employees are required to work from home mental health and engagement issues may emerge. Forget employee engagement scores and focus on underlying culture.

f) **Information Technology and Communications** are front and centre as employees log-on from home and customers switch to on-line ordering. The challenge will be to develop meaningful measures that reflect IT effectiveness and security in this environment.

Contact Geoff Nunn or Di Percy if you wish to talk about strategic responsiveness or resilience.

Board & Executive Remuneration: The Debate Continues

Belt tightening across the government and corporate sectors continued last fortnight. Cuts to board and executive remuneration captured the headlines and the media sometimes underplayed other significant events. Consider the following:

1. **Federal Public Servants to take Six Months Freeze:** on 9 April 2020 the Federal Government announced that it will freeze pay rises for all staff across 74 departments for a period of six months. This potentially impacts up to 240,000 employees. The Queensland State Government has announced a pay freeze for public servants and a similar move is under consideration in NSW. The Federal Finance Minister has asked the Commonwealth Remuneration Tribunal to freeze salaries for all the positions it governs.

2. **NZ Prime Minister and Ministers take 20.0% Pay Cut:** on 15 April 2020 Jacinda Ardern announced that she and her ministers would take a 20.0% pay cut for the next six months. Public Service heads will take the same cut. Whilst acknowledging that this will not materially impact NZ's financial position it was widely seen as a mark of hardship sharing.

3. **Major Logistics Group CEO takes 40.0% Pay Cut:** on 1 April 2020 Toll Group CEO, Thomas Knudsen, announced that he would take a 40.0% pay cut and other members of the executive team a 30.0% cut. Staff on $150,000 pa plus would take a 10.0% cut. A time period was not specified.

Many companies in the US and UK have made similar announcements. Again the gestures are seen as important, but largely symbolic, as was the case with Alan Joyce, Qantas CEO taking no pay until 30.6.2020. Most analysts remember that Alan was the highest paid Australian CEO for FY 2019 with aggregate earnings close to $24m.

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2020-2021 The Governance & Leadership Landscape

Board & Executive Remuneration: Covid-19

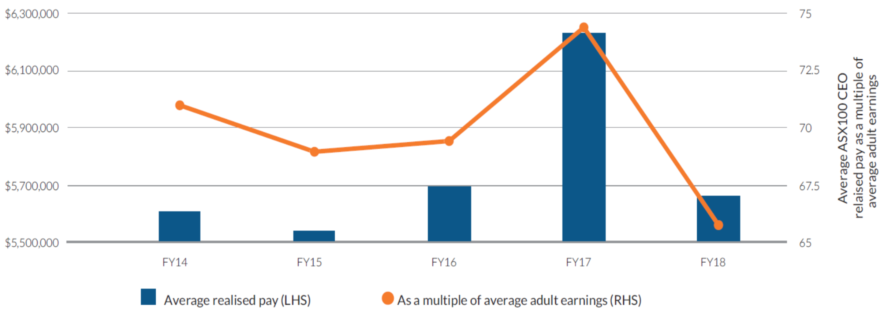
In the last Governance Update we canvassed the possibility the executive remuneration market might go backwards for the first time in a while. We see a lot of year by year variation as STI and LTI payments go up and down. But Total Reward Opportunity has moved progressively upward since the GFC. As each week passes and more companies freeze or reduce executive and board remuneration the likelihood of a contraction increases.

The Opportunity to Return to Rationality

The "All Industries" market, as the name suggests, is made up of a broad sample of companies from different sectors As remuneration drops in some sectors it brings the Median down. As companies freeze or defer STI and LTI payments the variable side of the equation will look decidedly fragile this year. It would not be good strategy for companies to be making large, cash based, STI payments in a year when dividends and distributions are down or non-existent. Nor would it go down well for fund managers to pay themselves bonuses when the value of their investor's holdings has tanked.

Over the past 10 years we've seen CEO remuneration in the ASX 100 running at around 65 to 75 times AWE. See the following graph from the ACSI 2019 CEO Pay in ASX 200 Report (Page 12):

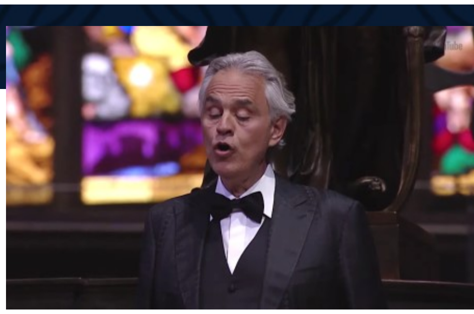
Graph 1: Average ASX100 CEO realised pay relative to average adult earnings FY14 – FY18[28]



The current situation, when combined with findings from the Banking Royal Commission 2017-2019, provides remuneration committees with a once in a generation opportunity for review:

"CEO pay remains a controversial topic. If the voluntary pay cuts spark a systemic change in the corporate mindset, we should welcome it with open arms. CEOs have a unique opportunity to regain our trust and show that they deserve their pay. Capitalising on this opportunity may be, perhaps, one of the few good things coming out of this pandemic."

Assoc. Prof. Mariano Heydon and Prof. Mathew Haward, Monash Business School, ABC News 17.4.2020.



Bocelli sings Panis Angelicus to an empty Duomo in Milano, Easter Sunday, 2020. He took no fee for his performance. Yet his contribution to the world on that day was priceless.

If your organisation is considering a freeze or reduction to board fees or executive remuneration there are a number of factors to consider.

Factors to Consider in Decision Making:

- The direct financial impact of any downturn your business is experiencing. The impact on revenue and cashflow are critical considerations.
- The cost of board and executive remuneration in relation to your overall cost base.
- The view of key stakeholder groups including shareholders, regulators, customers and suppliers.
- The relative position you have taken in the market. If you are paying in the upper quartile it may be appropriate to wind back. Paying at Q3+ is not a good look at the moment and movement back to the Median will put downward pressure in the market.
- The balance of FAR/STI/LTI in executive packages. If "At Risk" components activate there may be a long term upside if share prices are down.
- The relative cost of delivering on vested STI and LTI amounts. Deferral may be an option.
- The relationship of board and executive remuneration to management and employees covered by enterprise agreements.
- The impact of any lay-offs or redundancies your organisation has had to undertake.

To discuss the potential impact on your organisation contact leading board and executive remuneration specialist: Geoff Nunn on 0418 595 107 or gtnunn@gna.net.au

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