GEOFF NUNN & ASSOCIATES
Governance and Board Advisors

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2020 - A Challenging Governance Landscape for Directors

2020-2021 The Challenges Ahead

In January the World Economic Forum (WEF) released its 2020 Global Risk Report. The Report was compiled and issued before Covid-19 really began to impact the world economy. A large number of businesses have since been forced to enact emergency management plans. Some face an uncertain future. Many small business have closed their doors and some will not re-open even when the current crisis has passed.

The WEF Report presents considerable challenges for governments at all levels and companies large and small. These risks may appear to have been overtaken by recent events but will be back on the agenda in six to nine months. Perhaps the most confronting are risks associated with climate change. They continue as the Top 5 in terms of likelihood. In summary they are:

1. Extreme Weather Events
2. Climate Action Failure
3. Natural Disasters
4. Biodiversity Loss
5. Human Made Environmental Disasters

Data Theft and Cyber Fraud come in as Numbers 6 and 7. For the full WEF 2020 Global Risk Report see: https://www.weforum.org/reports/the-global-risks-report-2020 Continued on Page 3.

An Unique Opportunity to Reframe

In putting together this newsletter I was reminded of some words of that contemporary philosopher Dr. B. Alan Wallace published in response to the current Covid-19 situation:

"This virus has forced society to slow down and draw inwards. May we transform this adversity into the path by doing a reality-check ."

The Santa Barbara Institute, 20.3.2020

Alan does not intend any parsimony in this statement. Rather he invites his readers to engage in a deeper, more reflective dialogue about the relative importance of all our endeavours at this time.

There is a message in here for companies and governments of all persuasions. As we stand at the crossroads there is a unique opportunity to examine the assumptions and values that underpin our ways of doing business and model of corporate governance.

Geoff Nunn in Rome 2019. No longer possible!

In this Newsletter we discuss the unique circumstances surrounding the current Covid-19 pandemic. We talk about the potential to return to rationality in the executive remuneration market and some of the challenges presented in the WEF 2020 Global Risk Report.

Some of the issues uncovered in the Banking Royal Commission in 2018 and 2019 may be temporarily off the agenda. They will return in force later this year. Directors and executives need to keep an eye to future strategy while responding to the current situation.

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 & Committee Charters

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Challenges for Board & Executive Remuneration

Over the last 2-3 weeks we've seen a number of companies move to freeze or reduce board fees and executive remuneration in response to current business conditions. Some industry sectors have clearly been hit harder that others. He are some examples:

1. **Qantas:** on 10 March 2020 Qantas announced that it's Chair, Richard Goyder and CEO, Alan Joyce would take no remuneration for the remainder of FY 2020. The Board would take a 30 percent cut in fees and Executive a 30 percent pay cut. Executive STIs and LTIs have been reduced to zero and will not accrue this year.
2. **Virgin Australia:** on 13 March 2020 Virgin announced a 15 percent reduction in board fees for FY 2020 and a freeze to executive and senior management salaries. Executive STIs and LTIs have been cut to zero and will not accrue this year.
3. **Seven West Media:** for the remainder of FY 2020 employees on $80,000 pa to $200,000 pa would reduce from 5 to 4 days per week. Effectively at 20 per cent pay cut. Executives and managers earing over $200,000 pa will take a mandatory 20 per cent pay cut.
4. **KMPG:** on 2 April KPMG announced that partners likely to take up to 35 percent reduction in earning. This is based on a 17 percent salary cut and approximately 16 percent in loss of profit distribution. Staff earning $68,000 pa or more asked to take 20 percent pay cut until 1 August 2020.
5. **Federal Government:** The federal government will freeze all pay rises for department secretaries and agency heads and the Finance Minister has asked the Remuneration Tribunal to freeze salaries for all of the positions it governs. No period has been specified.

Many other companies have announced similar moves and more will, no doubt, follow suit over the next few weeks. A number have adopted a watch and see approach. The degree to which freezes or reductions in board fees or executive remuneration packages will make a material difference to the financial viability of an organisation will depend on its individual circumstances. For those with a large number of employees covered by enterprise agreements the impact is likely to be minimal. For others with a substantial professional base, where reductions across the board are being called for, the impact will be significant.

Beware Tokenism

Stakeholders are likely to react with cynicism if the freeze or reduction is perceived to be tokenistic. That is, if it lacks material significance and is more about positioning than substance. Organisations should take professional advice about freezes or reductions and present considered and thoroughly researched options to their Remuneration Committee.

Seven West Media CEO Shane Warburton announced a 20% pay cut on 1.4.2020

Will This Lead to a Market Correction

Remuneration surveys, as undertaken by a number of advisory firms in Australia and worldwide, are by their very nature, a lag indicator of what's really going on. Market movement is calculated by comparing same incumbent remuneration year on year. Surveys rounds for 2020 are underway at the moment and are unlikely to show to much decline. That won't happen until next year by which time it might all be over. But the reality is that the market will be down.

For some time we've been arguing that the top end of the executive remuneration market in Australia has been out of alignment with community and stakeholder expectations. This is particularly true of the larger ASX listed companies.

A mix of Fixed Annual Remuneration (FAR), Short Term Incentives (STIs) and Long Term Incentives (LTIs) is the usual reward structure in listed companies. Equity based STIs and LTIs are likely to be underwater this year as revenue and total shareholder returns come under increasing pressure. Despite a re-balancing of KPIs over the last 12 months in some organisations financial metrics are still likely to make up at least 50% of the KPIs driving STIs and 100% of the KPIs driving LTIs.

With the downturn in business activity and profitability boards and remuneration committees have a unique opportunity to review the structure and quantum of executive remuneration. Right now shareholders and other stakeholders would welcome a re-alignment which takes the total structure back to basics and removes the perception of corporate excess.

Contact Geoff Nunn for considered advice.

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The WEF 2020 Global Risk Report (Cntd from Page 1.)

The following table indicates the likelihood and impact associated with various risk categories:

Likelihood	Impact
Extreme weather	Climate action failure
Climate action failure	Weapons of mass destruction
Natural disaster	Biodiversity loss
Biodiversity loss	Extreme weather
Human-made environmental disasters	Water crises
Data fraud or theft	Information infrastructure breakdown
Cyberattacks	Natural disasters
Water crises	Cyberattacks
Global governance failure	Human-made environmental disasters
Asset bubble	Infectious diseases

The Report emphases the challenges ahead:

1. **Turbulence is the New Norm.** The Report emphasises that BAU (business as usual) is a thing of the past. The Covid-19 pandemic provides overwhelming evidence of this. Number 10 in terms of potential impact now seems very understated. Global networks that have promoted stability are under siege. The collective global mind-set will shift.
2. **The Impact of Climate Change is Real.** Climate change and climatic events affect our economic well being. The bushfires across Australia in late last year impacted not only the local economy but disrupted power generation and distribution, water supply, telecommunications, the insurance industry, agriculture and manufacturing.
3. **Economic Stability is Under Challenge**. Low interest rates, decimated share prices and a lack of investment by the corporate sector challenge our economic well being. Trade tensions and protectionism stifle growth. Boards need to embrace strategic navigation and be prepared to take calculated risks.
4. **Cyber Security and Data Theft Present Major Risks.** Industries and governments of all persuasions face major cyber security risks. The capacity for agencies of nation states and other non-government groups to disrupt essential services and critical industries through cyber attacks and data theft has never been higher. Boards need to ensure IT Security is high on the risk register and that appropriate resources are allocated to system security.

NEW GNA Videos - Navigating 2020 and 2021

Later this year Geoff Nunn & Associates will release a series of short videos aimed at briefing boards and directors on the challenges for 2020-2021. The videos are not about providing all the answers wrapped up in a neat package. Governance does not work that way. They support engagement where directors can engage in a new form of de-regulated dialogue.

The videos are as follows:

Video 1 - The Changing Governance Landscape: As we deeper head into 2020 the narrative that has driven the business world for the last 30 years seems to be shifting. Liberal democracy and the free market economy are under challenge from a range of forces including the protectionism of Donald Trump, the UK Brexit, the assertiveness of China, climate change and the devastating impact of the Coronavirus. Directors face a very uncertain risk environment.

Video 2 - The Strategic Mindset: Some leaders who seem to have the foresight to see ahead clearly. They retain the flexibility to shift and adapt to significant events or trends (although few predicted the current challenges). They innovate in time of adversity. Some are doing this right now. This is a skill set that needs to be present in the executive team and on the board. It can be re-discovered. But the prescriptive nature of boardroom governance practices works against it.

Continued Next Page

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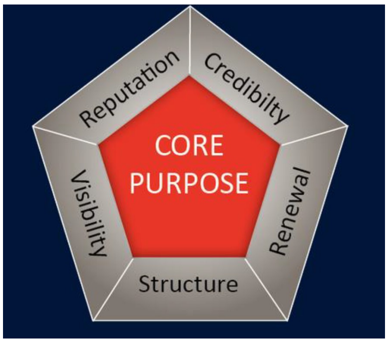
New GNA Videos - Navigating 2020 and 2021 (Continued)

Video 3 - The Governance Conundrum: Increasingly directors and board members face what's been called the "Governance Conundrum"). The prescriptive nature and compliance requirements of board practice in Australia sets up a conundrum. How, in the mix of formality and procedure, do directors find time for innovation and real strategic thinking. Somehow directors need to make space for a different type of conversation amongst themselves, the CEO and leadership team. We call this "De-regulated Dialogue".

Video 4 - 2020 - 2021 - Challenges for Directors: In this video we polish up the crystal ball and have a look at the changing face of governance in 2020—2021. Here are our predictions:

- **Emergency Management** has become a core focus for 2020. The risk register will be under intense review in many organisations which have not contemplated the current pandemic situation.
- **Regulatory Controls** will continue to tighten. Compliance costs will increase. Directors will find it difficult to balance real engagement with financial performance and compliance. More regulation means less time for strategy and innovation. This is the "Governance Conundrum" mentioned in Video 3.
- **Corporate Culture** - the focus on the board's role in guiding corporate culture will intensify. Particularly in the current environment. It's not about administering more employee engagement surveys and running culture workshops. The strength of team dynamics and the capacity to connect remotely will provide new insights about an organisation's culture.
- **Industry Super Funds** and other fund managers are shifting their focus and looking to the companies they invest in to conduct themselves ethically and with due regard for the environment.
- **Executive Remuneration** will remain centre stage for private sector corporations. The need to move away from the current paradigm has not yet been fully recognised by Remuneration Committees. As mentioned on Page 2 current circumstances provide a unique opportunity to make the shift.
- **Climate Change and Cyber Security** will be high on the board agenda for major corporations. Hydrogen as a fuel will become increasingly important as a climate change mitigation strategy.
- **Accountability** - being a director is going to get tougher in 2020. If your organisation commits breaches of various acts and regulations boards and directors will be held to account.



Di Percy and Geoff Nunn 2018

Video 5 - Key Imperatives for Boards in 2020 - 2021

Articulate Core Purpose

Post the Hayne Royal Commission lots of companies are re-visiting their "Core Purpose". Why they exist and how they can be present and committed to the communities they are part of.

Build Reputation

Reputation is a fragile asset. Issues that emerged from the Banking Industry Royal Commission highlight the very real risks to an organisation's reputation if its conduct dips below good governance standards.

Enhance Credibility

When an organisation acts in ways that are perceived as deceitful or dishonest by stakeholders, it quickly loses credibility. Paradoxically the current Covid-19 situation provides some organisations with a unique opportunity to re-build credibility.

Focus on Renewal

Board renewal is not just about finding new directors. It means taking time out to work *on* the board as well as *in* the board, fresh approaches to old problems and new conversations.

Be Visible

The majority of customers, employees, suppliers and other stakeholders see directors as shadow figures in the background. They are largely unknown. Being visible is an active pursuit.

Align Board Structures

The foundations of effective board functioning (structure) are not always appropriately aligned with core purpose. Company and industry changes may call for structural review and development resulting in innovation and adaptation.

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