

WHY GOVERNANCE MATTERS?

IOD Thailand

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Presented by Mervyn E King SC

GLOBAL REALITIES

- ★ Changing times require changed approaches
- ★ Primacy of the shareholder, yesterday's thinking
- ★ From short term profit at any cost to value creation in a sustainable manner
- ★ Increased demand for product with a declining natural asset base
- ★ To be accountable reports have to be understandable

OPPOSITION TO AN ARTIFICIAL PERSON

An individual with immortality lacks a soul to be punished by the Almighty,

Lacks a body to be kicked

Is a person without a conscience

“No soul to be damned and no body to be kicked.”

John Poynder 1844

Negative reaction by society to a person not being a creature of the Almighty

Limited liability statutes were passed in the middle of the 19th century

INCAPACITATED PERSON

- ★ Young healthy individual, soul and heart in the body
- ★ Incapacitated of mind
- ★ Artificial person no heart, mind or soul
- ★ Directors become the heart, mind and soul
- ★ Content to a director's duties of good faith, care, skill and diligence

“PRIMACY” – A SOCIAL CONSEQUENCE

- ★ Wealthy families provided the equity capital
- ★ Members of the families directors
- ★ Seen as “owners” of the company
- ★ Primacy of the shareholder developed
- ★ Public discourse of shareholders’ “ownership”
- ★ Short term profit for shareholders even at a cost to society and the environment
- ★ Free economy subsidized monetary gain
- ★ Focus on financial capital

THE PRIMACY OF SHAREHOLDERS REINFORCED

- ★ The Dodge Brothers vs Henry Ford 1919 – minority shareholder
- ★ Ford wanted to use profits to pay better wages
- ★ Court ordered Ford to discharge its primary duty to shareholders and pay a special dividend
- ★ So thinking was directors had to act in the best interests of the shareholders - primacy
- ★ Corporate success was equated with share price
- ★ There was a focus on shareholder centric corporate governance

OWNERSHIP MYTH DEBUNKED

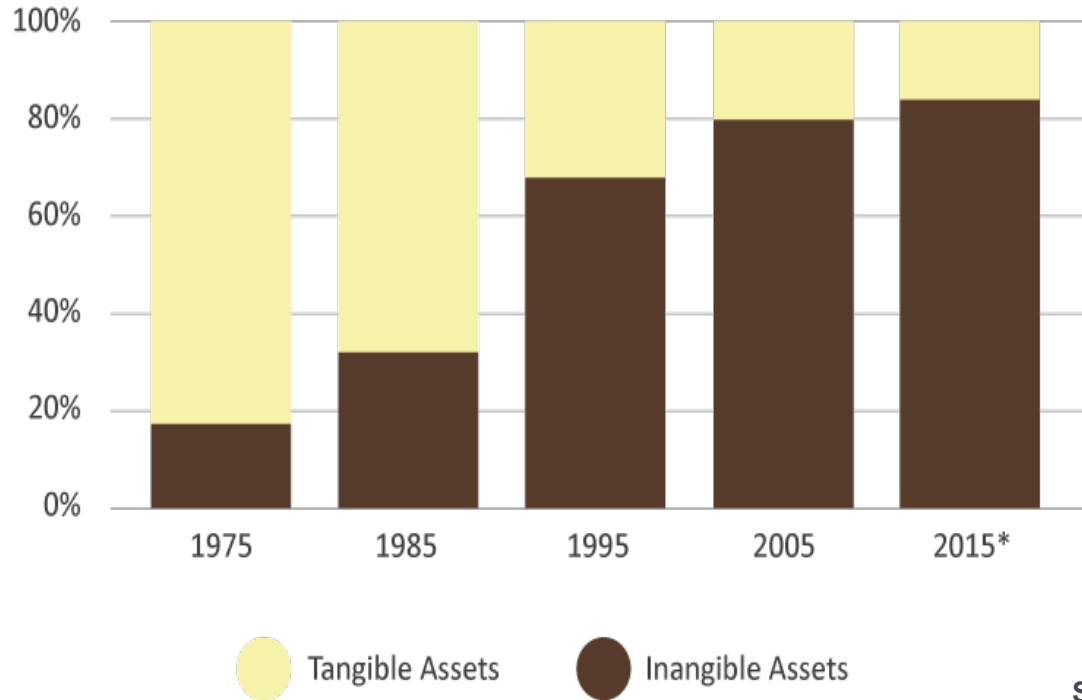
- ★ Shareholders no rights:
 - To possess the company's assets
 - To use the company's assets
 - To manage the business of the company
 - To the income of the company
- Shareholders have no duty or responsibility to the company
- Representative shareholder duty of RI to their ultimate beneficiary hence UNPRI
- Practising RI a driver of quality governance

THE ERROR OF CORPORATE LEADERS

- ★ Duty to the company not shareholders
- ★ Agency theory requires directors to obey
- ★ Independence of mind fettered
- ★ A company's health not its shareholder's wealth
- ★ Time has come to challenge maximising shareholder value
- ★ Distracts boards from building the company's health
- ★ Professors Stout (Duke) and Paine (Harvard)



COMPONENTS OF MARKET VALUE



Source: OCEAN TOMO LLC
January 1, 2015

INTANGIBLE ASSETS

- ★ Ecological overshoot and population explosion
- ★ Strategy – long term value creation
- ★ Reputation – perceptions of stakeholders
- ★ Supply chain – legitimacy of operations
- ★ Human rights – child labour
- ★ Stakeholder relationships – civil society
- ★ Positive and negative impacts on triple context
- ★ The quality of governance of the organisation
- ★ How does the company make its money?

INNOVATIONS IN CORPORATE REPORTING AT BEGINNING OF 21ST CENTURY

- ★ Enhanced business reporting
- ★ Balanced score cards
- ★ Triple bottom line – theory - context
- ★ Sustainability reporting
- ★ Each trying to communicate value creation

BEYOND FINANCIAL REPORTING

- ★ Triple context
- ★ Reporting in monetary terms
- ★ FR critical but not sufficient
- ★ SR critical but not sufficient
- ★ The two in silos divorced from reality
- ★ Required was a report integrating the financial and the sustainability issues
- ★ IR was a concept whose time had come
- ★ Inputs, business model, outputs, outcomes

DRIVERS OF CHANGE (1)

- ★ Global financial crises
- ★ Climate change crisis
- ★ Ecological overshoot
- ★ Radical transparency – tax policy
- ★ Greater expectations from stakeholders

DRIVERS OF CHANGE (2)

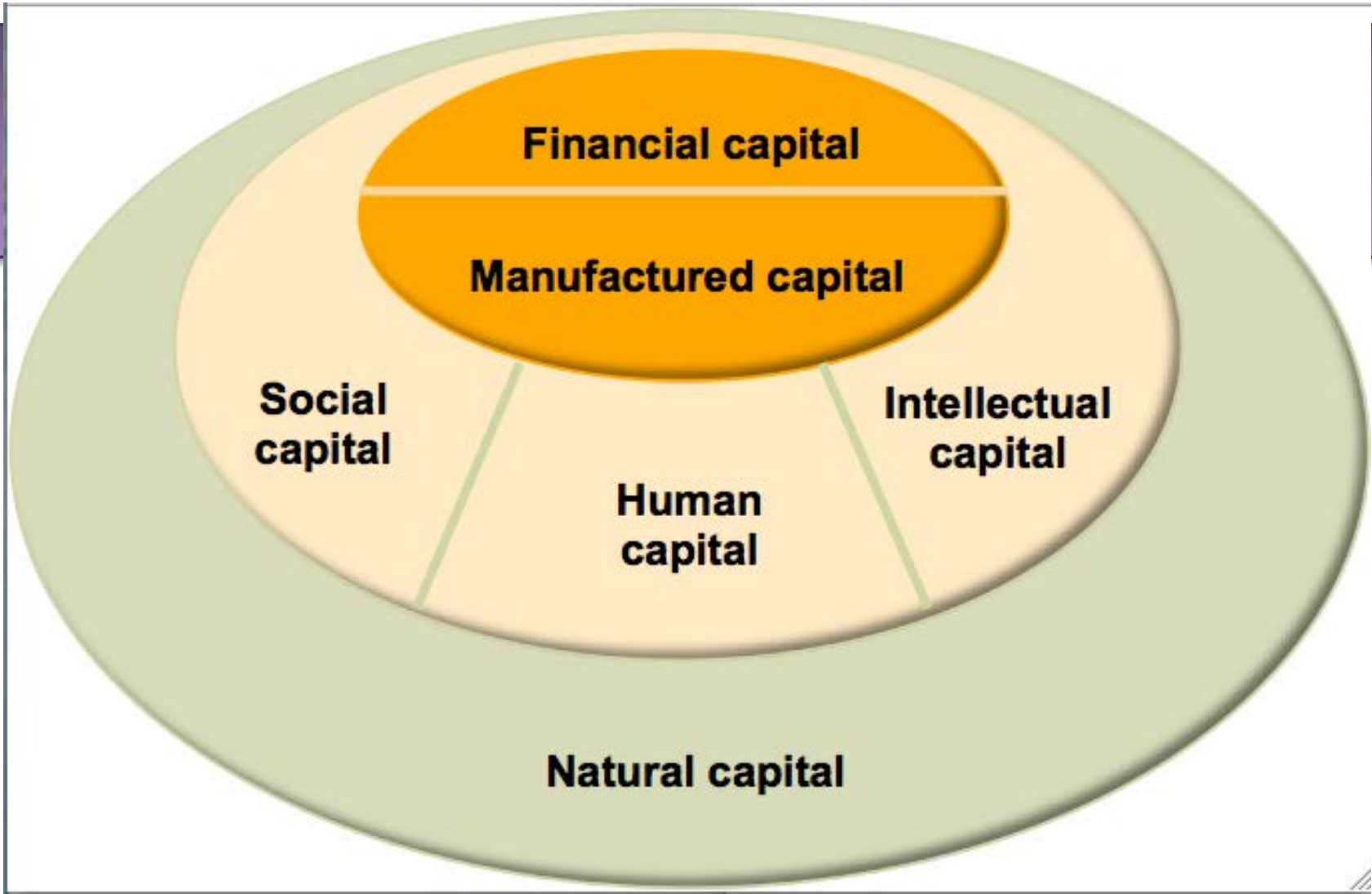
- ★ Responsible investment
- ★ Population growth
- ★ Digital and net generation era - fourth Industrial revolution
- ★ Cannot carry on business as usual
- ★ Have to learn to make more with less

“FREE” PROFIT

- ★ From Friedman’s “free” economy profits
- ★ 21st century value creation by a company
- ★ Historically book value – the difference between total assets and total liabilities
- ★ Book value greater or less than the market value
- ★ Book value equals market value
- ★ Value of money – the present value of discounted future cash flows
- ★ All through a financial lens

VALUE TODAY

- ★ In a resource deprived world with increasing population
- ★ How does the company make its money?
- ★ The positive and negative impacts on the triple aspects of the company's business model and output – financial, social and environmental
- ★ Enhancing the positives, eradicating or ameliorating the negatives
- ★ Embedding sustainability issues into strategy
- ★ As water is critical to the beverage manufacturer
- ★ Now value is seen through a value creation lens in a resource deprived world
- ★ In the long term better interests of shareholders



All organizations depend on a variety of **resources and relationships** for their success. These resources and relationships can be conceived as different forms of “capital”.

Source: Incite *Sustainability 2.0: A Guide to Competing in a Changing World*

mek Corporate Legal Advisers

THE SIX CAPITALS



Financial



Manufactured



Human



Intellectual



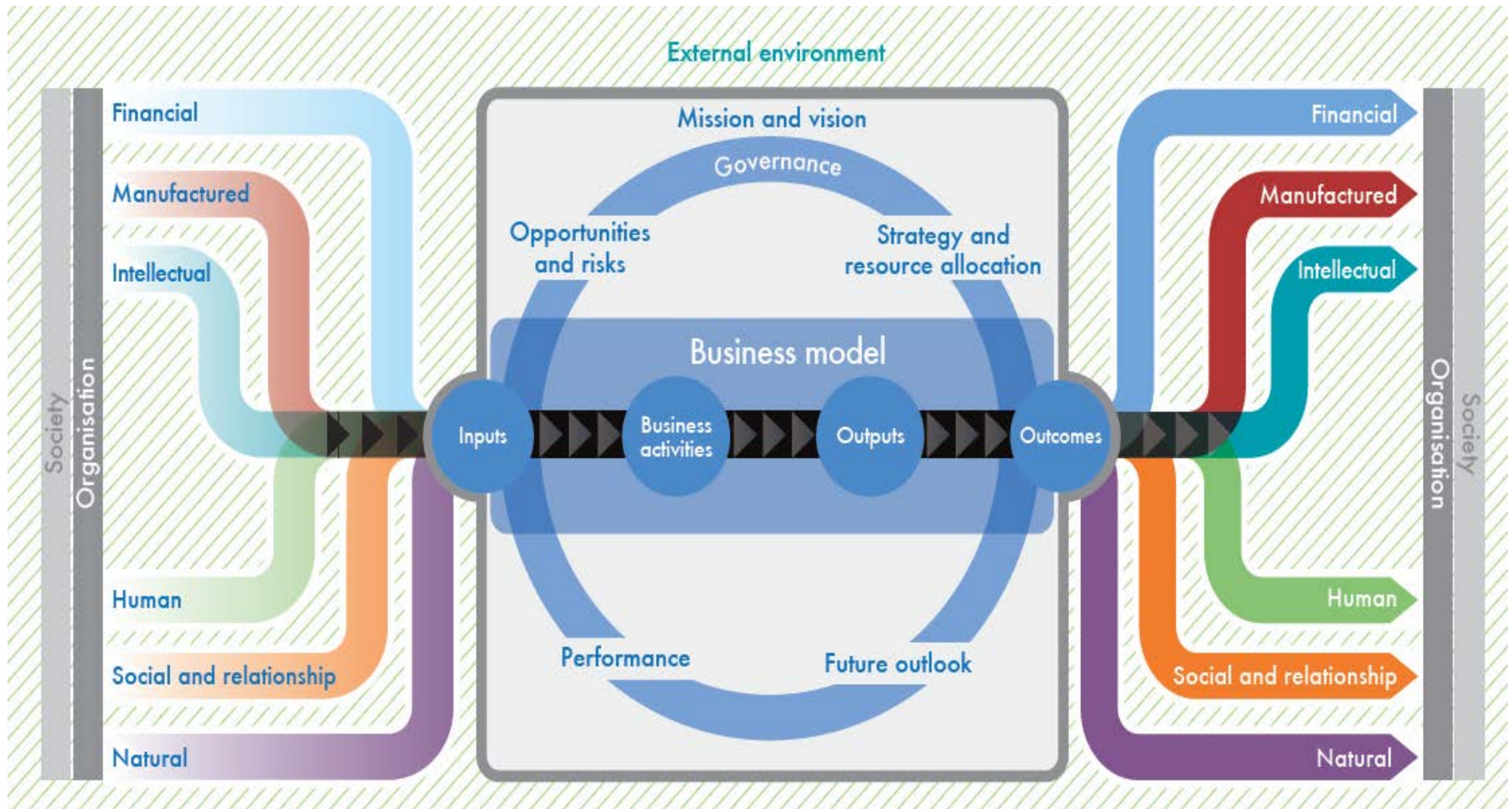
Natural



Social



AN ORGANISATION'S VALUE CREATION PROCESS





At Coca-Cola, we believe active lifestyles lead to happier lives. That's why we are committed to creating awareness around choice and movement, to help people make the most informed decisions for themselves and their families. Coca-Cola commits to:

- 1** Offer low- or no-calorie beverage options in every market.
- 2** Provide transparent nutrition information, featuring calories on the front of all of our packages.
- 3** Help get people moving by supporting physical activity programs in every country where we do business.
- 4** Market responsibly, including no advertising to children under 12 anywhere in the world.

INTEGRATED THINKING

- ★ Every company dependent on relationships and sources of value creation
- ★ The six capitals, F, M, H, N, I, & S
- ★ Mindset change at board & senior management level, including the CFO
- ★ Symphony of resources and relationships
- ★ Knowledge of stakeholders' legitimate NIE's
- ★ Greater stakeholder expectations
- ★ Agenda items: stakeholder relationships
- ★ : inputs to outcomes

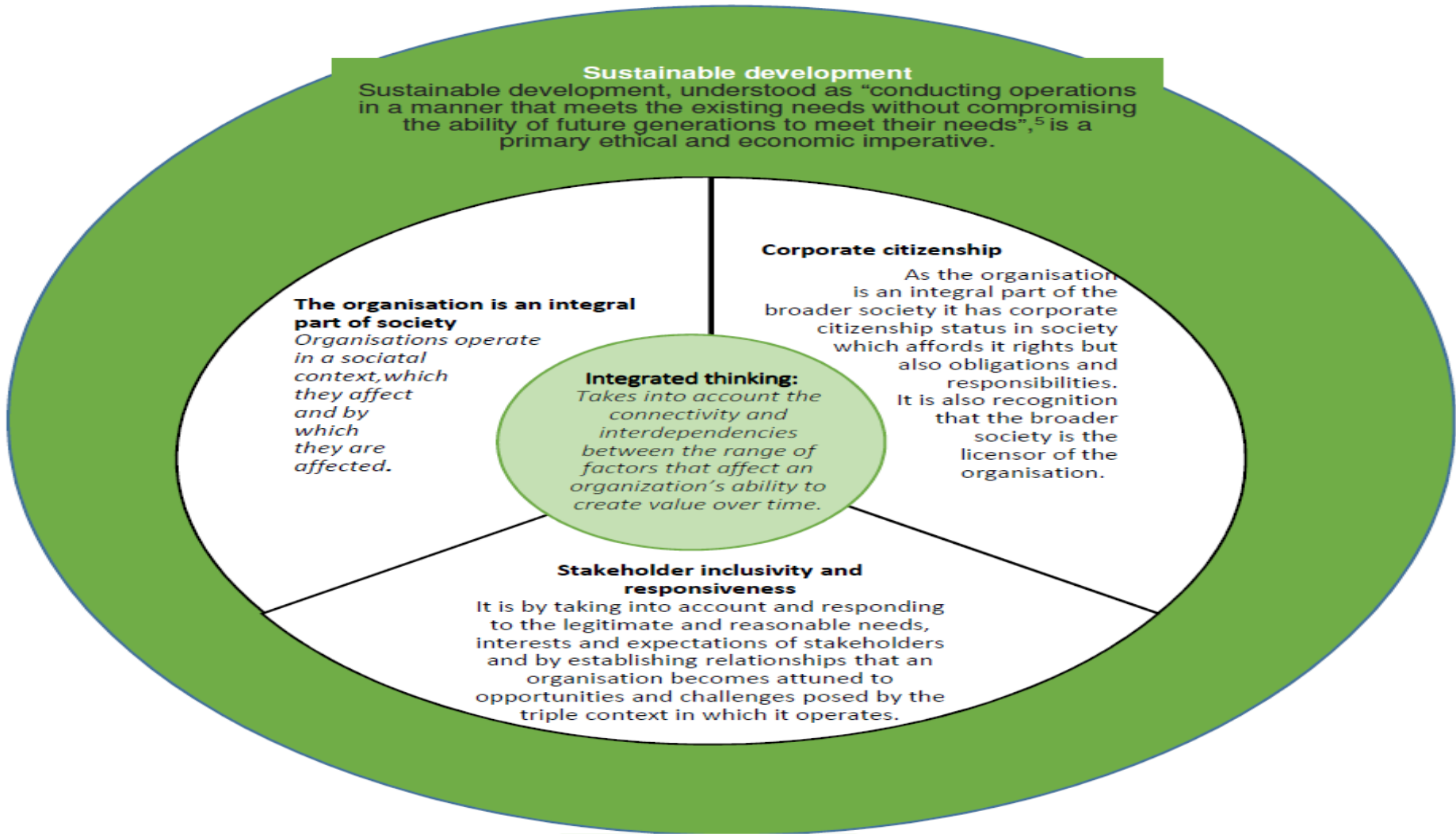
SHARE VALUE TO VALUE CREATION

- ★ Board decides how, affects and strategy
- ★ To generate long term value
- ★ For its business, society and the environment
- ★ Success depends on internal and external outcomes:
 - ★ internal financial return
 - ★ external social, environmental and economic results

CONCEPTS OF MODERN CORPORATE GOVERNANCE

- ★ Ethical leadership
- ★ Role of the company in society
- ★ Responsible corporate citizenship
- ★ Value creation in a sustainable manner
- ★ Company centric governance
- ★ Integrated thinking
- ★ Integrated reporting

Source: Foreword to King IV Report

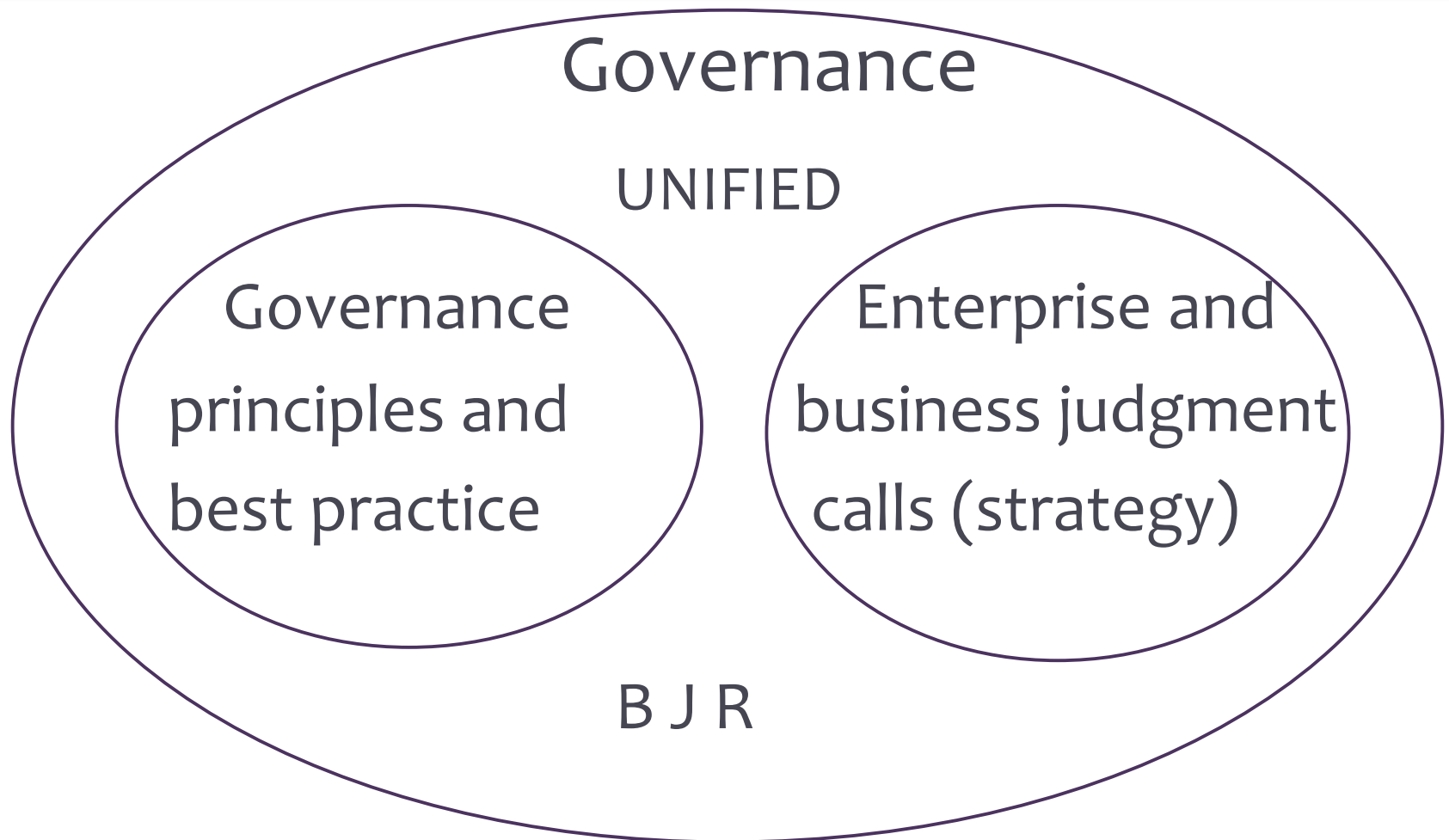


Integrated annual report
‘tells the story’ of *how* – that is, the business model, by which the organisation creates value.

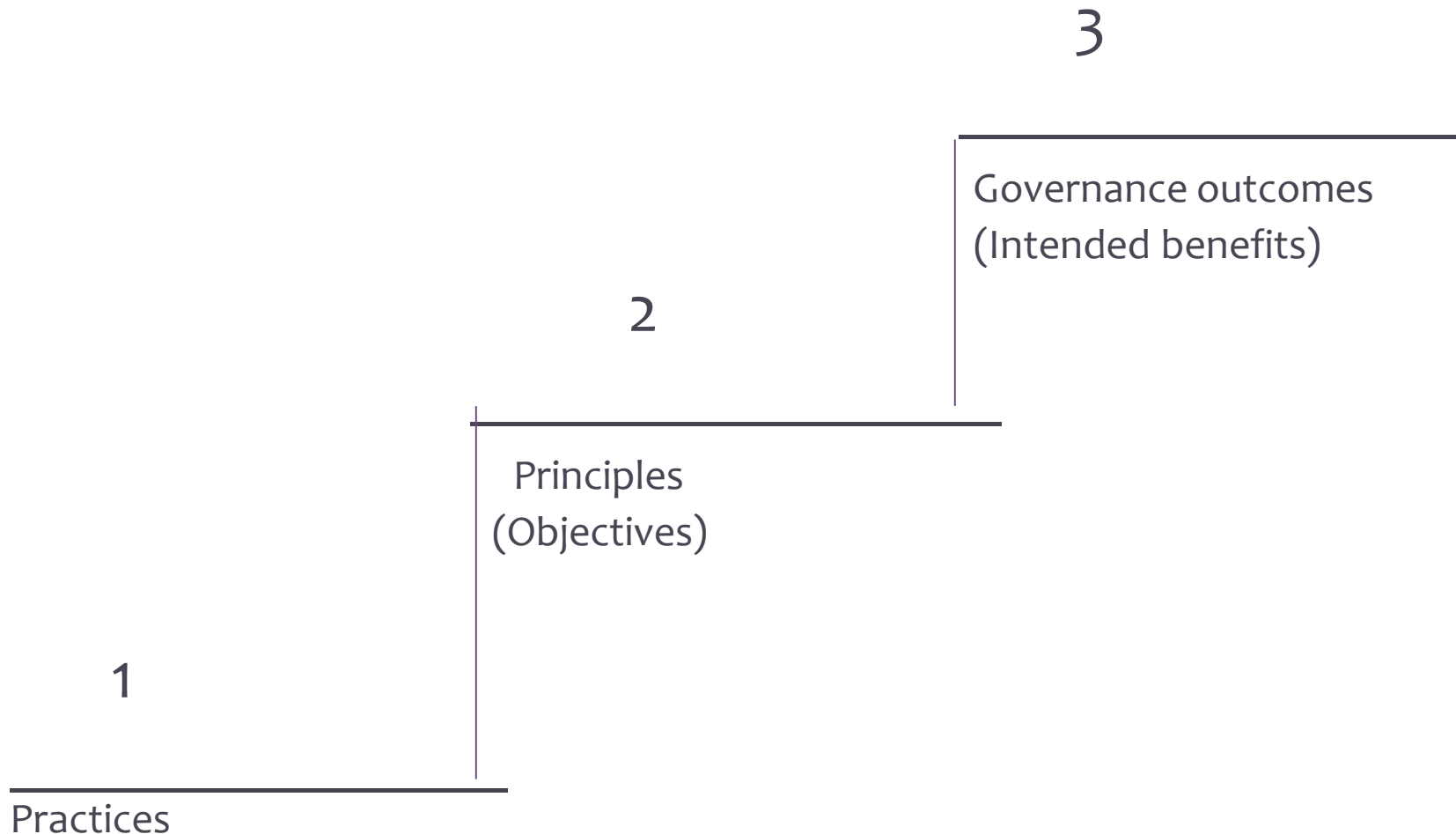
FOUR OUTCOMES

- ★ Ethical culture and effective leadership
- ★ Performance and value creation in a sustainable manner
- ★ Adequate and effective controls
- ★ Trust, good reputation and legitimacy
- ★ Need these outcomes because of value of intangibles
- ★ Good governance results in these outcomes
- ★ Governance does matter!

THE GOVERNANCE EQUATION



STEPPED APPROACH



ETHICAL CULTURE

- ★1. The board should lead ethically and effectively
- ★2. The company is and is seen to be a responsible corporate citizen.

PERFORMANCE AND VALUE CREATION

- ★3. Value creation process in a sustainable manner
- ★4. Reports enable stakeholders to make informed assessments of the company's performance and its short, medium and long term prospects

EFFECTIVE CONTROL (1)

- ★ 5. The board should comprise the appropriate balance of knowledge, skills, experience, diversity and independence
- ★ 6. The board should ensure that the evaluation of its own performance and that of its committees, its chair and its individual members, support continued improvement in its performance and effectiveness

EFFECTIVE CONTROL (2)

- ★ 7. The board should govern risk in a way that supports the company in setting and achieving its strategic objectives
- ★ 8. The board should govern technology and information in such a way that supports the company setting and achieving its strategic objectives
- ★ 9. The board should govern compliance with applicable laws and adopted non-binding rules, codes and standards in a way that supports the company being ethical and a good corporate citizen

EFFECTIVE CONTROL (3)

- ★10. The board should ensure that the company remunerates fairly, responsibly and transparently
- ★11. The board should ensure an effective control environment

TRUST AND LEGITIMACY

- ★12. The board should adopt a company centric approach in the interests of its long term health

NELSON MANDELA

★ “Action without vision is only passing time, vision without action is merely day dreaming, but vision with action can change the world.”

BASIC PRINCIPLES

★ I C R A F T

★ Incapacity

★ Good faith, care, skill, diligence

★ Essence of good governance– acting with intellectual honesty in the best interests of the incapacitated company of which the director is its heart, mind and soul

★ Good governance matters

THANK YOU

Prof Mervyn E King SC