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Directors' Series
BEYOND COMPLIANCE

Directly from our business leaders
Interviews for Directors' Alert 2014

This transcript should be read in conjunction with the **Deloitte Directors' Alert 2014 – Greater oversight, deeper insight: Boardroom strategies in an era of disruptive change.**

Conversations with our experts

"All is flux, nothing stays the same"

Heraclitus c. 535-475 B.C.

In the past, disruptive changes usually happened only periodically and resulted in a sustained plateau – the automated assembly line, for example, which revolutionized industry in the early twentieth century, continues to be a central feature of modern manufacturing. Today, however, disruptive change has become a perpetual occurrence in which one change instantly sparks a chain of others. What's more, these changes are being generated by a variety of factors – digital disruption created by continuing technological advances, regulatory reforms, economic turmoil, globalization, and shifting social norms and perceptions.

In this environment, everything and anything may change at any time as category boundaries are becoming blurred, supply chains are being disrupted, and long-standing business models are becoming obsolete. With change, however, comes opportunity. Technological advances enable organizations to generate new revenues by targeting new customers, new sectors and access new geographies while more fully automating back office activities and divesting of declining assets to reduce costs. The challenge for organizations is to recognize when disruptive change is occurring and to act quickly and decisively when it does.

The 2014 edition of Directors' Alert, *Greater Oversight, Deeper Insight: Boardroom strategies in an era of disruptive change*, examines 10 key issues facing boards of directors as they address the disruptive changes that surround and affect them and their organizations. The articles in the *Directors' Alert* were developed with the input of specialists from Deloitte member firms ("Deloitte") around the globe, who provided insights into the opportunities and risks in each area that boards and management must address in order to develop the right strategies.

In this publication, a companion to *Directors' Alert*, Deloitte specialists expand their discussions of the issues by providing additional professional insights and personal observations regarding important trends for boards and organizations to assist directors who wish to "dig deeper" to broaden their understanding of the issues and improve their boards' effectiveness in dealing with them.

Recognizing when disruptive change is occurring and responding effectively will be a challenge for many organizations. We hope the conversations included in this publication, together with the discussion of the issues provided in the Directors' Alert, will help your board succeed in this environment and serve as a catalyst for discussion with your board. We encourage you to contact our specialists or your Deloitte partner to continue the conversation.

Damien Tampling
Damien Tampling is a partner and the Technology, Media and Telecommunications industry leader with Deloitte Australia. He is based in Sydney, Australia.

Making innovation happen
A conversation with Damien Tampling

It is said that there are organizations that make things happen and there are organizations that wonder what just happened. How effective are organizations about innovating and making things happen?

Five to ten years ago, when innovation was first moving into the mainstream in business, there was certainly less experience about how to make it work, and some of what organizations were investing in didn't end up achieving significant benefits. We've come a long way since then. Today, organizations' discipline around innovation and disruptive thinking is becoming sharper, including a better understanding of the different types of innovation, the objectives of each and how innovative ideas should be measured.

A lot of focus at the moment is around digital because of the large proportion of disruption being driven and created by digital technologies. Two key questions that leading organizations are asking are: How is digital disruption affecting our industry and our organization? And, how can we best respond to this in order to minimize the threats and maximize the opportunities presented by this change?

At the board level, many boards are looking carefully at the skills and experiences their members have around digital disruption. They recognize that the days are long gone when digital should be thought about as a standalone investment and area. Today, digital needs to be a fundamental part of every organization's business strategy, and therefore every board needs some members with expertise in this area.

Are there trends emerging in the way organizations are innovating?

There are. Innovative organizations bring an innovative ear to listening to their customers in order to understand what they want, to thinking about what might be new and different, and then bringing that thinking together to act and deliver. The "why" of innovation is led by putting the customer first and then continuing to iterate to achieve success.

Another trend that is quickly gaining speed is in the number of organizations that are looking externally and innovating through a broader eco-system. A few years ago, organizations would bring together their top thinkers to generate ideas. Today, leaders in this space are also becoming more comfortable driving innovation programs that engage experts and entrepreneurs outside their own organization, even sharing privileged assets with these people. While doing so has its risks, several organizations have found those risks are far outweighed by the quality of the resulting new ideas, products, services and momentum created.

Leading innovative organizations are also taking on two, three or sometimes more innovations within their business models, for example implementing innovations that cross distribution channels by developing new and differentiating products and/or services or establishing new markets.

What are the risks to the organization that boards should be concerned about?

Management needs to understand where disruption is occurring, and then be able to quickly and courageously address that. Time and again, we've found that when disruptive change is left unaddressed, it has an exponential impact on the organization. Boards should be asking for management's perspective on the disruptive trends affecting the organization and how the organization is responding to them, and whether it is doing so in a timely fashion.

Another risk may be in the organization's underlying knowledge management systems. We've seen organizations that come up with the right ideas, and have a willingness to invest in those ideas, but they're held back by their own lack of systems infrastructure. In today's world, it is difficult to respond quickly and effectively to disruptive trends without robust front line and back office systems. Boards should be asking their chief information officer about where the organization is investing in technology, what areas are being upgraded, and whether the organization is becoming more agile with its core IT systems to better enable innovation on the front line with customers.

Nick Galletto
Nick Galletto is a partner and the National Leader of Technology Risk Solutions for Deloitte Canada and the Deloitte Americas Security, Privacy and Resiliency Leader. He is based in Toronto, Canada.

Understanding cyber risks
A conversation with Nick Galletto

Cyber attacks seem to have become more prevalent. Why is that and who is most at risk?

Everyone is at risk. Today, if your organization hasn't yet been a victim of a cyber attack, it may have been and you haven't realized it or there is a high probability that it will be a victim in the near future.

A lot of the risk is driven by connectivity. Five to ten years ago, when organizations weren't as interconnected with one another, we focused on protecting the perimeter – building strong walls around our organization and its IT environment to protect our assets. We controlled access to that environment by letting in only those who needed to be let in. Today, we're much more connected. When organizations enter into business relationships or partnerships, as part of a supply chain, for example, there's a need to exchange information. That means we can't seal off the organization and its information anymore, so we've become more exposed.

Another thing that has changed is the threat landscape. When we built strong perimeters it was to control who was trying to come in through the "front door." Today's cyber criminals are trying to identify the "back doors" to gain entry through them.

What do you mean by "front doors" and "back doors"?

An attack through the "front door" was one that came in through remote access or a web browser, and those attacks still occur. It's much easier, however, to get in through a "back door." These are attacks that focus on people and use social engineering attacks, such as phishing, to trick the person into performing a specific action, such as clicking on a link or an attachment. They succeed because these attacks are very sophisticated. The message looks like it comes from a legitimate individual who the target knows and trusts.

The people who are targeted are ones with privileged access, a systems administrator, for example, who knows the passwords the cyber criminal needs to gain entry.

What are cyber criminals looking for?

Every organization has critical assets that provide it with a competitive edge. Cyber criminals will target critical assets for financial and competitive gain, or for intelligence purposes. Many will succeed because the cyber criminal community is highly organized and very well funded. It's also very knowledgeable. We know the recent attacks that targeted financial institutions included people employed in that industry. Why? Because they understood the processes they needed to breach to gain entry.

In a time of connectivity, some cyber attacks target one organization in order to gain information they need to reach their ultimate target, which is another organization. For example, we know of at least one instance where a security software company was attacked to gain access to the algorithms they used in their software to generate a two-factor authentication. The cyber criminals wanted those algorithms in order to attack their real target, which was a specialized manufacturer that protected itself with the security software company's product.

What do organizations need to focus on to protect themselves?

Traditionally, organizations concentrated on the people and the information and data that was coming into the organization and whether any of that posed a risk. What they rarely looked at was the information that was leaving the organization. Some of what leaves the organization goes to legitimate business partners. On the other hand, there are also uncontrolled information leaks. The organization may have disclosed information unintentionally, or the information it shared was not sufficiently protected by an employee or business partner. It's almost like the organization becomes a cyber beacon – it provides bits and pieces of information that, when pulled together, creates a profile to launch a cyber attack – individual things said about it appear harmless, but when everything is combined it could create a threat vector for the organization that makes it a target for cyber criminals.

Understanding cyber risks
A conversation with Nick Galletto
(continued)

What should the board be concerned about?

Ultimately, the question for boards to ask is: what is our organization's ability to detect and respond to cyber threats? If I was a board member, I would want a comfort level of knowing the organization is doing the right things. That is not to say we still wouldn't be attacked. Instead it is saying that we're proactive in protecting ourselves. That means we would recognize when we're being attacked, and the nature of the attack. It would mean that we have a plan in place to respond to an attack. It would mean we are monitoring our key risk indicators and we know what is trending as it relates to our organization and our industry, what is changing and what is occurring.

Organizations need to proactively manage and monitor their environment. The last thing you want is for your customers to tell you that something has gone wrong and you've been a cyber victim.

Nicolai Andersen
Nicolai Andersen is a partner and the Innovation Leader for Deloitte Germany. He is based in Hamburg, Germany.

Unleashing productivity
A conversation with Nicolai Andersen

There has been some debate about what creates the greatest benefit for organizations: innovation or productivity? What is your view?

In an ideal world, every organization would like to be both highly innovative and highly productive. In the real world, however, not every organization can achieve that objective. Whether innovation matters more than productivity to an organization will depend on its circumstances, including its business model, competitive environment, industry and so on.

For example, every organization does not have to be an innovation champion. There are many examples of very successful organizations that chose to be fast followers – organizations whose strategy was to quickly follow an innovator into the market with their own version of that innovative product. That being said, however, being a fast follower is also challenging. To succeed, the organization not only needs to get its product to the market quickly, but the product must also be "better" than the original, whether that is because it is cheaper, has greater functionality or some other distinguishing feature.

What does it take to be a fast follower?

To succeed as a fast follower, the organization must have already invested significantly to build its research and development capabilities, since it will need to leverage them if it is to develop its own, better version of the product and get it to market quicker than other potential fast followers.

Investments in R&D, machinery and equipment and information and communication technologies are important for all companies, especially organizations in developed countries that have comparatively high costs – salaries, materials and so on. To compete globally, they need to be innovative and that includes maximizing their productivity levels.

Consider, for example, automotive companies such as Mercedes, BMW and Audi. The success of these companies depends primarily on two things. One is that they will be innovative; their customers expect their automobiles to embody the best of everything that is possible in car manufacturing. The other thing is productivity; these companies must maximize the efficiency and effectiveness of their production processes to be competitive.

When it comes to productivity, what should boards be concerned about?

Boards of directors should have insight into the organization's productivity. Boards should ask management to report on productivity, most importantly, is the organization investing in productivity? Does it have the R&D and other resources to be agile in responding to changes in the market?

When the organization's senior leaders talk about the performance of the organization, does that discussion also include their view on trends in the industry and how they are reacting to them? Are they on top of what is gaining speed and impact compared to what may be declining and no longer worth pursuing?

We hear complaints about the way regulatory or legislative changes affect organizations and disrupt their productivity.

I see it as a matter of perspective. New rules and regulations that force organizations to change their behavior may be viewed by many organizations as a threat. A better approach, however, may be to view the new rules as an opportunity to innovate and differentiate the organization.

For example, the European Union is reviewing the allowable emissions levels for automobiles. Germany and some other countries with strong automotive industries naturally want to protect their industries and, therefore, don't want the new requirements to be set at too high a level. My view, however, is that when tougher requirements are introduced, it forces companies to be more innovative. Industries that are protected by softer regulations risk being left behind by organizations that operate in tougher regulatory regimes and have learned to adapt to those tougher requirements.

Stefan Dierks
Stefan Dierks is a partner and Head of Strategy, Commercial and Operational Due Diligence at Deloitte CIS. He is based in Moscow, Russia.

Strategies for disruptive times
A conversation with Stefan Dierks

Setting strategy seems to have become a very public process in which anyone and everyone may try to impose their views on the strategic choices they want to see organizations make.

Organizations have always faced a public response to their strategic choices, but it has usually been a market-based response. For example, if an organization's strategic choices are based on a correct assessment of the market and its opportunities, customers will respond in a positive way and the organization will grow. If the organization makes incorrect assumptions, customers will take their business elsewhere and the organization won't grow as it had hoped.

What is different today is many stakeholders who disagree with an organization's strategic choices may want to express their disagreement in a very vocal way. In fact, many are willing to be very proactive in challenging and opposing those organizations with the objective of forcing them to change their strategies. Today, organizations should expect their strategic choices to be challenged at any time by any known or unknown stakeholder.

What is more, organizations may find their strategic choices being challenged well after they have been made and when they appear to have been accepted. For example, a major infrastructure development project that has been under development for years may suddenly be challenged just as it is nearing completion.

Another important consideration is that social media and other technology enables even the smallest groups to bring a lot of attention to an organization's activities, which it may need to justify. As a result, organizations may find themselves devoting considerable time and effort to addressing issues that are receiving a lot of attention yet are of importance to only a few people.

Have there been situations where an organization has reversed its strategic choices?

Reversing strategic choices happens every day. One of the strengths of strategic planning is that it allows to learn. But while the number of cases where stakeholder activity plays a role in such a decision is increasing, that isn't always what drives change.

Take "reshoring" as an example. We've seen a number of reshoring activities across the more mature markets. Some of the decisions have come in the wake of stakeholders being very vocal in expressing their opinions regarding offshoring. However, many have occurred because organizations have seen the cost advantages from manufacturing offshore beginning to diminish. There are many reasons for that, including governments having changed their tax structures to "restore tax fairness." Other reasons include the fact that since the financial crisis, many governments have found it difficult to find infrastructure financing; the gap between labor costs in low-cost and high cost countries is getting smaller; finding qualified staff in low-cost countries becomes an art in itself; and technology is about to boost labour productivity in high-cost countries.

How is technology impacting the way organizations work?

Technological advances change the way we think about management. For example, decision making support will become increasingly digitalized and a significant share of analytical work will be performed by technology and advanced algorithms like predictive analytics. The same is true for modern production processes, which will become digitally certified according to similar standards. Optimal enterprise control will be in the area of computational sciences and robotics development. This all will lead to a rethinking of the "white collar" work environment.

With respect to strategy definition, these technologies will allow us to include a greater number of "weaker signals" into the strategy equation. But it also means we are likely to have more of a "winner takes it all" environment since organizations that excel in this new era of decision making and issue identification will be able to quickly create advantages for themselves, and it will be much more difficult for the fast-followers and early-adaptors to catch up with them.

On the people side, we could see a similar trend within an organization. Technological advances will have a significant impact on lower value jobs – and these jobs will likely include many of those that are currently viewed as being of high value. As a result, a comparatively small number of people will be employed in higher value positions, and that will have a tremendous impact on organizations and the way they manage their people.

Strategies for disruptive times
A conversation with Stefan Dierks
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Organizations will need to work hard to create an environment where this small number of high-value mavericks don't operate as independent, elite individuals, but instead work together cooperatively as teams.

What can organizations do to enhance their ability to make and defend their strategic choices?

Boards have disruption on their side and should make use of it. Organizations should use unstructured data analytics to identify relevant patterns in an otherwise overwhelming flow of data and events to help them reduce uncertainty and turn unknown risks into known and manageable risks.

While I spoke about the way technological advances are changing the way organizations are run, the challenge for many organizations is to take advantage of that, because it often involves making fundamental changes to time honored processes and procedures, and there can be a lot of resistance to that. But with the proper technological structures in place, organizations can create new advantages for themselves. In a world where digital disruption if blurring industry lines, redefining supply chains, and otherwise disrupting business models, organizations need to be bold in the way they respond.

Gerhard Vorster
Gerhard Vorster is a Partner and Chief Strategy Officer for Deloitte Asia Pacific.
He is based in Sydney, Australia.

Growth amid disruptive change
A conversation with Gerhard Vorster

Uncertain economic conditions have made growth a challenge for many organizations. How can they improve their growth rates?

Some domestic economies continue to struggle; however, the global economy is growing. By definition then, organizations need to grow at the same pace just to maintain their share of the global economy. So, while it will continue to pose challenges, growth is still a requisite attribute for every organization.

When it comes to growth, the choice of markets in which an organization chooses to compete is becoming increasingly important. Organizations should align themselves with the higher growth domains – countries such as Brazil, China, India, Indonesia, the Russian Federation and South Korea – which together are expected to account for more than half of the world's economic growth over the next decade. There are also sectorial growth domains: health and health-related services, tourism, international education and wealth management, all of which are being driven predominantly by the emerging middle class in China and other developing economies. I also expect to see strong growth in the clean energy sector, and in agri-business and food security.

What effect is digital disruption having on organizations' growth?

All industries are being affected to some degree by digital disruption, and certain industries are especially disruption prone, such as retail, finance, professional services and real estate, just to name a few. Organizations in these sectors are seeing their revenue streams and cost structures becoming disrupted and, as a result, they will need to make fundamental changes to their business models.

This disruption and the need to create new business models will pose a significant challenge to organizations and their management teams and boards. Something the organization has historically done (say with a value of 100 associated with it) is now being done by the organization and its competitors, but with only a value of 20 associated with it. As a result, growth margins are declining, so how does the organization respond? It's easy to get stuck in the business dynamics of the past and to try to use productivity to arrest this decline, but by doing so, the organization may be missing the gorilla in the room – the fact that their business model has been fundamentally disrupted and they need to make significant changes to it in order to survive. It is almost a re-set of the base line, because you may not end up with the same numbers initially, but you will end up with a much stronger platform.

What should the board's role be in this situation?

With the blurring of boundaries and greater convergence of industries, to understand what the next big thing will be in your industry, you've got to spend some time out of it. Directors and the C-suite need to take steps to put themselves outside their industry, and then look back in. In particular, boards need to understand the major trends affecting their organization. These include macroeconomic trends, as well as trends in management, leadership, KPIs to be measured, and so on.

Assumption management is also becoming increasingly important. Management makes assumptions upon which it bases its growth strategies, and these assumptions must be continually tested, especially in the short-term, to determine whether or not they are playing out the way they should, or, whether there have been changes, which would require a change in strategy. Boards, therefore, need to understand the mega-assumptions that surround activities expected to move the organization forward, if the board is to be able to test them effectively.

Another important issue is that every entity needs to look at productivity all the time – the productivity of people and of capital and, more importantly, the productivity over a five year period. The board should have a clear visibility of the portfolio of new initiatives being pursued by the organization and should take responsibility for creating an environment where the development and pursuit of these initiatives is encouraged and supported.

Heather Stockton
Heather Stockton is a partner and the Human Capital Leader of Deloitte Canada.
She is based in Toronto, Canada.

Developing leaders
A conversation with Heather Stockton

What attributes should organizations be looking for in their leaders?

Every organization needs leaders capable of setting direction, establishing the appropriate tone at the top, working collaboratively to build cohesive teams with talent from diverse backgrounds and influencing and inspiring the organization's broader workforce to successfully execute the organization's strategy.

In the past, organizations were much more insular than they are today. Given the economic uncertainty and other factors affecting organizations, such as regulatory changes, technological advances and digital disruption, management needs to focus much more on things occurring outside the organization in the broader marketplace, and then bring that back to the leadership table for debate.

This requires leaders to be networked both inside and outside of their organizations to encourage diversity of thought at the leadership table. Leadership teams need to be able to be agile in their thinking, using all the information they have at their disposal to make informed and timely decisions, whether it relates to regulation, customer demand, market pressure, or costs, or something else.

What should boards be doing to ensure the organization is developing leaders capable of taking the organization where it wants and needs to go?

In the past, boards focused on governance and the accuracy and quality of financial results. Today, boards are increasingly concerned about the sustainability of business results, which requires a much deeper insight into the organization. When it comes to leadership, simply being assured that the organization has a succession plan is not enough for boards. Instead, the board needs to know that the organization is actually executing against that plan and that the things being reported in the plan are really happening.

Boards also need to ensure that the organization is layering its business strategy into its leadership development activities, talent and customer practices and the performance management of the organization's leaders so that is part of the fabric the organization's culture.

Obtaining this type of assurance would seem to require more than just a formal presentation to the board.

As a leading practice, boards should have regular, ongoing two-way conversations with the CEO and CHRO about these issues because the board and the CEO need to work in collaboration to make adjustments to the parts of the business that need it.

Many boards, either as a whole or through a committee of the board, sit down with their CEO at least annually, or more depending on the circumstances, to discuss execution against strategy, business results, organizational risks and how they are being mitigated, the company's talent strategy and leadership bench – who's developing and who's not, and what the competitors are doing, and so on.

You mentioned "leadership bench." What should boards be looking at in this area?

Boards should ensure that the leadership bench strength in the organization is sufficient for the organization to be successful over the next five years. Beyond the typical board report and succession list, boards should be asking what additional insight can be provided to satisfy them that the bench is real and ready. They need to demand that this analysis be a fact-based assessment, not just a "gut sense" check.

Developing leaders
A conversation with Heather Stockton
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For example, boards should look closely at onboarding. Are the senior people brought into the organization able to execute and deliver on what they were expected to deliver? How successful have these people been? Some boards will look at the ROI of external hires by evaluating retention, contribution, execution compared to business case and the potential they demonstrate.

Knowledge transfer is also important. When an organization has senior leaders nearing retirement who have deep knowledge of critical aspects of the organization's business – its products, customer base, supplier relations, and so on – that knowledge and those relationships need to be transferred to the new generation of leaders. Are the boards reviewing the succession and transition plans for key senior leaders? These changes take time and when not managed well can result in poor transition and the failure of the incoming leaders.

Organizations aren't static, and the best leader for today likely won't be the best one for tomorrow. That's why organizations need to be as predictive as possible about the leaders they need in future, and need to continually revisit and retest these assumptions to keep them aligned with where the organization is today and where it is going.

Consuelo Hitchcock
Consuelo Hitchcock is a principal with Deloitte LLP (United States). She is based in Washington, D.C.

Making disclosures meaningful
A conversation with Consuelo Hitchcock

It seems like the demand for disclosure is ever increasing, as new requests and requirements arise year after year. How can companies anticipate and prepare for such changes?

New requirements may arise from a specific event or market environment and may be difficult to foresee, such as we saw after some of the financial scandals of the early 2000s. In other cases, however, there may be grassroots calls for disclosure that trend and sometimes accelerate. I think we've seen that with environmental, social and governance reporting, and in the area of executive pay. I think it benefits organizations to be aware of such trends, to watch when regulatory requirements are being considered, and even to consider whether and what new disclosures might be appropriate in advance of a requirement.

Has the demand for more disclosures helped people to better understand organizations, or has it just created a lot of "white noise"?

I think both. Over the years the volume of information that organizations provide – either in compliance with regulatory requirements or voluntarily – has increased dramatically. While much of this information is useful, and technology has made some of it easier to process, I do think that as volume increases, investors can have difficulty determining what information really is important to their investment decisions, and what is less so.

When directors review their organization's disclosures, they should consider stepping back and looking at the total picture to determine how well the organization is telling its story. Is the organization emphasizing the right things and clearly telling its story? It's easy for organizations to get focused on ticking the boxes – making sure the organization complies with all the disclosure rules set out by the regulators. It's also important to step back and ensure that the organization is providing the information its shareholders need in order to make investment decisions.

What alternatives do organizations have when some groups are very vocal about wanting information disclosed that most people would not find all that relevant?

In situations where the issue is of concern to one particular shareholder or group, boards could consider engaging – or encouraging company management to engage – directly with these shareholders individually to gain better insight into their concerns. Perhaps those concerns could be met in some way other than including additional information in the organization's formal disclosures, such as meeting with that shareholder to address those concerns – bearing in mind, of course, that the organization needs to take care not to violate the rules of fair disclosure by giving material information to some people and not others.

You spoke earlier about the dangers of a "ticking the box" mentality, but a lot of organizations feel that's inevitable given the speed and number of new requirements being introduced. What approach should organizations take instead?

One way organizations can address concerns about the pace and number of new requirements is to get involved in the regulatory process. Of course, not all potential regulations affect every organization in the same way or to the same degree. So the first step is to focus on the developments with the greatest potential to affect the organization, and then get involved in the process. Regulators generally welcome feedback from all constituents on proposed rules and standards that they issue for comment. Organizations that get more actively involved in that process – either individually or through industry groups – can express their perspective at a time when there is still an opportunity to shape the way the rules will be implemented.

Nina le Riche
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She is based in Cape Town, South Africa.

Adapting to integrated reporting
A conversation with Nina le Riche

Integrated reporting has been mandatory for listed companies in South Africa since 2010. What has the experience been?

Initially, integrated reporting was introduced on a "comply or explain" basis before becoming compulsory for listed companies in 2010. At that time, it was a new concept and the integrated reporting framework had not yet been published so companies had some difficulty determining what they needed to do. A lot of them just put their sustainability report into their annual report.

Both the South African and international frameworks for integrated reporting have since been published and they were well received in the market. As for implementation, companies are having varying levels of success with integrated reporting. Some organizations have done a very good job, while others have done less so. Most mining and financial companies have done a good job, but there are other star performers in other industries. In fact, good reporting isn't so much determined by industry as it is the value set within the organization, particularly the value it places on excellence in corporate reporting. Clear values, principles and objectives overseen by solid governance structures should lead to clear reporting on values, management practices and performance.

Why are some organizations struggling with integrated reporting?

A big part of the problem is that it is called "reporting" when it is actually a process. A lot of organizations initially viewed it as a reporting exercise, until they began working through the process and tried to embed it in their organizations. That resulted in a "cart before the horse" situation. Usually organizations take action first, and report on it afterward. In this case, they began with the report, which subsequently began driving different types of behavior.

A lot of companies have had difficulty realizing the business benefits of integrated reporting because of what they have reported in the past. Before integrated reporting became mandatory, many organizations voluntarily issued sustainability reports, or a construction or mining company, for example, may have reported loss time injuries because they can win work based on that strength. Often, these reports were scoped in a way that would present the organization in the best light. Now, they must report these things according to the integrated reporting framework, with the result that sometimes the picture isn't as bright as the company had previously portrayed it.

These sound like transitional issues that will work themselves out over time.

Definitely. In fact, we've seen the bar move upward quite significantly in the first three years of mandatory integrated reporting. What was considered acceptable reporting just 18 months ago is now seen as being not good enough. Organizations have come to understand that the information they present has to be comparable to other information presented in their reports, and it must make sense. At first, a lot of companies focused on reporting on their sustainability and carbon footprint, even though that was irrelevant for many industries. Now there is a realization that organizations need to link what they report to the strategic direction of their organization.

What counts is whether or not a report reaches the targeted audiences and can help create value through better explaining the activities, value system and behavior of the reporting company. It is key that the report provides the information that captures all of the organization's relevant business sustainability issues.

Integrated reporting promotes the need to answer the important questions around long-term value creation – and in a world where economic instability and longer-term sustainability threatens the wealth and welfare of society in general, this further push towards improved corporate transparency is definitely welcomed.

Trust in an organization is achieved through transparent behavior and is a key success factor for the business to operate, innovate and grow.

What do directors need to know about integrated reporting?

Integrated reporting gives organizations the opportunity to tell their story…the whole story. Once you put your story out, however, it needs to continue to make sense in the future. There is still a very big practice among organizations of chopping and changing what is reported based on what the organization did well in the previous year. Directors need to think carefully about what the organization reports because once they put the story out, it will be difficult to change it in the future, especially with the comparability standards and principles contained in the reporting frameworks.

Adapting to integrated reporting
A conversation with Nina le Riche
(continued)

It is also important for boards to understand that this isn't a public relations exercise, and it can be very tempting to make it that especially when the information being reported really reflects well on the organization. But that's not what integrated reporting is supposed to be about. It is supposed to represent the collective thinking of the board and the C-suite on the long-term sustainability of the organization. Once the board and C-suite have an agreed upon clear picture of that, then by all means the organization should use it for its maximum public relations benefit, but don't start the exercise from a public relations standpoint.

Albert Baker
Albert Baker is the Global Tax Policy Leader for Deloitte. He is based in Toronto, Canada.

The changing tax environment
A conversation with Albert Baker

Over the past year, organizations and their tax strategies have become a controversial topic. What has happened?

It started in the United Kingdom after people became aware that some non-UK based organizations that carried on business in the UK were not paying substantial amounts of income tax in the UK. Since then, the same focus has been brought to bear on international companies operating in other jurisdictions, and has led to unfavorable media reports and, in some cases, organized boycotts of these organizations.

The perception is that, at a time when many governments are reducing spending to control expenditures and reduce their deficits, the general public is paying more taxes than necessary because some taxpayers are not paying their fair share. It gets complicated because what constitutes a fair share depends upon your perspective. The organizations that have been called out on this were, in fact, paying all of the taxes they were required to pay under the law. Those who criticized these organizations, however, viewed that tax rate as unfair and even immoral.

How have organizations reacted to this?

The reaction has been very different. In the UK situation that sparked this, the company voluntarily paid a greater amount of tax. On the other hand, at hearings into this issue held by the United States Senate in the summer of 2013, a CEO was unapologetic about the rate of tax paid by his company. He argued that they were following the law and suggested that if the government wasn't happy about the amount were paying, then it should change the tax laws. In the meantime, they had a responsibility to their shareholders and they wouldn't pay any additional taxes until they were legally required to do so.

Are there particular areas where organizations might be exposed?

Countries have long competed with each other using tax policies and other incentives to encourage desirable companies to set up operations in their country in order to achieve certain policy objectives, such as creating high value jobs, strengthening a key industry, helping build expertise and capacity in a particular field, or making other contributions that are considered beneficial to the country.

For example, the tax regimes of several European countries include provisions for patent boxes, which are designed to encourage innovation. They encourage organizations to locate high-value jobs related to developing, manufacturing and utilizing patents in the country by allowing them to pay a low rate of tax on tax on the profits they earn from the patents that are attributable to that country. The philosophy behind the patent box is: what the host country loses in additional tax, it gains through higher employment in globally competitive fields. The question now, however, is whether that trade off will be accepted in the court of public opinion, and if it isn't, what the impact may be on a company in this situation.

What other developments are occurring?

Most countries – certainly, the G20 countries – are concerned about the erosion of their tax bases. They support the Organization for Economic Co-operation and Development (OECD), which has presented an *Action Plan on Base Erosion and Profit Sharing (BEPS)*. There are 15 areas to be addressed under the plan, and initial reports will be issued beginning in mid-2014. The OECD's objective is to eliminate so-called "double non-taxation" and curtail competition between countries based on income taxes, and these goals will only be achieved if all countries agree to adopt the proposals that are released. It will require countries to make changes to their domestic tax laws and international tax treaties, which could be a lengthy process, though the OECD is exploring a novel approach of using a multinational instrument to change all of a country's tax treaties with a single instrument. Time will tell whether or not countries do agree to adopt the OECD proposals, and whether the multinational instrument will be effective.

In the meantime, some countries are already taking their own steps to address this situation. France, for example, is eliminating deductions for payments made to related parties if the income is not being taxed at a certain rate in the other country. Austria and Mexico have also put forward similar measures. Canada is taking steps to eliminate "treaty shopping," which refers to a company based in a country that doesn't have a tax treaty with Canada, setting up an intermediary company in a country that does have a tax treaty in order to indirectly access the benefits of a tax treaty with Canada.

The changing tax environment
A conversation with Albert Baker
(continued)

What should companies and boards be doing?

Tax law is very complex and tax has often been viewed as a black box, a complicated area that many boards didn't delve into in the past. That's changing. Boards recognize they need to understand more than just what the tax technical risks are, but also the potential reputational risks.

Organizations should begin looking at the OECD BEPS proposals and other tax domestic proposals – such as tax reform in the United States – with the objective of getting out in front of them to understand the potential impact of these new rules on their organizations from a business, financial, tax and legal perspective.

Boards and management need to determine the type of tax strategy they want to pursue. Is their primary objective to avoid controversy and challenges from tax authorities, even if that results in them paying a higher effective rate of tax? Is their objective to take full advantage of all of the available tax saving opportunities, even if that results in challenges from tax authorities that need to be resolved in court, and possibly generating unfavorable media attention? Or is their objective to be somewhere in the middle?

If the company has taken advantage of the tax incentives available in a particular a country, those arrangements may, at some point, no longer be effective. Companies need to carefully determine which of their tax structures might be affected and in what countries. Boards should ask management to determine the potential impact on the organization's effective tax rate and, therefore, on its financial statements.

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Boardroom depth and diversity
A conversation with Daniel Aguinaga

Boardroom diversity is becoming a greater priority for shareholders.

Although a growing amount of attention is being given to board diversity, the key issues for the board remain the same: Do we currently have the right mix of talent and expertise on the board? And, do we have access to the top candidates in order to refresh the board's membership? Diversity is one element in that mix of talent and expertise that boards should consider.

Some jurisdictions don't think boards are giving diversity enough consideration, and have set gender diversity quotas. Is this the way to go to create more diverse boards?

The intention is good, but the requirement to meet mandatory quotas can be problematic, especially in the short and medium term.

When a gender quota is imposed under regulation, most, if not all, publicly-listed companies will need to recruit women directors. The question is whether there are enough qualified women director candidates available to fill all of those board positions. The experience of some European companies suggests there are not, based on the concerns those companies have raised with the regulators. However, since the organization must comply with the quota regulation, there is a risk that the director candidates it recruits may not be the ones with the best knowledge and experience considering the current situation of the companies.

Even though growing numbers of shareholders and other stakeholders want to see a greater diversity on boards – in terms of gender, ethnicity, backgrounds, and so on – their primary concern is still to have board members with the range of experience and expertise to be able to effectively address the challenges facing the organization.

In other words, there is a risk that experience and expertise may be traded off in favour of diversity.

In the short-term, that is certainly the risk. Ideally, though, there shouldn't need to be a trade off – expertise and diversity are both attributes that boards should look for when recruiting directors. Many studies have found that more diverse boards are higher performing than less diverse boards. They may be able to generate new ideas faster and bring those ideas together in new and better ways because they approach the issues from more diverse perspectives.

What approach should boards take in recruiting and managing their membership?

Continuing economic uncertainty, regulatory changes, digital disruption and other factors are radically transforming organizations and their operating environments. As a result, the experience, knowledge and expertise required to lead the organization is also changing, both at the C-suite and board level.

Boards need to have a clear understanding of the expertise, experience and other attributes they require of their directors. For this reason, there should be a regular evaluation of the board, its committees and individual directors to determine their effectiveness and to identify any skills or knowledge "gaps" among its current members that need to be filled. The results of that evaluation should be used to develop a "profile" of the ideal director candidate's ideal director candidate's attributes – experience, areas of expertise, background, and other factors. A well defined and regularly updated board "profile" is an essential tool for the nominating committee or a third party recruiter to use for recruiting and building an effective board.

Of course, adding new attributes to the board isn't about making the board bigger. Inevitably, as circumstances change, some directors' experience and skills will become less relevant to the board and those people will need to step down from the board. For a lot of boards, that's still a difficult transition that many that many struggle to manage.

Are there other critical issues facing boards when they are looking for new directors?

Boards should also be concerned about their ability to access the best possible candidates and successfully recruit them to the board. If this is a problem for the organization, it will need to take steps to address that issue. Part of the answer may come through better board education, to help build the knowledge of the current board. Another part of the answer may be through better recruiting, perhaps by making use of outside recruiting specialists to help improve the board's recruiting strategies.

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