Middle East

Point of View

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A word from the editorial team

Nothing is certain except death and taxes. So said Benjamin Franklin in 1789. Since then, there is much that has become certain, such as uncertainty, wars, tax evasion, money laundering and business travel to name but a few. Oh, and mobile telephony. Future historians will eventually make sense of our uncertain and unpredictable times. For now, we will just have to go with the flow.

It does help, however, to try and make sense of the world around us and this is precisely what our contributors do in this issue of *Middle East Point of View*. It is indeed a careful world we live in and much has become about assessing risk and mitigating it.

But there is still much room for excitement, especially as regards the advancement of technology. Enter 5G, the fittest and fastest mobile network so far. Emmanuel Durou, Pedro Tavares, Guilherme Oliveira, Hugo Pinto, Pedro Venâncio, and Gonçalo Horta review the new network and the challenges faced by mobile operators. Despite the need for monetization, the authors say: "More than ever, Telcos cannot afford to miss the proverbial 5G boat—it is not about differentiation anymore, it is about survival of the fastest in every sense of the word."

Mitigating risk is of increasing importance for both banks and the construction industry. Reduced liquidity due to changing market dynamics, namely a reduction in oil prices, is forcing banks in the GCC region to rethink their lending policy due to a rise in Non-Performing Loans. David Stark and Karim Labban advise in their article *NPLs on the rise* that corporates "should seek creative financing and restructuring solutions to mitigate default risk and engage in transformation initiatives to adapt to the changing dynamics of the market."

The effects of tighter financial policies in the Middle East, according to Matt Hanson, can certainly be felt in the construction industry and are leading to slightly more careless contracts. This is wrong, he says in his article *The case for risk management in the Middle East construction market*, as "tight management of project costs and clear visibility of project risks will become critical in ensuring overruns are avoided and stakeholders retain confidence in an organization's ability to deliver projects successfully."

Even business travel is no longer immune to taxes and risk. As organizations become more global, says Jayne Stokes in her article *Business Travel, managing risk in an evolving landscape*, "employees are increasingly expected to take on global or regional roles [giving rise] to a complex array of tax, immigration and payroll risks for both the organization and the employee."

And what better for mitigating risk than an insurance policy? That is precisely what Walid Chiniara and Yasmine Omari propose in their article *The "Triple S" family business insurance policy*. Although "there is no standard "Family business" insurance policy," per se, "it is possible to put in place a governance structure, akin to an insurance policy, to safeguard the capital of a family in all its forms: financial, human, social and intellectual."
No issue of our magazine would be complete without a commentary on reporting and anti-money laundering standards. Angelito Catacutan reviews the "Big Change" in IFRS 15, that affects the recognition criteria of revenue and will surely affect many industries especially some of the big real estate players and key telecommunications companies, who have chosen an early adoption of the standard.

Roy Gillespie, in his article *ISO 37001 anti-bribery management system: time for implementation* outlines the required measures and fundamental elements to ensure a successful implementation of the system, including top-level commitment, communication and adequate resources and budget.

Finally, Andrea Derler, Anthony Abbatiello, and Stacia Garr discuss the five ways to nurture developing leaders in their article reprinted from the *Deloitte Review, Better pond, bigger fish*. "Developing future leaders isn't just about putting them through programs," they say, "new research points to the critical importance of supporting them with the right organizational context—a workplace environment that encourages knowledge-sharing, risk-taking, and growth."

We are fairly certain that you will find this issue of the *Middle East Point of View* as informative and pertinent as ever, as certain as we are of paying our taxes.

ME PoV editorial team

Contents

The "Triple S" family business insurance policy

There is no standard "Family business" insurance policy that can truly mitigate and cover all the risks associated with a family-owned business.

There are various underlying principles that propel individuals to purchase insurance policies depending on their needs, be it to safeguard and protect their business, their assets, their family or their employees. These principles can also be applied within a family business context.

While key policies may protect the business to a certain extent, and life/health insurance policies will protect the family and employees to a certain extent, the coverage is understandably limited when considering the bigger picture: that of a family business.

There is no standard "Family business" insurance policy that can truly mitigate and cover all the risks associated with a family-owned business. However, it is possible to put in place a governance structure, akin to an insurance policy, to safeguard the capital of a family in all its forms: financial, human, social and intellectual.

Insurance policies are also used to provide financial security in the case of unfortunate and unforeseen events, ranging from the merely inconvenient to the truly life-changing.

What if?

While in some instances it is a legal requirement to have insurance policies in place (such as medical insurance for UAE employees), insurance policies are also used to provide financial security in the case of unfortunate and unforeseen events, ranging from the merely inconvenient to the truly life-changing:

- What if I crash my car?
- What if I break my leg on a skiing holiday?
- What if my bag is stolen?
- What if my house catches fire?

But there are also many "what ifs" that can affect a family business, such as:

- What if one of the family shareholders wishes to exit?
- What if the key family executive(s) passes away or wishes to leave the company?
- What if family members have different ideas about the commercial direction of the company?
- What if my children want to set up a business in competition with the family business?
- What if I work harder than my sibling(s) but they receive the same salary as me?
- What if a family member wants to join the firm, but does not have the right skills or attitude?

Any one of these scenarios can upset the delicate balance within a family, which in turn can generate financial, commercial and moral repercussions for the family, the business and its employees. So why not put in place a plan to secure the financial and commercial viability in the face of potential shocks that may affect the business?

The Triple S family business insurance policy

The first step to mitigate against these scenarios is to recognize that running a business and being a family are two separate matters. When the two become intertwined there is a need to create boundaries and rules. Family governance is the Triple S (3S) insurance policy that ensures the long-term security, sustainability and stability of the family business.

A Summary of the 3S insurance coverage

The coverage required will differ from family to family, but typical clauses should:

- Set out core values to which all members of the family should adhere to, so as to ensure that the family identity and cultural capital is upheld;
- Set out a family investment policy i.e. strategy of operating businesses, investments and family office;
- Define a succession plan to secure a smooth transition from one generation to the next;
- Provide a mechanism for decision-making among the family;
- Define a dividend policy that meets the needs of both, the family and the business and to ensure that family members' expectations are managed;
- Provide a way for next generation family members to be given responsibility for matters within the governance framework, provide mechanisms for their employment and integration into company operations;
- Provide agreed-to mechanisms for conflict management between family members; and,
- Provide a means for articulating the family's philanthropic vision and putting it into effect.

In essence, the family governance framework addresses all the potential "what-ifs" associated with a family business. It addresses the concerns of the different stakeholders within the family structure and it defines the roles and guidelines under which they should operate.

Agreeing on such a framework in advance allows the family to decide how to resolve problems and conflicts before they arise. Without a prepared response strategy, dealing with an unexpected problem at the same time as finding the right solution is not always immediately possible; any delay can cause a relatively minor issue to snowball into a much more problematic matter.

Governance is more than a hypothetical ideal or a physical or legal structure put in place to safeguard a family's wealth. It is the rules of operation for a given family, a set of systems and policies by which a family and all of its members can interact and work together to promote the family's vision and philosophy while maximizing returns and preserving the family's asset base.

It is important to realize that a family governance framework cannot be imposed on a family, rather, it must be developed by the members themselves. In the same way that insurance premiums are based on an actuarial assessment of the risk of the insured individual/item, there are many factors within each family business that will affect the design and coverage of the Triple S insurance policy.

While there is a financial investment associated with implementing a governance policy, this can be far less than the long-term risks (and consequent costs) of inaction such as a forced disunion of a company, a stifled or ineffectual board, loss of commercial opportunities, irreparable damage to family relationships or costly litigation and other legal bills.

Family governance is the Triple S (3S) insurance policy that ensures the long-term security, sustainability and stability of the family business.

Governance or succession planning is not a mandatory legal requirement... ...but maybe it should be?

The economic and social fallout of the failure of a large family business should not be underestimated, nor should the impact of the damage caused to relationships within the family.
As with all insurance policies, it is important to shop carefully and be certain of the extent of the coverage provided. Make sure the 3S policy purchase is adequate for the needs of the family and business. Just as business insurance policies can be changed and customized to suit the needs of the business and family, so can any given governance policy.

After all, entrepreneurs work so hard building their business, serving the community and creating employment, they owe it to themselves to ensure that their hard work has not been in vain, and that the family business is adequately protected. To quote Henry David Thoreau, "if you have built castles in the air, your work need not be lost; that is where they should be. Now put the foundations under them[1]."

by **Walid Chiniara**, Partner and Head of Family Enterprise Consulting, Deloitte, Middle East and **Yasmine Omari**, Manager, Family Enterprise Consulting, Deloitte, Middle East

Endnotes

1. Henry David Thoreau, *Walden*,1854

Survival of the fastest

5G – A glimpse into the expectations and challenges of next generation mobile networks

5G is seen by the telecoms industry as the key building block of our future mobile digital world and our networked society. Can the technology live up to its expectations?

Way beyond just speed improvements, 5G is expected to enable continually connected services with much lower latency than what is currently experienced today in mobile networks.

5th Generation Mobile Network, or 5G, is the new generation of mobile networks that will enable a range of new applications from Internet of Things (IoT) to self-driving cars, through higher speeds and lower latencies. The deployment of 5G networks is slated to begin in 2020 and there are significant efforts underway by Telcos to develop the business cases for 5G. This article examines the enabling aspects to making 5G a reality, as well as the challenges and concerns ahead that need to be addressed during the 5G standardization and implementation journey.

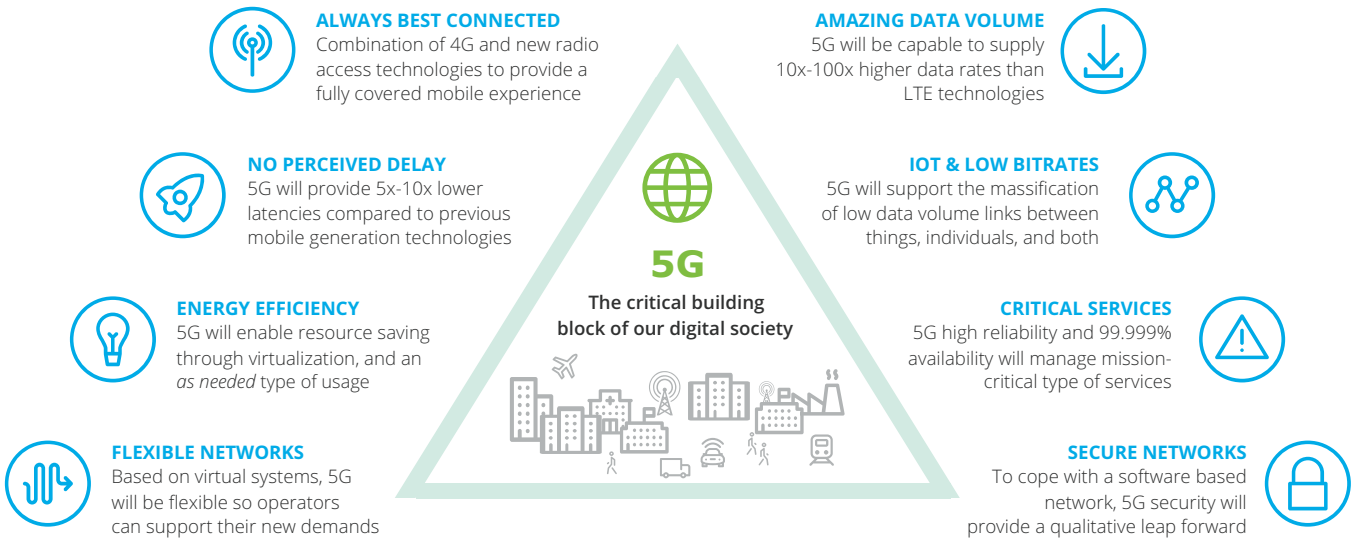
The new Telco Graal

5G is expected by many to be the forthcoming revolution in mobile technology. Way beyond just speed improvements, 5G is expected to enable continually connected services with much lower latency than what is currently experienced today in mobile networks.

5G will also enable the massive roll-out of connected sensors and bring about mass-market IoT—think trillions of connected devices. Thanks to higher reliability, flexibility and with a variety of trade-offs between speed, latency and costs, 5G promises to bring to market a range of new services and service improvements as presented in the graphic below.

However, a number of new and existing conditions need to be in place to reap the full benefits of 5G. These technologies, which go from radio to core, are yet to be developed and/or implemented. Among these, availability of the right spectrum bands for 5G deployment will be key. 5G will also be supported by the new generation of radio technologies (e.g. cognitive radio) coupled with new equipment and technologies (e.g. Software Defined Networks) in the Access and Core networks.

5G possibilities and opportunities for several industries



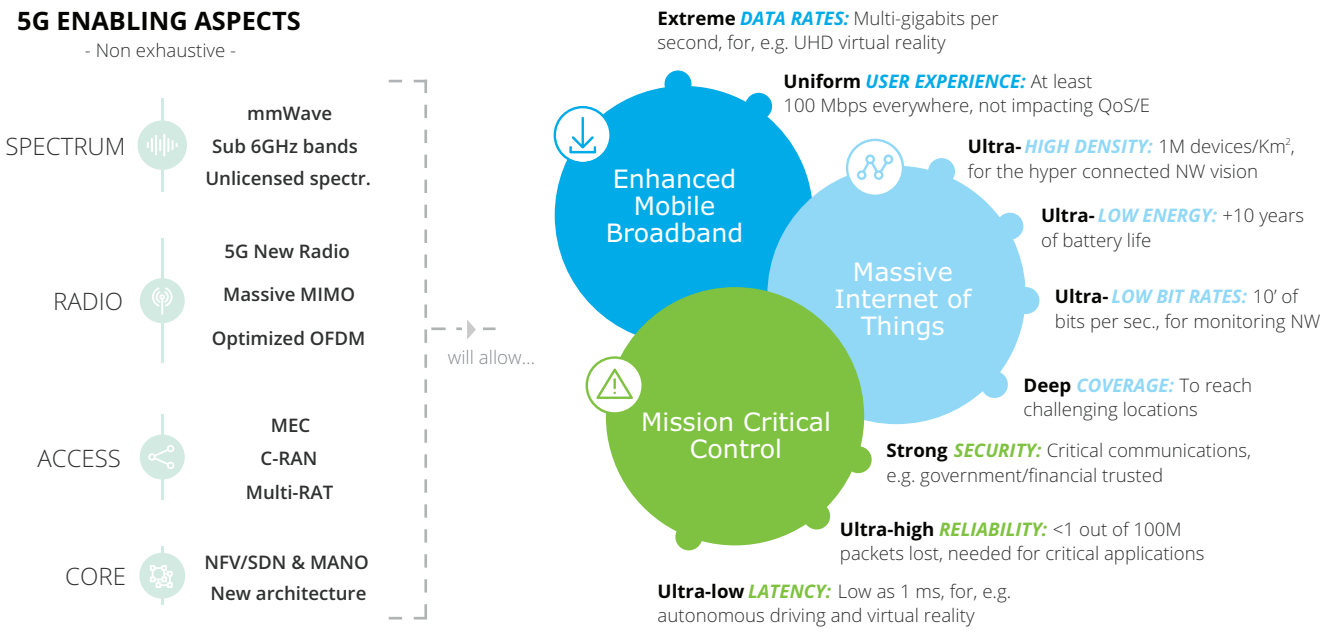
Source: European Commission

Once these are in place, the three main applications of 5G that will most affect our everyday lives are:

1. Enhanced mobile broadband—allowing seamless customer experience from a broadband speed point of view and the rise of new applications on-the-go such as UHD Augmented Reality;
2. Massive Internet of Things—essentially enabling the smart cities of the future;
3. Mission Critical Control—a must in the democratization of applications such as self-driving cars.

Telcos need to gain a clear picture on the monetization potential and return on investment for 5G. Beyond strategy, there are clear operational challenges ahead for the 2020 planned 5G deployment.

5G main use cases



With great expectations come great challenges

With new applications will come new business models for Telcos. However, Telcos need to gain a clear picture on the monetization potential and return on investment for 5G. Beyond strategy, there are clear operational challenges ahead for the 2020 planned 5G deployment.

Over the next few years, mobile operators will continue to face increasing margin pressure as data traffic continues its exponential growth, while operators' revenues grow at single digit pace, if any. As traffic keeps growing, operators must reduce cost-per-bit, as revenues will keep on decoupling from traffic growth. Thus, it is vital for the mobile operators to

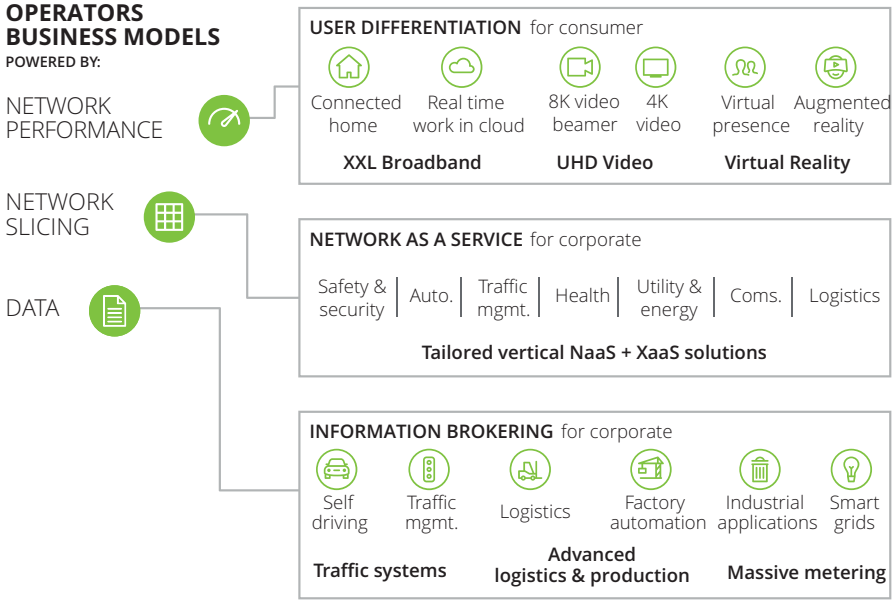
From the perspective of network operators, new business models will emerge with 5G leading to new ways of monetizing the network—building ecosystems for smart cities and IoT being two of the many examples of new models enabled by 5G.

reinvent their business models to address this challenge and exploit service differentiation in order to protect margins. From the perspective of network operators, new business models will emerge with 5G leading to new ways of monetizing the network—building ecosystems for smart cities and IoT being two of the many examples of new models enabled by 5G.

Overall we believe that three types of new business models will be supported by 5G deployment:

- On the consumer side, user differentiation that includes superfast broadband, ultra-high definition video to mobile devices and virtual reality;
- On the corporate side, Network as a Service (Naas) and information brokering, a byproduct of IoT and analytics.

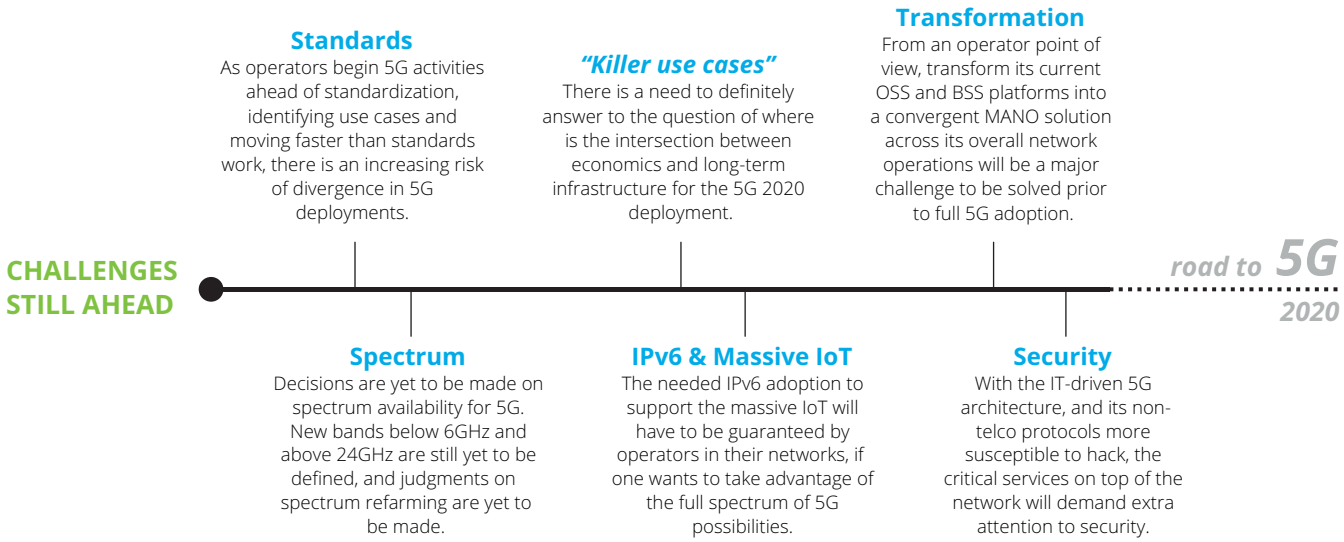
5G business models for operators



The first business model, aimed at the consumer, allows operators to take advantage of increased network performance to provide new differentiated services for end users (such as augmented reality.) In the case of NaaS, enabled over network virtualization, the focus is on corporate customers' needs. Operators can expose their Operations Support Systems (OSS) and allow corporate customers to configure their networks (network slices) in the way that best suits their needs depending on their industry verticals. Information brokering, also aimed at the corporate segment, intends to use the transactional and control data produced by 5G networks to empower new services that benefit from contextual real-time and non-real-time data. Operators can broker critical services information to industry, where events need to be addressed in real time: for instance in the assembly lines of automated factories.

However, many strategic and operational challenges lay ahead that need to be overcome on the road to a full and optimal 5G deployment. In many ways, 5G is posing transformational questions to Telcos on the rise of new business models, the need to operate in a more efficient and mission critical way and, of course, the adaptability of the operators to new technological challenges. In addition, to start the journey, the current lack of 5G standardization creates a risk for Telcos in divergent technology deployment that will in turn lead to higher costs and compatibility concerns.

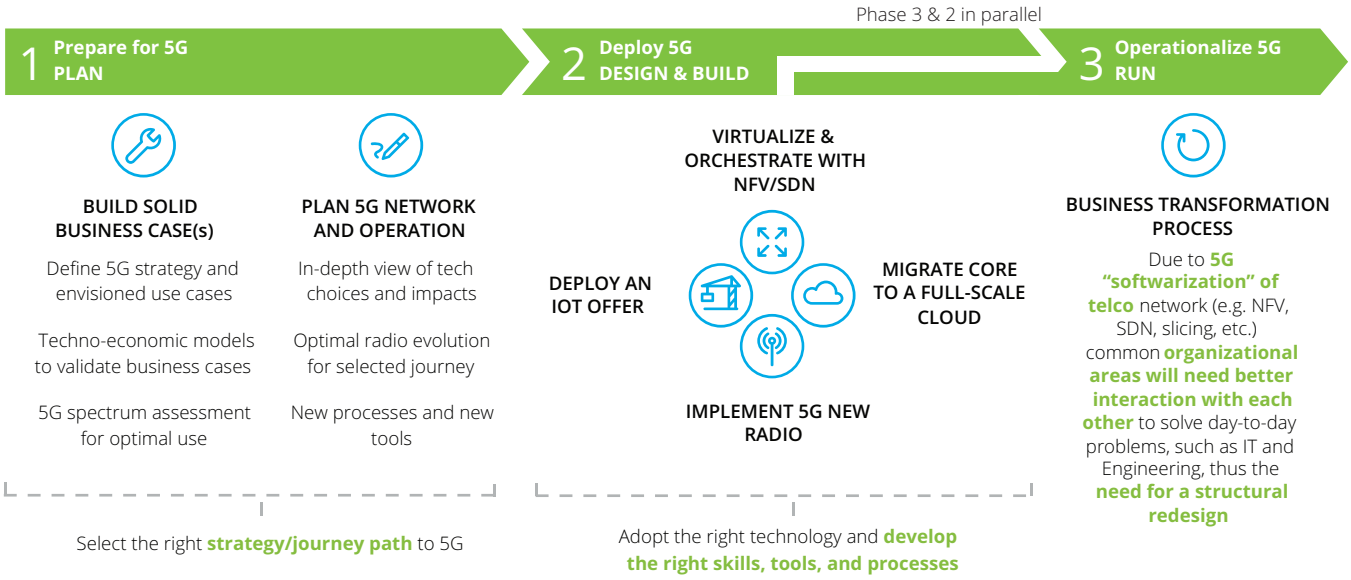
Challenges that need to be addressed for 5G deployment



Thus, to prepare for 5G, mobile operators need to make objective decisions on when and how to make the required network investments, and need to take into consideration the operational changes that are required to evolve to a 5G environment. The key steps of this evolution are shown in the graph below.

To prepare for 5G, mobile operators need to make objective decisions on when and how to make the required network investments.

Overall business transformation process



Smoothing the transition from 4G to 5G

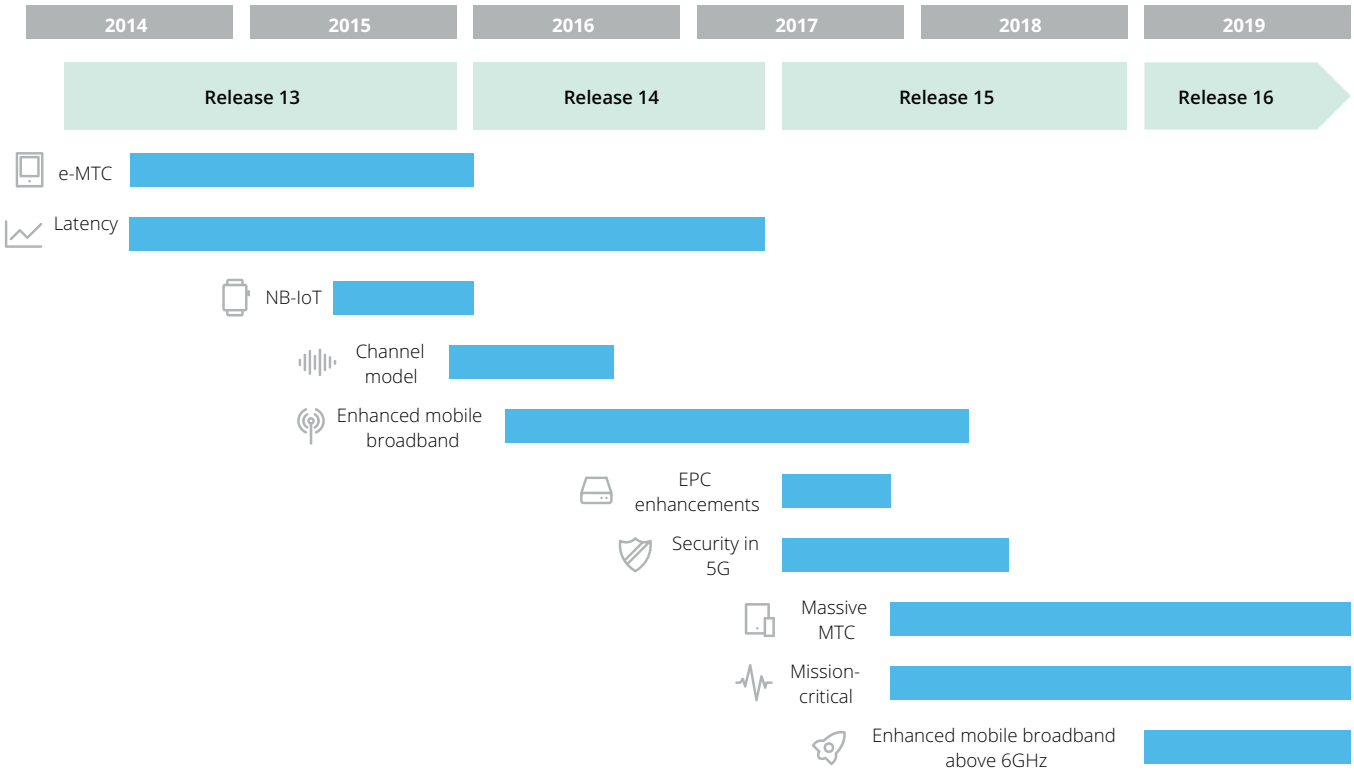
Transition technologies such as LTE - Advance Pro (4.5G) will bridge the transition from 4G to 5G networks, allowing operators to maximize the value of their current networks.

Mobile Telcos continue to build out their LTE networks with a push to upgrade to LTE-A and are also looking to advance to 5G. However, prior to the 5G rollout a mid-step will take place, more specifically LTE-Advance Pro or 4.5G. 4.5G will be backward compatible with prior LTE releases, increasing 4G capabilities with multi-gigabit per second bitrates and even lower latencies.

4.5G will begin providing the capabilities to support new 5G use cases, allowing to adjust network architectures ahead of time for 5G deployment. In addition, 5G networks will need a network architecture that meets certain requirements, such as adaptation to different service types, network slicing and backhaul requirements for lower end-to-end latency and ultra-high bandwidth. This will be enabled by parallel developments on Network Function Virtualization (NFV) and Software-Defined Networking (SDN). As of today, 5G is still in its technical requirements definition, with inputs provided from different standardization organizations, prior to its expected release in 2020. The following diagram shows the predicted roadmap for 5G.

Advance Pro (4.5G) will bridge the transition from 4G to 5G networks, allowing operators to maximize the value of their current networks.

Roadmap for 5G deployment



Conclusion

Telcos will continue to experience double digit growth—estimated at a 23 percent compound annual growth rate (CAGR) up to 2020—in data traffic, meaning that they need to keeping investing in new infrastructure and expansion to attend the market demand. Additionally, competition from OTTs are eroding revenues that are not growing at the same pace as their capital expenditure (CAPEX.) Thus, it has become a survival imperative for operators to rethink their business and operating models. Service providers are aiming to reinvent themselves into agile digital players looking for new sources of revenues, developing innovative value added services, reducing time to market and cutting their cost to serve. A successful transition to 5G becomes therefore one of the cornerstones of this transformation.

Until 2020 there will be multiple challenges related to a successful 5G implementation. The telecommunications industry is going through a period of profound mutation and 5G will play a crucial role in the operators' transformation agendas. More than ever, Telcos cannot afford to miss the proverbial 5G boat—it is not about differentiation anymore, it is about survival of the fastest in every sense of the word.

Service providers are aiming to reinvent themselves into agile digital players looking for new sources of revenues, developing innovative value added services, reducing time to market and cutting their cost to serve. A successful transition to 5G becomes therefore one of the cornerstones of this transformation.

by **Emmanuel Durou**, Partner and Technology, Media and Telecommunications Leader, Deloitte, Middle East, **Pedro Tavares**, Head Partner of Deloitte´s Telecom Engineering Excellence (TEE), Deloitte, Portugal, **Guilherme Oliveira**, TEE Manager, Deloitte, Middle East, **Hugo Pinto**, TEE Senior Manager, Deloitte, Portugal, **Pedro Venâncio**, TEE Senior Consultant, Deloitte, Portugal and **Gonçalo Horta**, TEE Consultant, Deloitte, Portugal

Business travel

Managing risk in an evolving landscape

As organizations become more global, traditional mobility types are becoming rarer—employees are increasingly expected to take on global or regional roles, travelling to emerging markets and being required to fulfill short-term project needs. This expanded global footprint, together with an ever-increasing interdependence between tax and immigration, gives rise to a complex array of tax, immigration and payroll risks for both the organization and the employee.

Individuals are frequently expected to take on regional or global roles, with oversight not only of the teams or markets in which they are based, but also within other jurisdictions in their region and beyond.

The global nature of work

The way in which businesses operate today has evolved significantly from how they operated ten years ago. Organizations increasingly need to be digitally agile—businesses can no longer continue to operate in rigid hierarchical structures, but need to work in networks of teams that cross functions, service lines and, in many cases, jurisdictions.

Within this context, individuals are frequently expected to take on regional or global roles, with oversight not only of the teams or markets in which they are based, but also within other jurisdictions in their region and beyond. This is particularly relevant within the Middle East given the relative size of the region and the number of countries it encompasses. It is feasible that an individual based in the United Arab Emirates (UAE) will have a remit over the wider Gulf Cooperation Council (GCC) region, if not further afield into jurisdictions as diverse as Iraq, Iran or Afghanistan. Inevitably, individuals are required to travel and spend time in those other jurisdictions.

An evolving risk landscape

The nature of business travel is inherently *ad hoc*. Such travel is often not predictable, and is driven by the needs of the business—frequently and with little prior notice, making it challenging for organizations to manage the complex array of exposures that can be created from a tax, social security and immigration perspective.

At an organizational level, corporate income taxes and withholding taxes can be triggered for the business as a result of individuals spending time and performing work in another location. These taxes can come as an unwelcome surprise to commercial teams where tax has not been factored into the price of a contract. Similarly, for the employee, travelling to, and working in other jurisdictions can expose that individual to personal income tax and social security in those other jurisdictions.

Increased border security, owing to the current geopolitical climate, together with initiatives to protect the local national workforce, have also placed an increased emphasis on immigration compliance. The scope of activities that may be performed compliantly as a business traveler is generally limited, and will vary from country to country. While it may be acceptable to travel to a country for a few days to attend meetings, spending significant amounts of time working on a specific project in a country is likely to raise a red flag from an immigration perspective. Such risks will increase where the individual is routinely traveling to that country to perform various tasks.

So how do organizations approach managing business travel?

Many businesses face internal limitations such as a shortage of resources or technology to help proactively manage or monitor business travel, or a lack of accountability within the organization as to who owns the risk. It can also be difficult to obtain the buy-in of employees or business owners to engage with human resources or mobility teams to inform them of any planned (or completed) trips, particularly where there is an urgent commercial need for the individual to travel.

For those businesses that are in the early stages of identifying risks with respect to business travelers, the task may seem daunting, and the easiest course of action is to do nothing. However, as the interdependence between tax and immigration, as well as exchange of

information between competent authorities, increases, this approach may no longer be acceptable for the majority of multinationals.

As a first step, businesses can seek to identify where risks have been created already, and look to quantify potential exposures as well as introduce risk mitigation measures. Technology solutions can help in this respect. Data analytics can be used to identify key traffic lanes and to determine where action should be taken. An analysis of data provided by the company's travel provider, or a review of employee expense reports, can be a valuable first source of information. With this initial perspective, the business can understand the size of the issue and consider appropriate remedial action.

Having identified where risks may already have been created, the business can look to define the employee population for which action is reasonable on a proactive basis—be it through formalization of employment arrangements for individuals who are spending significant time in a given jurisdiction, or consideration of where a formal legal entity registration would be appropriate. This initial work can in turn form the basis of a policy and process map to manage business travel on an ongoing basis, as well as assigning ownership and accountability for travel to the relevant business owners.

Educating employees and business owners on the risks that can be created as a result of business travel, and getting their commitment to engage with relevant stakeholders is critical. Pre-travel assessment tools can also be used to determine in advance whether a proposed trip is likely to give rise to any compliance considerations. For example, an individual can input details of their planned trip and intended activities, and receive a live assessment of any immigration considerations to be aware of prior to departure. Such a pre-travel assessment can be incorporated into a formal approval process which takes place before the trip is actually finalized.

In addition to maintaining compliance, obtaining a clearer view of the organization's approach to business travel can provide additional value added to the organization. Travel often accounts for a substantial portion of the overall expenditure of the business, and therefore a review of an organization's approach to business travel can be incorporated with a cost management exercise, and in turn lead to opportunities for savings.

Above all, communication is key. The types of risks created by business travelers are not restricted to one function within the business—while responsibility for corporate income taxes may sit within the organization's tax or finance team, compliance with employee taxes and immigration will typically fall to human resources or mobility to manage. Coordination between these teams, together with business owners within the organization, will be fundamental to successfully managing any organization's business travel policy.

by **Jayne Stokes**, Director, Global Employer Services Leader, Deloitte, Middle East

For those businesses that are in the early stages of identifying risks with respect to business travelers, the task may seem daunting, and the easiest course of action is to do nothing. However, as the interdependence between tax and immigration, as well as exchange of information between competent authorities, increases, this approach may no longer be acceptable for the majority of multinationals.

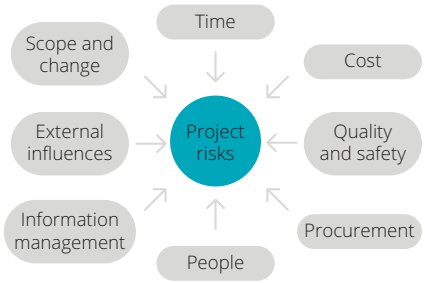
The case for risk management in the Middle East construction market

It is perhaps difficult to see how this view will continue to prevail with a decreasing pipeline of new opportunities and tighter financial policies across the Middle East region. Tight management of project costs and clear visibility of project risks will become critical in ensuring overruns are avoided and stakeholders retain confidence in an organization's ability to deliver projects successfully.

The Middle East construction industry has not fully embraced the concept of risk management as regards construction projects—or the value it can provide—despite the countless risks that may affect projects and their typical consequences (Figure 1):

- Increased unrecoverable project costs and reduction in profit;
- Delays to key milestones and project completion;
- Reputational damage; and at worst,
- Financial distress, or insolvency.

Figure 1 - Typical sources of risk on capital projects



The problem

The risks associated with capital projects are often manifested in two ways: the first is at the start of projects, where budgets used to control costs, either do not include a monetary allowance for possible risk events or, more typically, use an arbitrary percentage allowance for non-specific risks ("contingency".)

The second is during project execution. Risk events that could affect the likelihood of project success are not proactively identified, quantified or managed and are inaccurately reported, due in large part to the absence of a dedicated risk management team within an organization and an understanding of the difference between risks and issues.

The results are cost and time overruns that often come as a shock to project sponsors and senior management within organizations. In the absence of any risk allowance and proactive risk management, the project manager ultimately takes the blame—and often unfairly so.

The challenge—changing mindsets

When questioned on the absence of risk management processes, procedures and specialists in organizations, responses from project teams are usually met with indifference.

It is perhaps difficult to see how this view will continue to prevail with a decreasing pipeline of new opportunities and tighter financial policies across the Middle East region. Tight management of project costs and clear visibility of project risks will become critical in ensuring overruns are avoided and stakeholders retain confidence in an organization's ability to deliver projects successfully.

The other challenge often encountered is of the "if we price risk, we won't win the job" type which, in a competitive market fighting for limited opportunities, may hold some weight. However when costs begin to escalate and margin forecasts erode because of risk events, it is inevitable that strained relationships and difficult conversations will arise. Open and honest disclosure of project risk (and quantification thereof) at the outset is essential.

The solution—tools and techniques

An increased focus on risk management, as a key part of robust and mature project controls, is required to provide certainty of a project's outturn cost and completion date. Companies are typically at stage one or two of the risk management maturity scale shown in Figure 2 on the right.

Stage three represents the creation of a risk management plan and risk register at the start of the project, which forms a key component of project performance monitoring and reporting. Through various identification techniques, risk events are identified and probabilities and cost impacts assigned in order to define the risk exposure for the project, which is then maintained, developed (and re-assessed) throughout the project.

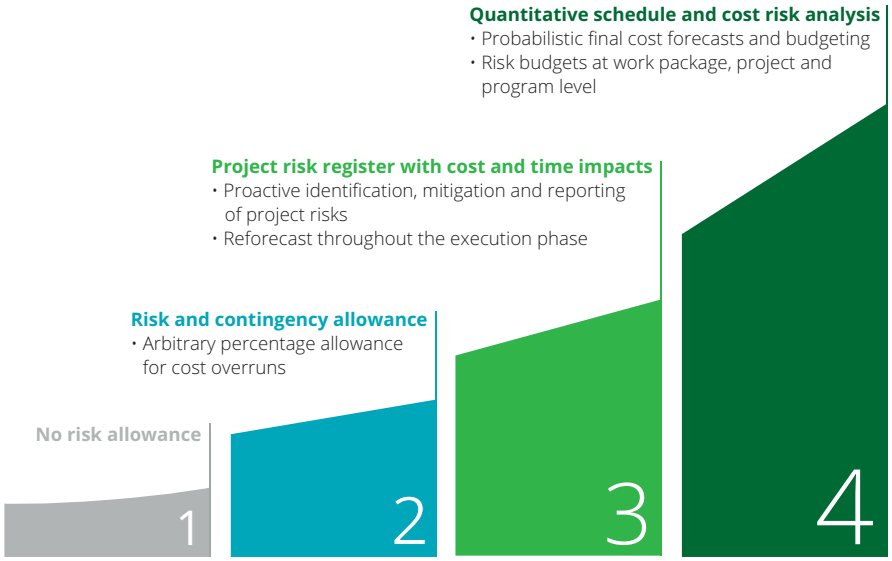
Stage four (a more advanced good practice approach) is to use the risk register, project budget and schedule to undertake a quantitative schedule and cost risk analysis using modeling tools, such as Monte Carlo analysis. This provides a range of benefits including a determination of the probability that the project will be delivered according to a given budget and timescale.

Conclusion—the benefits

Establishing appropriate risk processes, utilizing some of the tools described above, and establishing a proactive risk management culture will generate the following benefits:

- **Open and honest disclosure** – all project stakeholders obtain a clear perspective on project risks and achieve a greater certainty in a project's outcome—avoiding sudden shocks;
- **Resilient project budgeting** – appropriate cost and time risk budgets, based on robust analysis, can be established through their inclusion in a project's baseline budget; and,
- **Avoidance of blame culture** – project teams are encouraged to identify and preempt risk and, importantly, share responsibility for their mitigation (or exploitation.)

Figure 2 - Maturity levels of risk budgeting and management on capital projects



Finally, clients who award work to contractors who fully consider project risk benefit from greater certainty in outturn costs, since such contractors are less inclined to continually submit change notices in order to recover unpriced losses due to risk events.

Risk Management is an essential part of project controls and in a "survival of the fittest" construction market those who proactively manage risk to increase certainty of the final cost of projects are most likely to prevail.

by **Matt Hanson**, Assistant Director, Capital Projects, Financial Advisory, Deloitte, Middle East

Clients who award work to contractors who fully consider project risk benefit from greater certainty in outturn costs, since such contractors are less inclined to continually submit change notices in order to recover unpriced losses due to risk events.

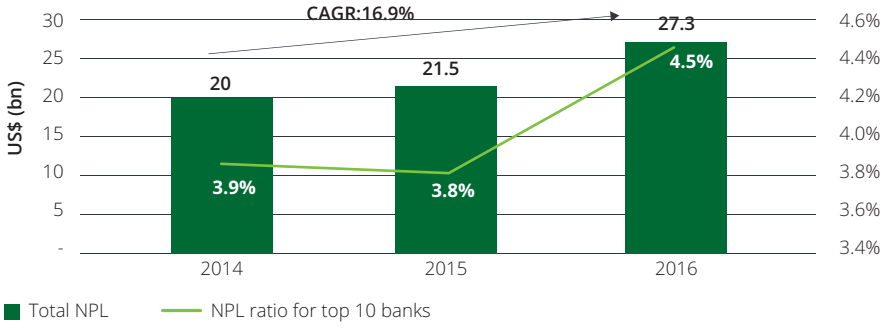
NPLs on the rise

Drivers and mitigating measures

Having exhibited positive signs of recovery and growth following the financial crisis in 2008, the Gulf Cooperation Council (GCC) banking sector is currently facing serious macroeconomic challenges that are reshaping its loan market.

Borrowers are facing increasing liquidity challenges driven by a changing economy that has been significantly impacted by the reduction in oil prices since 2014. This has given rise to increasing non-performing loans (NPL) as borrowers struggle for cash and find it more difficult to service their bank debt.

NPL trend in the GCC banking sector



Source: Banks audited financials, Deloitte analysis
Note: Comprises data for the top 10 GCC banks by asset sizes as at Dec 16

If not addressed properly and proactively, NPLs can have a serious impact on the banking sector and the economy in general. They can adversely impact banks' profitability, credit ratings and capital requirements, thus leading to restrained lending measures and worsening liquidity.

Changing dynamics

Macroeconomic factors

Since the significant decline in oil prices in 2014, the GCC economies have struggled for liquidity, given their high dependency on oil export revenues. They have reduced government spending, particularly in the oil and gas, real estate and construction sectors.

Corporates heavily invested in those sectors and highly dependent on government spending have subsequently faced declining profitability, suffering in turn from their own liquidity pressures. It has become more challenging for companies to fully and timely service their existing project finance commitments and debt exposures, driving the increase in NPLs across the banking sector.

SMEs and skipped portfolios

In the absence of liquid bond markets, banks in the GCC are by far the main and largest source of funds for corporates, including small and medium-sized entities (SME) and start-ups.

SMEs and start-ups in the economy are usually the first to feel the impact of a decline in market liquidity and economic growth, and consequently become desperate to meet short-term financing needs to sustain or grow their businesses.

As banks started to impose restrictions on SME lending, largely due to tightening credit risk management, shareholders of SMEs and start-ups were left in fear of criminal charges, particularly in the case of bounced checks. When faced with the potential risk of prison, and in the absence of developed restructuring platforms to encourage borrowers to engage in constructive discussions with banks, some shareholders chose to abscond. This has left the GCC banks with large SME portfolios of skipped cases with limited recourse and recoverability.

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Rising NPLs—so what?

A decline in banks' profitability

NPLs adversely impact the banks' asset quality and profitability. They result in reduced interest income, increase in impairment costs, unrecoverable principal, lower credit ratings and increased cost of funding. If not managed properly and proactively, this could lead to a reduction in the banks' cash flows and lending abilities.

When faced with a higher NPL ratio, banks are required to recognize greater loan provisions, hence reducing their profitability. As a result, regulators will require more capital to be set aside by banks to improve their solvency and capital adequacy ratios. This could reduce the banks' ability to provide lending and is generally exacerbated by the very measures taken by banks to address their NPL concerns, which often come in the form of tighter credit policies and further restrictions on lending.

Corporates face increasing liquidity struggles

Once corporates start to exhibit signs of financial distress, obtaining further credit becomes even more difficult. This would, in turn, worsen their liquidity struggles and make it more difficult to finance their

projects and short-term working capital needs. Corporates should seek creative financing and restructuring solutions to mitigate default risk and engage in transformation initiatives to adapt to the changing dynamics of the market. In the absence of similar initiatives, corporates risk deepening challenges if they remain loyal to an outdated business model that might no longer be viable under the new macroeconomic and financial parameters.

Some causes for optimism

While the rise of NPLs is a serious risk not to be taken lightly, there are measures that can be undertaken to potentially restore economic growth and financial stability. Those measures might include:

Political and regulatory support to encourage banks to review, assess and remediate the quality of their assets, particularly their loan portfolios. Shareholders and management would need to establish and empower work-out units within the banks to oversee distressed loans and seek deleveraging solutions whether in the form of aggressive collection, debt restructuring, outsourcing services or sale of non-core assets.

Distressed loan sale market should be developed in terms of the infrastructure and regulatory environment necessary to attract investors and encourage banks to participate. An NPL market could offer banks an opportunity to raise liquidity, clean their balance sheet and enhance their capital structure. It could also offer new return opportunities for bullish investors willing to trade with distressed loans. To support such a market, portfolio sale advisers, loans servicers, lawyers and other professional advisory firms should be encouraged to participate.

Developing the legal framework to improve existing bankruptcy laws and align them with international resolution and restructuring standards. This move could restore confidence and drive efforts towards consensual solutions rather than encouraging shareholders to abscond.

Capital markets, in particular bond markets, could be further developed as an alternative source of funding that could fill the gaps left by the lack of liquidity in the banking sector, tightening credit policies and lending restrictions.

Corporates should seek creative financing and restructuring solutions to mitigate default risk and engage in transformation initiatives to adapt to the changing dynamics of the market.

Most of these measures are already being considered by banks in the GCC, along with more aggressive provisioning and pursuit of absconders. Banks continue to look for new ways to restructure their balance sheets and dispose of non-core assets, which is driving further M&A (merger and acquisition) opportunities in the banking sector and generating interest in distressed loan sales both by potential sellers and investors.

On the other hand, regulators and banks are being more proactive in prioritizing new regulatory, capital adequacy and reporting standards (such as IFRS 9, IFRS 13 and Basel III) as well as considering the impact and potential implementation frameworks of these new standards.

A new bankruptcy law has been issued in the United Arab Emirates (UAE) and similar laws are being finalized in Saudi Arabia and other GCC countries. This law constitutes a major step forward towards encouraging the offering of alternative restructuring solutions and increasing creditors' and investors' confidence in the financial markets by developing a structured legal framework for restructuring discussions.

In conclusion...

There is a serious risk of a rise in NPLs across the GCC banking sector that could have an adverse impact on market liquidity and economic growth. However, the risk can be mitigated by pursuing proactive measures as highlighted in this article.

While there are some serious macroeconomic and liquidity challenges to overcome, there is cause for optimism as stakeholders across the GCC have started to demonstrate a fair level of awareness to these challenges. Measures and reforms are being undertaken but there is still considerable room for improvement and efforts should continue as the journey to maintain stability and drive growth is a long one.

by **David Stark**, Partner, Restructuring Services and **Karim Labban**, Assistant Director, Restructuring Services, Financial Advisory, Deloitte, Middle East

Better pond, bigger fish

Five ways to nurture developing leaders in an ecosystem for growth

Developing future leaders isn't just about putting them through programs. New research points to the critical importance of supporting them with the right organizational context—a workplace environment that encourages knowledge-sharing, risk-taking, and growth.

Swimming upstream?

As the director of business operations for a large division within a pharmaceutical company, Lynn was a rising star in her organization. Her business leader, recognizing her potential, nominated her to attend the company's weeklong executive leadership training program. Energized by the powerful insights and fruitful discussions she experienced during the training, Lynn formulated an action plan to improve her leadership capabilities. But back at the office the next Monday, the realities of her workplace environment drained her enthusiasm. How could she follow through on her plan when her role kept her isolated from the experiences she needed to grow? The company's work processes and culture seemed at odds with the capabilities she was supposed to develop, and her daily work schedule allowed her little room for interactions with other departments and leaders. As Lynn left work that evening, she wondered how she could ever apply what she had learned.

Developing future leaders is a need for most organizations, and many have invested in impressive leadership development programs aimed at doing just that. Yet most companies report they lack the leaders they need. Deloitte's 2016 *Human Capital Trends* study revealed that nearly 30 percent of organizations have weak or very weak leadership pipelines, and nearly 90 percent of organizations see this as a critical business challenge.[1] The lack of adequate leaders jeopardizes companies' ability to thrive in fast-changing markets.

Now, our new research offers a refreshing perspective: Leadership development happens most effectively in a business context, not just in training sessions. Our analysis shows that, no matter how much organizations focus on delivering sophisticated leadership programs, if prospective leaders are immersed in a workplace that does not support leadership development objectives, such efforts will likely produce limited returns—as Lynn's experience attests.

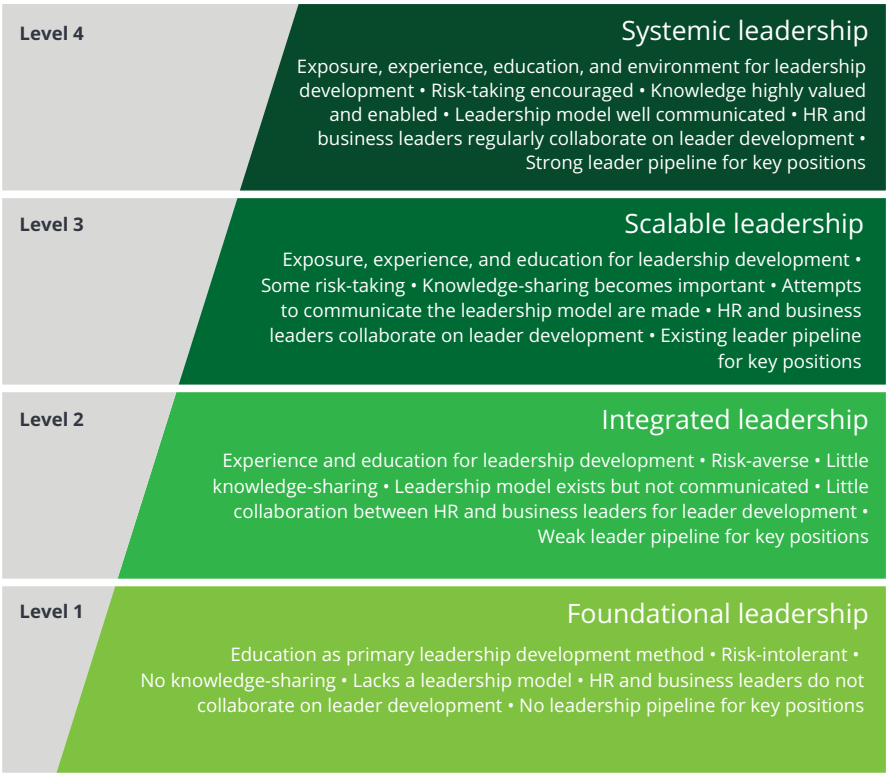
After spending so much effort establishing strong programs, it's time for organizations to think differently. Up until now, companies have focused primarily on training the "fish"—the individual leader or high-potential candidate—but have neglected the "pond"—the company culture and context—in which the fish swims. Our data show that organizations should instead increasingly focus on creating a context that demands that leaders grow and perform at their best while also forcing nascent leaders to stretch. Practically speaking, this means embedding development activities in leaders' own business environments and challenges. After all, leaders have enough challenges in their own work that they do not need made-up problems or case studies to hone their leadership capabilities.

Leadership development happens most effectively in a business context, not just in training sessions.

Leadership development through organizational design and culture

The results of our global research with more than 2,000 business and HR leaders operating in 95 countries informed the creation of our Leadership Maturity Model (figure 1). The model illustrates that the least mature companies (those at levels 1 and 2)[2] rely primarily on formal training programs for leadership development; they generally do not focus on the culture and design aspects of their organization as levers of leadership growth.

Figure 1. Leadership maturity model



Source: Bersin by Deloitte, Deloitte Consulting LLP, 2016. Deloitte University Press

In contrast, the more mature companies on levels 3 and 4 embed leadership growth into their daily work processes and culture. They deliberately orchestrate work processes, decision making, and collaborative initiatives in a way that enhances business outcomes and results in a higher percentage of leaders with critical leadership capabilities. Further, they craft and foster a culture that is based on a strong company identity and recognize and celebrate successful leadership. They consider a climate of knowledge-sharing and risk-taking as table stakes for success. Further, they align and integrate critical talent processes with intentional leadership development efforts, all based on strong ties between HR and business leaders.

In short, organizations that are most effective in developing leaders continuously clear their waters of polluting objects—or practices—that may hinder their fishes' growth and, instead, cultivate an ecosystem that enables and fosters continuous performance and development. Once the waters are clear, these organizations create an ecosystem that introduces different pressures that reinforce the development of desired leadership capabilities.

The organizations with the strongest results in terms of financial and business outcomes were those that develop leaders by connecting them with other leaders, and providing continuing opportunities for emerging and growing leaders to exchange information, knowledge, and new ideas about the company identity and leadership profile. Specifically, relative to companies that relied solely on leadership programs to grow leaders (those companies on level 1), high-maturity companies (those on level 4) had 37 percent higher revenue per employee and 9 percent higher gross profit margins.[3] These high-maturity companies were also much more effective at anticipating and responding to change, and they had a higher percentage of leaders displaying some of the most critical leadership capabilities (figure 2).

Figure 2. The impact of high leadership maturity

37%
higher revenue per employee

9%
higher gross profit margin

5x
more likely to be highly effective at anticipating and responding to change

10x
more likely to be highly effective at anticipating and identifying and developing leaders

Source: Bersin by Deloitte, Deloitte Consulting LLP, 2016. Deloitte University Press

We found five of the critical practices share one underlying theme: Leaders tend to learn best with other leaders and from other leaders—inside or outside of their organization.

The key question to answer, then, is: What are the practices and activities that comprise the right kind of "pond" to grow the biggest fish? Out of 111 potential practices we tested in our survey, the data revealed more than a dozen that were strongly correlated to business and leadership outcomes. Looking closer at these practices, we found five of these critical practices share one underlying theme: Leaders tend to learn best with other leaders and from other leaders—inside or outside of their organization.

1. Let's talk about it: What does successful leadership look like?

Many organizations have carefully crafted leadership competency profiles—but relatively few leaders actually know or use them. Worse, many companies cannot effectively measure against them. As a result, most people learn how to lead by seeing and hearing about what leaders do around them—which may not be exactly what the organization wants to convey as its leadership profile. An antidote is to consistently and explicitly promote the company's view of what effective leadership looks like.

Often a neglected activity in less-mature companies, talking about the organization's "leadership profile"—specifically, the capabilities, behaviors, and attributes of successful leaders—is essential for laying the groundwork for leadership development in any business environment. A clear understanding of what capabilities, behaviors, and attributes leaders should display should exist at all leader levels in an organization, regardless of the behavioral variability that each role may entail. We found that companies that effectively communicate their desired leadership profile were five times more likely to excel at identifying and developing leaders. This makes sense: Defining what the company stands for, and specifying which capabilities enable leaders to execute the business strategy, helps set expectations as to what leadership should look and feel like. It also forms the basis for identifying and developing future leaders, as well as supporting performance and succession management practices that build the company's leadership pipeline.

There is a catch: This is not HR's job alone. Business leaders—who are

immersed in the day-to-day context and who represent success—should craft their stories and help others understand the leadership profile. IBM shows one way to do this. Every year, the company recognizes 50 "leader champions" whose task it is to advocate for, role model, teach about, and talk about successful leadership at IBM.[4] These leader champions play an active role in conducting roundtables, town-hall meetings, and other knowledge-sharing activities, communicating and reinforcing the message about the company's identity and its leadership profile throughout the organization. In turn, the leader champions can benefit by enhancing their ability to translate workforce and customer trends into meaningful action and by developing a strong followership—a necessary capability of influential leaders.

Action step checklist: Communicating the leadership profile

For business leaders:

- Identify business contexts and challenges that future leaders should be able to manage effectively and determine what attributes those leaders need to bring to the table. This is the basis for creating the leadership profile—a clear articulation of the required capabilities, personal factors, and behaviors of the "ideal" leader at your company.
- Socialize the leadership success profile with peers and direct reports and provide insights back to HR.
- Communicate what it means to be a leader in the organization at every opportunity. This might mean, for example, that leaders blog, tweet, or record videos or podcasts about experiences with real-life business issues that illustrate how desired leadership behaviors led to success.
- Model the behaviors you expect other leaders to demonstrate.

For HR:

- Co-create an evidence-based leadership profile with business units to set clear expectations for leadership.
- Use the leadership success profile to identify, assess, select, and develop leaders.
- Identify and use different communication channels for discussing leadership expectations and the required capabilities for future leaders. This likely means working with business leaders to create opportunities for communication such as those described above.

According to our research, the most mature companies encourage risk-taking to grow leadership capability. They intentionally nurture an ecosystem that allows and encourages the exploration of new concepts and ideas on a daily basis by all employees. So, in addition to knowing which potential leaders in an organization can take a "meaningful" amount of risk and challenge the norm, organizations can foster "experimenting" behaviors as part of their culture and foster a breeding ground for superior leadership capabilities at the same time.

There are many other examples of organizations that build a culture of risk-taking with the goal of developing people and encouraging innovation.

2. Have you taken a risk today? Fostering a climate of exploration and experimentation

To work effectively in fast-changing markets and technologies, budding leaders need to build up their risk tolerance. In fact, the ability to assess and take appropriate risks is a personality trait associated with leadership potential.[5] An individual's ability to express this trait, however, is influenced by the level of risk tolerance in the work environment: Risk-taking endeavors can be nipped in the bud rather quickly in a risk-intolerant culture where others frown upon developing and acting on new concepts and ideas. Our data suggest that many organizations struggle with creating a culture that values risk-taking, but those that enable it are five times more likely to anticipate change and respond to it effectively and efficiently, and seven times more likely to innovate than others that do not.

For ways to build a culture of risk-taking that promotes risk but also manages it by "failing fast" before failures become costly, we can look at companies that focus on innovation and change. For example, Qualcomm has formalized storytelling specifically to build a culture of risk-taking that encourages, nurtures, and supports the creative process.[6] The company nurtures this ecosystem by telling stories of failures that reinforce the value of risk-taking and learning from mistakes. New stories are constantly captured from employees around the globe via an email link on the company's home page, by learning and development staff who are always listening and collecting new stories, and through regular interviews with employees. The idea of being unafraid to try new things, and not look back at how things have been done in the past, is deeply immersed in Qualcomm's culture.

There are many other examples of organizations that build a culture of risk-taking with the goal of developing people and encouraging innovation. One CEO used to hand out "get out of jail free" cards to allow risk-taking without penalty or questions.[7] Adobe's "Kickbox Innovation Workshops" equip participants with starter kits that include a US$1,000 prepaid credit card to help develop capabilities that bring ideas to life.[8] And a third company has an annual award for the team that has had the biggest failure that led to a big insight.[9] When employees learn and understand the results of experimenting, and that failing fast is acceptable, it helps build a capability that the organization needs to drive transformational change.

The bottom line: If leaders know that the organization values—not discourages—risk-taking and learning from failure, then they'll likely be motivated to explore, innovate, and build teams to exploit new ideas.

Action step checklist: Cultivating a culture of risk-taking

For business leaders:

- Share examples of effective and poor risk-taking, and explain the differences.
- Create an environment in which people feel genuinely comfortable with taking risks, such as sharing and implementing new concepts and ideas. For example, before meetings, leaders can state the value of risk-taking as a practice that can enhance the meeting's outcome. They can create incentives and rewards for action that demonstrate appropriate risk-taking by team members, and reprimand counterproductive behaviors.
- Identify obstacles that discourage risk-taking and help people navigate those obstacles. For example, determine whether existing cultural values inhibit risk-taking, or if specific typical behaviors express risk intolerance in employees.
- Publicly recognize and reward those who take calculated risks, even when they fail.

For HR:

- Use evidence-based assessments to identify high-potential leaders with change potential and high risk tolerance.
- Publicize stories of how appropriate risk-taking practices led to good business outcomes.
- Set expectations and design processes to promote rapid-prototyping approaches to new ideas.

3. Spread it like wildfire: Knowledge-sharing as a tool for leadership development

A winning business strategy is not enough to stay competitive; business leaders also need to be aware of what's going on in the larger organization and external environment. Large organizations in particular, however, have a tendency to keep new insights and innovations stuck in a single unit or area—"If only we knew what we know" is a common lament. Not all organizations are committed to sharing knowledge across company silos. Our research clearly showed that knowledge-sharing is common at level 4 companies (42 percent always and 40 percent frequently do it) but rarely practiced at level 1 organizations (35 percent never or very infrequently do it, and 40 percent infrequently do it).

A company's culture should support knowledge-sharing to give potential leaders a supportive environment in which to grow. This means that one attribute of the "pond" in which leaders develop is the free exchange of information. Too many people see knowledge as a possession to be

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While important for a variety of business reasons, knowledge-sharing is vital for effective leadership development. It gives both leaders and employees broader exposure to what is percolating in the organization and broader market

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While important for a variety of business reasons, knowledge-sharing is vital for effective leadership development. It gives both leaders and employees broader exposure to what is percolating in the organization and broader market: For example, knowledge-sharing about the organization's history can instill purpose and reinforce desirable leadership behaviors that align with the prevailing strategy and culture. In addition, sharing information about new products and services, personnel decisions, or client feedback in other business units helps develop a deeper understanding of the business itself. Equally important, hearing about shared successes and failures can enable collective learning moments and inform people's business and leadership awareness and decision-making processes.

HR can help encourage knowledge-sharing by providing structural reinforcement to help business leaders spread the word about their part of the business. For example, the Federal Reserve Bank of Cleveland developed a culture of knowledge-sharing by creating a repository for leading practices and a platform for employee discussion. The organization had a cross-functional team research barriers to knowledge-sharing, and then used those insights to create knowledge-sharing events as well as a specific program called "Lessons Learned," a searchable video repository.[10] More specific to leadership development, a global clothing retailer did a leader exchange program with Intel in which leaders from each company teamed up on real projects and shared practices and insights for the purpose of developing leaders in the context of real-life business challenges they were facing.[11]

Action step checklist: Using knowledge-sharing for leader development

For business leaders:

- Communicate about new company insights and innovations every day.
- Learn to be a more effective storyteller: Use stories to explain the company's history, identity, and culture.
- Foster building reciprocal relationships and alliances across the business.
- Advocate for digital tools and social media channels to help improve knowledge-sharing.
- Recognize and reward those who continually learn about the business broadly.

For HR:

- Establish real-time, broad communication of company insights and innovations.
- Build storytelling about the organization's history, identity, and desired culture into development initiatives.
- Reinforce that helping others learn is a part of every employee's job.
- Raise expectations and resources to support peer-to-peer feedback.

4. See the world: Exposing leaders to other leaders, new contexts, and novel challenges

According to our data, 84 percent of global organizations offer formal learning programs for leadership development, and 76 percent develop leaders through experiential programs such as business projects, job rotations, or stretch assignments. While nothing is wrong with formal leadership programs—in fact, they are part of a holistic approach—the problem is that in many organizations

they are the only approach and often represent an unbalanced focus on growing just the individual "fish" through skill-building.

One of the key findings of this study is that the learning methodology that is most effective for leadership development is exposure to peers and colleagues, as well as to consumer feedback, new external contexts, and social networks. We see the multidimensional nature of exposure for leadership development popping up in several places. First, coaching and mentoring are common ways to expose high-potentials to diverse challenges and solutions, and this can go beyond the usual assignments with established managers. For example, a transportation company connects its high-potentials with veteran leaders outside the company through a virtual and face-to-face external mentoring program. Another company, Xerox, exposes leaders from various life stages and generations to each other.[12] The goal is to build awareness between senior leaders and Millennials about their various perspectives and approaches to the business—and then to leverage those insights to foster an effective work environment.

Second, a key aspect of exposure in leadership development is providing leaders with an external perspective. For example, "leadership consortiums" are a phenomenon in which companies across industries get together for mutual leadership development efforts. Other initiatives integrate client input as part of leader growth efforts, as seen in "immersion labs" that are increasingly a part of senior executive leadership programs, as well as "externships" and "shadowing programs" for leaders to gain external exposure to the needs of clients and partners.

The data are clear. Exposure is how leaders learn best, because exposure is what enables them to gather intelligence in the relevant business context: They learn with and from other industry leaders what works and what does not. Organizations that make the effort to offer opportunities for exposure as part of their leadership development double their ability to innovate and anticipate change over those that offer formal programs only.[13]

Action step checklist: Exposing leaders to each other and to enriching experiences

For business leaders:

- Involve emerging leaders and high-potential leaders in real business scenarios to expose them to important learning moments (for example, issues that involve innovation or digital disruption).
- Collaborate with HR and other business leaders to enable cross-organizational collaboration for high-potential leaders—for example, through short-term job rotations or virtual cross-collaborative projects.
- Encourage high-potential leaders to gain exposure to customers, partners, or industries outside their own. For example, require them to join external professional associations, or allow them to do a rotation in a customer-facing part of the business.
- Improve your and your team's capabilities at coaching and giving and receiving feedback, and include external feedback in the mix.

For HR:

- Design programs that build leadership capabilities through challenging experiences and frequent exposure to diverse leaders inside and outside the organization.
- Integrate real-life customer feedback into everyday learning activities to give developing leaders external exposure.
- Augment development programs with exposure to external business environments through interactions with outside leaders or immersion experiences.
- Add coaching and mentoring opportunities as ongoing aspects of leader development.
- Offer targeted opportunities for leader networking and social exchange.
- Teach future leaders ways to expand their network's breadth and depth.

5. Making contact: The importance of strong ties between HR and business leaders

When we compared the survey responses of HR and business leaders with regard to accountability for leadership development, we found a baffling discrepancy. While 41 percent of business leaders said that they are

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mainly responsible for leadership development in their organizations, only 16 percent of human resources leaders agreed with this statement. Regardless of what actually goes on at these companies, this discrepancy is indicative of the disagreement that exists between business and HR leaders on several aspects of leadership growth efforts. The disconnect between HR and business leaders may indicate misperceptions on both sides about the other's involvement in leadership development, or hint at the absence of communication about the governance around leadership development. Either or both may lead to a lack of accountability for and misalignment of leadership growth efforts, both of which are fundamental challenges to effective leadership development initiatives.

construction company, HR actively seeks working relationships with business leaders by staying close to the company's bid activities, maintaining close contact with the business development group, and being active members of a steering committee involving legal, business, and HR partners monitoring the organization's bid activities.

The contact does not always have to be initiated by HR—it can also be brought about by business leaders helping out HR, as in Intuit's case.[14] Facing fierce competition for critical talent, the company needed to gain an advantage in sourcing and selecting the talent it most needed. To do this, Intuit brought in an "innovation catalyst"[15] and a product manager from the business to help transform the way HR selected

To influence people effectively, leaders have to serve as connectors between the people with questions and those who can provide the answers.

The most mature companies we studied seemed to have found a way to create a symbiosis in which HR uses its expertise in leadership development to collaborate closely with business leaders, who apply and model leadership learning in the workplace. These power teams coordinate development efforts, ensure that business leaders go beyond passive sponsorship, and actively work to promote the growth of other leaders. At these organizations, HR leaders are not the "learning people" but, instead, strategic partners with business leaders. For example, at a global engineering and

candidates. The selection project, called "Assessing for Awesome," has produced a number of innovations for Intuit and has dramatically improved the quality of hires for the company.

As basic an activity as it may seem, many organizations struggle to connect HR with business leaders in a mutually supportive way, despite the fact that organizations with strong collaborative relationships between HR and business leaders are six times more likely to excel at identifying and developing leaders.[16]

Action step checklist: Creating strong ties between HR and business leaders

For business leaders:

- Develop an ongoing relationship with HR leaders on talent, leadership, and workforce planning initiatives.
- Develop a business unit-specific leadership strategy, aligned to the company's overall leadership strategy.
- Discuss with HR partners how changes in the business strategy or environment may affect leadership needs in each unit.

For HR:

- Reach out to senior business leaders to get input on business context and challenges that are critical for future leaders.
- Facilitate the constant exchange of talent-related information to enable better talent decisions. Set up regular meetings or advisory boards tasked with discussing ways to improve talent-related information.
- Prepare an "annual report" for the board that assesses leadership pipelines and succession plans.

The best ecosystem for leadership development: Your own organization

Our research shows that companies that created a "pond" conducive to leadership growth were more likely to grow "larger fish"—stronger leaders —and achieve stronger business results. In other words, the organizational context is where leadership development happens.

Let's revisit Lynn's story to see how this socialized approach can feel to rising leaders:

Despite her promising career path, Lynn was so discouraged by the lack of support for her development that she left her

company. Thanks to an acquaintance in the industry, she soon found a similar position at another pharmaceutical firm. Her onboarding included meetings with senior business leaders from across several functions, as well as various networking events. As part of her new role, she was sent on a one-week tour to visit clients together with some of the sales executives she would be working with. She was also tasked to set up her own advisory board of clients to ensure she was regularly hearing an outside perspective on her company's products and services and overall business trends. Further, her boss encouraged her to join a local business community group where she would meet other business leaders from whom she could learn. The encouragement to access information and learning opportunities via leaders outside of her organization and immediate job realm was new to Lynn, but she quickly learned she could bring back highly valuable insights to her company. Her onboarding also involved her working out a multifaceted and continual leadership development plan, customized for her role at work. This concerted effort included a 180-day plan focused around time, talent, and relationships (three of the most important factors driving the success of transitioning executives).[17] Learning and developing on a daily basis was an expected part of becoming a leader in the organization, a fact that made Lynn feel accountable and empowered at the same time.

With the growing complexity and interconnectivity of business, leaders' roles are shifting. No longer can an executive be the "sole truth-teller." To influence people effectively, leaders have to serve as connectors between the people with questions and those who can provide the answers.

Though formal training programs have their place, on their own, they have an individualist bias. They tend to send the message that individual skills and actions, independent of social skills and connections, are what matter to be a strong leader. Our research says otherwise. By socializing development into the workplace context, organizations can help to convey the new dynamics of leadership. The most effective way to promote social leadership is by setting the expectation that leadership happens in social settings every single day. Our research shows that this socialized approach works—and that organizations that use it have more capable leaders and stronger business outcomes.

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IFRS 15 Revenue from contracts with customers: Are you ready for the "Big Change?"

The recognition criteria of revenue in accounting standards is about to change—and your entity might be significantly affected, maybe even more than you expect!

Revenue is one of, if not the most, critical component of an entity's financial statements. It is among the key performance indicators of a business, monitored closely by different stakeholders including market analysts, and often used in benchmarking different players within the same industry. It also has a direct impact on the calculation of income taxes. Accordingly, it is critical that the accounting policy appropriately captures the nature of the business, the terms of agreements with customers, and is in accordance with the applicable accounting standards.

What triggered the change?

IFRS 15 was a result of the convergence work between the International Accounting Standards Board (IASB), the body that promulgates IFRS, and the Federal Accounting Standards Board (FASB), the standard setting body for US GAAP (Generally Accepted Accounting Principles.) It was created to fill the gap between IFRS and US GAAP, provide a robust revenue framework, and improve comparability among reporting entities through consistent and extensive disclosure requirements. It also provides guidance on a few of the gray areas on revenue recognition such as contracts involving multiple elements, treatment of costs to obtain and fulfill a contract, and accounting for contract modifications.

It is critical that the accounting policy appropriately captures the nature of the business, the terms of agreements with customers, and is in accordance with the applicable accounting standards.

What is the "Big Change?"

In May 2014, IFRS 15 (International Financial Reporting Standards) Revenue from Contracts with Customers was issued. It established a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. IFRS 15 supersedes the current revenue recognition standards including IAS 18 Revenue, IAS 11 Construction Contracts and their related interpretations. It will become effective on 1 January 2018, with retrospective application, and early adoption is permitted.

What are the key changes?

The core principle is to recognize revenue as depicting "the transfer of goods or services" to customers for an "amount that reflects the consideration" to which the "entity expects to be entitled in exchange for those goods or services."

The Standard introduces a 5-step approach to revenue recognition:

Step 1 – Identify the contract with a customer: a contract is defined as an agreement (including oral and implied), between two or more parties, that creates enforceable rights and obligations and sets out the criteria for each of those rights and obligations. The contract needs to have commercial substance and it is probable that the entity will collect the consideration to which it will be entitled.

Step 2 – Identify the performance obligations in the contract: a performance obligation in a contract is a promise (including implicit) to transfer a good or service to the customer. Each performance obligation should be capable of being distinct and is separately identifiable in the contract.

Step 3 – Determine the transaction price: transaction price is the amount of consideration that the entity can be entitled to, in exchange for transferring the promised goods and services to a customer, excluding amounts collected on behalf of third parties.

Step 4 – Allocate the transaction price to the performance obligations in the contract: for a contract that has more than one performance obligation, the entity will allocate the transaction price to each performance obligation separately, in exchange for satisfying each performance obligation. The acceptable methods of allocating the transaction price include:

- Adjusted market assessment approach,
- Expected cost plus a margin approach, and,
- The residual approach in limited circumstances. Discounts given should be allocated proportionately to all performance obligations unless certain criteria are met and reallocation of changes in standalone selling prices after inception is not permitted.

Step 5 – Recognize revenue as and when the entity satisfies a performance obligation: the entity should recognize revenue at a point in time, except if it meets any of the three criteria, which will require recognition of revenue over time:

- The entity's performance creates or enhances an asset controlled by the customer,
- The customer simultaneously receives and consumes the benefit of the entity's performance as the entity performs,
- The entity does not create an asset that has an alternative use to the entity and the entity has the right to be paid for performance to date.

Which industries will be most affected?

Actual impact will vary on each specific customer contract and will depend on the accounting treatment prior to implementation of IFRS 15. Also, depending on the industry and nature of the business, each of the five steps will have varying impact.

It is interesting to understand why some of the big real estate players in the region chose an early adoption of IFRS 15, and the majority of key telecommunication companies are making significant investments to assess its impact and have initiated implementation plans even prior to the date of adoption of the standard.

Telecommunication, software development, and automotive industries

These industries will be greatly affected by steps (2) and (4) with respect to the unbundling of contracts and allocation of total revenue to the unbundled parts. For example, telecommunication companies do provide mobile plans that include a mobile handset, call minutes and data package. Currently, telecom companies account for revenue differently. Some companies treated the value of mobile handsets as a cost of acquiring the customer, and recognize revenue based on the sale of monthly plans. Under IFRS 15, telecom companies are required to identify the performance obligations included in the bundled contract (i.e. handset, call minutes and data packages) and, accordingly, allocate the transaction price to each performance obligation based on an acceptable method. As such, the amount of revenue to be recognized under IFRS 15 will be significantly different than that recognized with the current accounting standards.

It is interesting to understand why some of the big real estate players in the region chose an early adoption of IFRS 15, and the majority of key telecommunication companies are making significant investments to assess its impact and have initiated implementation plans even prior to the date of adoption of the Standard.

Real estate and contract manufacturer industries

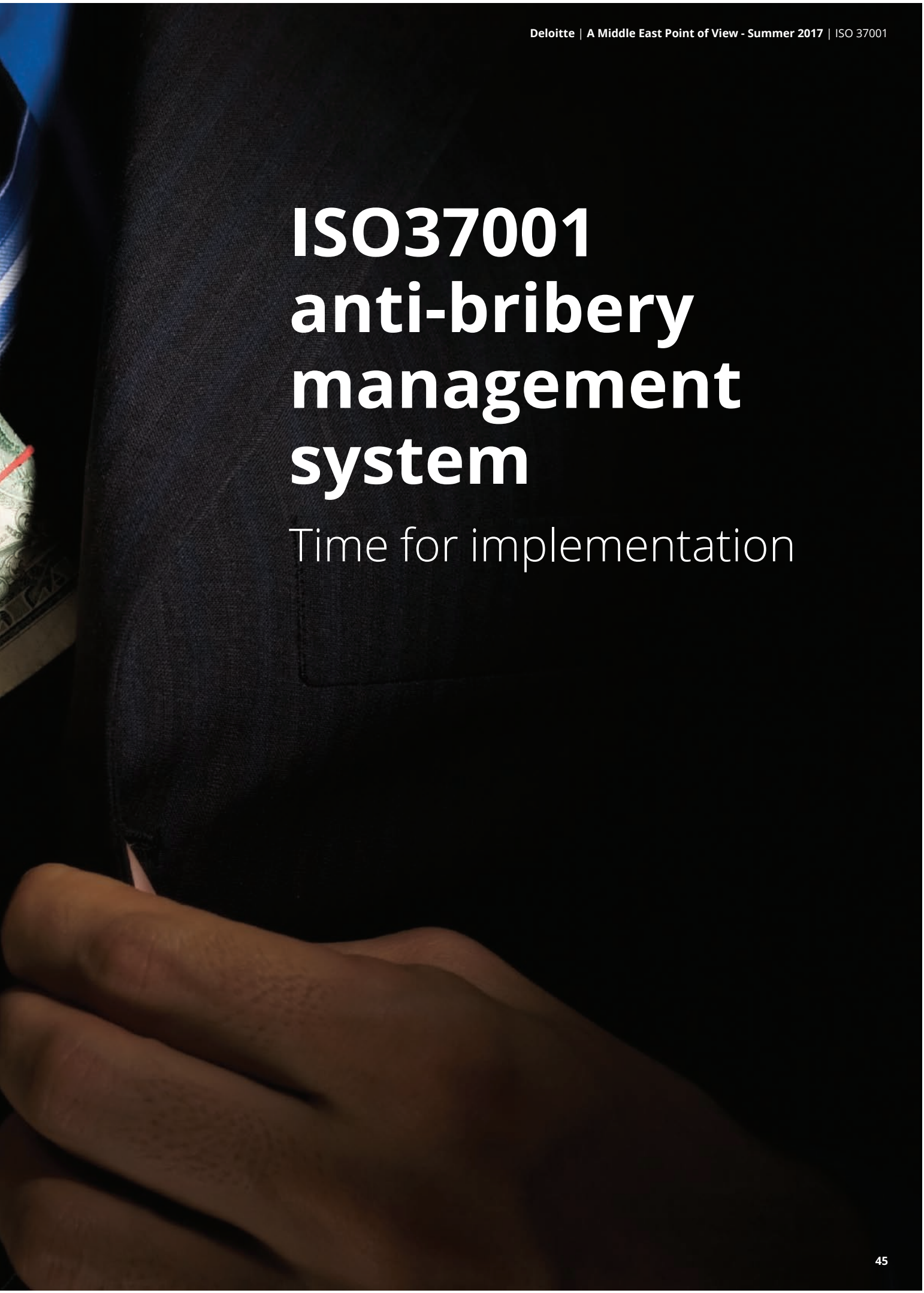
These industries will be mostly affected by step (5) that provides guidance as to when an entity can recognize revenue as it satisfies a performance obligation. For example, real estate companies currently recognize revenue upon the transfer of risks and rewards to customers in accordance with the IFRS Interpretations Committee (IFRIC) 15, which is practically upon completion of the project development and handover of real estate units to customers. With IFRS 15, real estate companies may now recognize revenue over time as they satisfy performance obligations during the construction period of the development project. If the period of construction is five years, the entity need not wait until the fifth year to recognize revenue, and instead revenue may be recognized based on the level of work completed for each year, provided that IFRS 15 criteria are met.

How to prepare for the change

An IFRS 15 impact assessment should be performed, which would include among others, the review of existing contracts with customers and its related accounting treatment, contract renegotiation and modification, to appropriately reflect the economic terms of the transaction, the engagement of legal and accounting advisors to better interpret the terms of the agreement and the applicability of IFRS 15, reconfiguration of front and back-end IT systems to adhere to the standard's requirements, and other necessary changes to ensure readiness for IFRS 15 adoption.

The complexities and extent of changes will depend on the nature of the business and the accounting policies and procedures currently implemented. It is highly advisable to act now and do the necessary assessment and collaborate with the experts on implementation plans to ensure that the entity will be ready when the "Big Change" comes.

by **Angelito Catacutan**, Principal, Audit, Deloitte, UAE



ISO37001 anti-bribery management system

Time for implementation

According to the World Bank approximately US$1 trillion is paid in bribes each year around the world. The economic loss from corruption is estimated to be many times that number.[1]

Undoubtedly one of the gravest risks to any business is corruption. In addition to the significant reputational harm it can cause and the subsequent in-country legal and criminal implications, there are a range of international conventions and legislations that can expose the business to a broader range of sanctions. These include, but are not limited to, the Foreign Corrupt Practices Act (FCPA) in the United States, the UK Anti-Bribery Act and the the French Sapin II Law.

The Kingdom of Saudi Arabia signed the United Nations Convention against Corruption on 9 January 2004 and ratified the same on 29 April 2013. May 2011 saw the establishment of the National Anti-Corruption Commission (Nazaha) to combat administrative and financial corruption. Nazaha encompasses all public sectors—with no exception—with the intent to combat financial and administrative corruption, defining corruption as "*every act that threatens the public interest as well as any abuse of the civil service in order to earn an individual advantage*."[2]

In a bid to assist organizations the International Organization for Standardization released the new ISO 37001: Anti-Bribery Management System Standard in October last year (see MEPOV Spring 2017.) Saudi Arabia was one of the 37 countries that participated in the development of this new standard which is designed to support organizations in their bribery and promote an ethical business culture by establishing, implementing and maintaining an anti-bribery compliance program.

The standard sets out a series of measures that an organization must implement and address that represent globally recognized anti-bribery best practice:[3]

- Bribery by the organization, or by its personnel or business associates acting on the organization's behalf or for its benefit.
- Bribery of the organization, or of its personnel or business associates in relation to the organization's activities.

It is crucial that top management fully support and back the compliance program.

This standard can be used by any organization, large or small, whether it be in the public, private or voluntary sector, and in any country. It is a flexible tool, which can be adapted according to the size and nature of the organization and the bribery risk it faces. But how exactly will this new standard benefit organizations? Here are a few examples:

- Ensuring compliance with global best practices in respect of anti-bribery good practice;
- Assurance to management, investors, business associates, personnel, and other stakeholders that an organization is taking reasonable steps to prevent bribery;
- Supporting organizations to establish, implement, maintain and improve an anti-bribery compliance program;
- Commercial advantage, particularly when contracting with other companies operating under strict anti-corruption laws, such as the United States;
- Certification – third parties will be able to certify an organization's compliance with the standard in the same way that they are certified with other standards such as ISO 9001 and 14001. Currently Microsoft and Wal-Mart are seeking such certification as they see value in having a uniform international standard to combat bribery[4];
- Providing minimum requirements and supporting guidance for implementing or benchmarking an anti-bribery management system;
- Evidence in court that an organization has taken reasonable steps to prevent bribery.

And just what measure will organizations have to implement? Broadly the measures to help organizations prevent, detect and address bribery include:

1. Implementing an anti-bribery policy and program;
2. Communicating the policy and program to all relevant personnel and business associates (joint venture partners, sub-contractors, suppliers, consultants etc.);
3. Appointing a compliance manager (full- or part-time) to oversee the program;
4. Providing appropriate anti-bribery training to personnel;
5. Assessing bribery risks, including appropriate due diligence;
6. Take reasonable and proportionate steps to ensure that controlled organizations and business associates have implemented appropriate anti-bribery controls;
7. Verify as far as reasonable that personnel will comply with the anti-bribery policy;
8. Controlling gifts, hospitality, donations and similar benefits to ensure that they do not have a corrupt purpose;
9. Implementing appropriate financial, procurement and other commercial controls so as to help prevent the risk of bribery;
10. Implement reporting (whistle-blowing) procedures;
11. Investigating and dealing appropriately with any actual or suspected bribery;
12. Conduct appropriate due diligence on staff, third parties, business partners and transactions.

The above required measures are designed to be integrated into the organization's existing management processes and controls and follows the common ISO structure for management system standards.

But there are also three fundamental elements that organizations who wish to ensure the success of the Anti-Bribery Management System (ABMS) need to consider, as outlined below.

Top level commitment

It is crucial that top management fully support and back the compliance program as without their support the program is doomed to fail from the start. Senior management needs to demonstrate that it is committed to preventing bribery and must clearly communicate its anti-bribery stance to all stakeholders.

Naturally senior management may be concerned that the implementation of this new standard would inflict an unnecessary additional burden of red tape on the organization, processes and procedures. This is not necessarily the case as the ABMS only requires that anti-bribery measures are implemented in a manner that is "reasonable and proportionate" to the:[5]

- Size and structure of the organization;
- Its location and the business sector within which it operates;
- The nature, scale and complexity of its activities; and,
- The bribery risk it faces.

Top management needs to understand that being able to demonstrate successful implementation of ABMS will provide assurance to all the stakeholders that the organization has implemented internationally recognized good practice anti-bribery controls and is taking reasonable steps to prevent bribery.

Communication

The second most fundamental element to ABMS is continuous communication. By using communication in conjunction with consultation and the participation of all stakeholders the organization will be able to establish and reinforce the significance of ABMS throughout the organization.

Senior management will have to continuously communicate its stance on anti-bribery and the importance of ABMS, the organization's anti-bribery policy, procedures and the duty to comply throughout the organization through poster campaigns, newsletters, company magazines, the company intranet, regular employee training and consistent e-mail communication.

In order to embed the bribery prevention policies and procedures and ensure they are understood, the organization will have to communicate the anti-bribery policy and programme to all relevant personnel and business associates, including joint venture partners, sub-contractors, suppliers and consultants among others. For record purposes the organization should retain a record on the training provided to employees and third parties, including the content of the training material, information on the training procedures, to whom it was provided and when. The challenge for the organization is to ensure that the training is properly understood by employees throughout the organization.

Compliance with the ISO 37001 demonstrates to customers, stakeholders, business associates, regulatory authorities, personnel, and the public that the organization is committed to ethical business practices.

Compliance with the ISO 37001 demonstrates to customers, stakeholders, business associates, regulatory authorities, personnel, and the public that the organization is committed to ethical business practices. In times of rigorous media scrutiny of business ethics, certification in terms of ISO 37001 also provides a substantial competitive advantage.

Adequate resources and budget

The third fundamental element is to appoint a compliance manager/officer to oversee the design and implementation of the ABMS program. The compliance manager's role will also include providing advice and guidance to personnel on the ABMS system and issues relating to bribery and ensuring compliance to the ISO standard.

The challenge for the organization is to ensure that this role is adequately resourced and funded and assigned to appropriate persons with the relevant skills, necessary competence, status, independence and authority. The compliance function must have direct access to top management.

Application of such a program can be challenging and there are a number of organizations grappling with implementation currently. With giants like Microsoft and Wal-Mart now seeking certification there will be pressure on more organizations to get their houses in order.

The ISO:37001 Standard can be found at: www.iso.org/standard/65034.html

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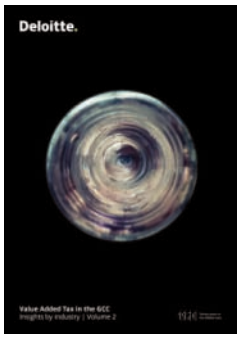

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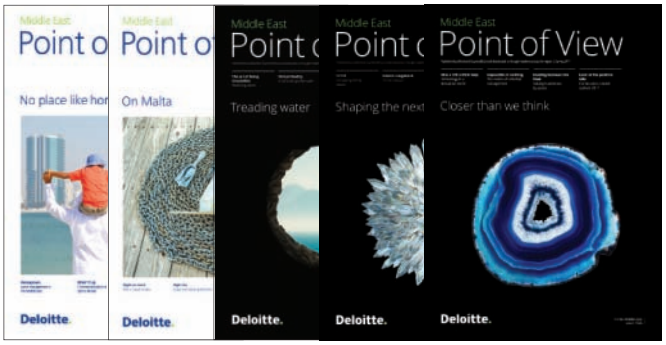

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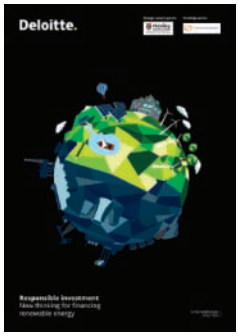

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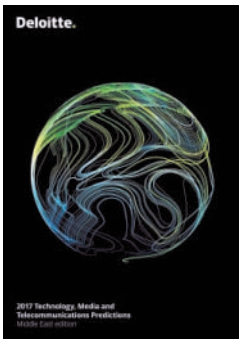

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