19th CENTURY PRESSURE

- Unlimited liability constrained growth
- Deterred wealthy persons from investing
- Unlimited liability seen as illusory
- Shareholders did not have the means to pay the losses
- Early 20th century pressure
- New wealthy middle class wanted limitation on claims
- Before investing in unlimited liability companies
- Political leaders wanted business to expand to stimulate economies
- The limited liability act was passed in 1855 in the UK
THE PUBLIC COMPANY

- Limited liability of artificial person
- Greater risk taking by those steering
- Ring fence risk
- Greater risk taking for greater rewards
- Driver industrialisation in the 2\textsuperscript{nd} industrial revolution
If directors and managers not liable
- How were shareholders seen as the investors protected?
- Law developed protection for shareholders
- Companies to disclose financial information
- The right of shareholders to sue directors for breach of their duties of care, good faith, skill and diligence
- This led to shareholder primacy
PROTECTION OF SHAREHOLDERS (2)

- Henry Ford vs the Dodge Brothers 1919 – minority shareholder
- Wanted to reinvest profits to pay better wages
- Court ordered Ford to discharge its primary duty to shareholders and pay a special dividend
- The late 1970’s – thinking was directors had to act in the best interest of the shareholders - primacy
- Corporate success was equated with share price
OWNERSHIP?

Shareholders are “the owners of the business” and the responsibility of the corporate executive is to “conduct the business in accordance with their designs, which generally will be to make as much money as possible while conforming to the basic rules of society .... There is one and only one responsibility of business – to use its resources and engage in activities designed to increase its profits as long as it stays within the rules of the game ....” Friedman

- Tacit – company not part of society
“The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing potential investors, lenders and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling, holding equity and debt instruments, and providing or settling loans and other forms of credit. The other primary users to whom general purpose financial reports are directed.”

Now to all providers of financial capital
SHAREHOLDERS INVEST IN COMPANIES

- IPOers
- Secondary market traders
- Transient shareholders

Have a claim to a future stream of income if company can pay its debts on due date and/or has readily realisable assets to pay its debts.

On bankruptcy shareholders stand at the back of the queue.

Shareholders self-protection - can disperse investment by investing in the equities of other companies.

Stakeholders such as employees or managers cannot disperse these risks in other companies.
COMPONENTS OF MARKET VALUE

S&P 500

- Physical and financial assets
- Other assets

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(SAICA)

Corporate Legal Advisers
INTANGIBLE ASSETS

- Strategy
- Reputation
- Supply chain
- Human rights
- Stakeholder relationships
- How the company makes its money
- Positive and negative impacts
- Quality governance
BEYOND FINANCIAL REPORTING

- Triple context
- Report in monetary terms
- FR critical but not sufficient
- SR critical but not sufficient
- The two in silos not sufficient
LAST DECADE OF 20\textsuperscript{TH} CENTURY

- 1994 - King I inclusive approach – special circumstances
- 1995 – first stakeholders report by Ben & Jerry, Vermont
- 1997 – North East America, Boston – White and Massie
- Intangibles 80%
- GRI born
- 2001 – oil from food scandal at UN – chairman
- Review and rewrite governance and oversight at agencies
- UNEPFI and UNCTAD
- Ecological overshoot
FIRST DECADE OF 21ST CENTURY

- King II and sustainability reporting according to G2
- Listing requirement
- FASB IFRS standards incomprehensible
- To the ultimate providers of capital
- Reporting in two silos in IFRS and GRI speak
- 2006 – GRI G3 guidelines
- 2008 – the GFC
- 2009 – the King III Report, integrated thinking and integrated reporting – to reflect daily reality in business
SECOND DECADE OF 21ST CENTURY

- 2009 – UNCTAD and IFAC at Geneva
- Chatham House Rules
- Financial reporting critical but not sufficient
- 2010 – IIRC formed at St James’ Palace
- IRC SA IR guidelines
- SASB formed
- GRI G4 guidelines
- 2013 – December, IIRC Framework
- 2016 – GRI Standards
DRIVERS OF CHANGE

- Global financial crises
- Climate change crisis
- Ecological overshoot
- Radical transparency
- Greater expectations from stakeholders
- Population growth
- Digital and net generation era
- Fourth Industrial revolution
- Cannot carry on business as usual
- Have to learn to make more with less
How does the company make its money?
The positive and negative impacts on the triple aspects of the company’s business model and product
Enhancing the positives, eradicating or ameliorating the negatives
Embedding sustainability issues into strategy
As water is critical to the beverage manufacturer
Now value is seen through a sustainable lens in a resource deprived world
THE SIX CAPITALS

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

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

- Parties who contract with the entity e.g. customers, employees, suppliers etc.
- Parties who have a non-contractual nexus with the entity e.g. civil society, local communities, NGOs, the environment.
- The State as legislator or regulator.
STAKEHOLDER RELATIONSHIPS

- Have to be managed
- Agenda item at each board meeting
- Critical in integrated thinking
- Who relates to stakeholders? - CSRO
- Management time and eye off the ball?
INTEGRATED THINKING

- Understanding, knowing and then planning:
  - How the company makes it money?
  - How the company will sustain value creation in the long term?
- Board should determine, inputs, how, products, outcomes
INTEGRATED THINKING

- Every company dependent on relationships and resources
- Mindset change at board & senior management level
- Symphony
- Knowledge of stakeholders’ legitimate NIE’s
- Greater stakeholder expectations
- Agenda: Inputs to outcomes
SHARE VALUE TO SHARED VALUE

- Board decides how, affects and strategy
- To generate long term value
- For its business, society and the environment
- Success depends on:
  - internal financial return
  - external social, environmental and economic results
  - SDG’s
Over the past few decades, sustainability issues have slowly become mainstream, and there is a shift from the creation of share value to the generation of shared value. Through shared value creation, a company links its operations to generating long-term value both for its business and for society as a whole and defines its success in terms of internal financial returns and external social and economic results. Ultimately, creating shared value acknowledges both the work that corporations need to do to reduce negative impacts on society as well as, and more fundamentally, how they can be part of progress on global challenges, such as climate change and the enforcement of human rights. Following this shift, there is a new trend of corporate reporting: the integration of financial and nonfinancial concerns into one accounting tool, known as IR.
To be accountable you have to be understandable

“If I had more time...”
At the beginning of February 2016, Larry Fink, CEO of BlackRock, the world’s largest investor with $4.5 trillion in assets under management, sent a letter to the CEOs of the S&P 500 and a number of large European companies. In his letter Mr. Fink urges CEOs to resist “the powerful forces of short-termism afflicting corporate behavior” and asks for CEOs to “lay out for shareholders each year a strategic framework for long-term value creation} and says that ”CEOs should explicitly affirm that their boards have reviewed those plans.”
Referring to this letter, Sandra Peters (Head, Global Financial Reporting Policy) and James Allen (Head, Capital Markets Policy—Americas Region) of the CFA Institute, wrote their own February 10, 2016 letter to the Financial Times in which they note that “Efforts by the International Integrated Reporting Council to develop a framework for reporting value creation seem very much in line with what Mr. Fink is suggesting. We have encouraged accounting standard-setters and policymakers globally to think more broadly about reporting on strategic objectives as well as about environmental, social and governance (ESG) factors.”
ECOLOGICAL OVERSHOOT

- Population explosion
- Limitless resources and infinite capacity
- Planet Inn
- 7.4 bn people today
- 9.3 bn by 2045
- Food insecurity
- 1.8 bn no access to potable water
NET GENERATION

- PhD students
- Millenials
- Global financial crisis only fiscal
- Global environmental crunch
- Prefer to take appointments at companies with sustainability embedded into strategy
- Shared value
Strategy no longer stops at output

- Board needs to be informed of stakeholder relationships
- Board needs to be informed of resources used
- Board needs to be informed of how the company makes its money
- Board needs informed oversight

Agenda item: inputs to outcomes – King IV
Should every business have a digital strategy?
Rather there must be a business strategy in a digital world
Agenda item: IT Governance and security – King IV
1. An institutional investor should develop a policy on how it incorporates sustainability considerations including ESG, into its investment analysis and investment activities. The matters to be dealt with in the policy should include but not necessarily be limited to, an assessment of:

a. the sum of tangible and intangible assets of a company
b. the quality of the company’s integrated reporting dealing with the long-term sustainability of the company’s strategy and operations. If integrated reporting has not been applied, due enquiry should be made on the reasons for this

c. the manner in which the business of the company is being conducted based on for example, alignment with targeted investment strategies of the institutional investor, and the company’s code of conduct and its supply chain code of conduct
Stranded assets are those with a value that would change dramatically, either positively or negatively, under certain scenarios such as a reasonable price on carbon or water, or improved regulation of labour standards in emerging economies. Stranded assets have the potential to result in significant reductions in the long term value of entire sectors ranging from oil and gas to pharmaceuticals, and not just the value of particular companies.
As a result, there is the potential for ‘stranded businesses’ – a prospect which seems to be giving many people an interest in maintaining and defending the status quo and slowing the transition to more sustainable models. Efforts to prevent progress on this front are as overt as lobbying for favourable policy and as covert as financing inaccurate, pseudo scientific ‘studies’ on the climate crisis, with the aim of creating false doubts about the reality the world is facing.
Until there are policies that establish a fair price for widely understood externalities, academics and financial professionals should strive to quantify the impact of stranded assets and analyse the subsequent implications for assessing investment opportunities.

(Al Gore)
THE THREE SHIFTS

From ‘Financial Capital Market System’ to ‘Inclusive Capital Market System’

From ‘Silo Reporting’ to ‘Integrated Reporting’

From ‘Short-term Capital Markets’ to ‘Sustainable Capital Markets’
THE GOVERNANCE EQUATION

Governance

UNIFIED

Governance principles and best practice

Enterprise and business judgment calls (strategy)

B J R
STEPPED APPROACH

1. Practices

2. Principles (Objectives)

3. Governance outcomes (Intended benefits)
Principle 1.1: The governing body should set the tone and lead ethically and effectively.

Principle 1.2: The governing body should ensure that the organisation’s ethics are managed effectively.

Principle 1.3: The governing body should ensure that the organisation is a responsible corporate citizen.
Principle 2.1: The governing body should appreciate that strategy, risk and opportunity, performance and sustainable development are inseparable elements of value creation.

Principle 2.2: The governing body should ensure disclosure and reporting that enables stakeholders to make an informed assessment of the performance of the organisation and its ability to create value in a sustainable manner.
Principle 3.1: The governing body should serve as the focal point and custodian of corporate governance in the organisation.

Principle 3.2: The governing body should comprise a balance of power and command the skills, experience, diversity, independence and knowledge as is appropriate to the organisation so that it is able to effectively discharge its role and responsibilities.
Principle 3.3: The governing body should delegate to assist with the effective discharge of its responsibilities without abdicating accountability.

Principle 3.4: The governing body should appoint a chairman, the Chief Executive Officer and a senior manager responsible for corporate governance to contribute to an effective system by which authority is exercised.
Principle 3.5: The governing body should ensure that the performance evaluation of board structures and individual role players results in improved performance and effectiveness.
EFFECTIVE CONTROL (4)

- **Principle 4.1:** The governing body should govern risk and opportunity so that it supports the organisation achieving its strategic objectives.

- **Principle 4.2:** The governing body should govern technology and information so that these support the organisation achieving its strategic objectives.
EFFECTIVE CONTROL (5)

- Principle 4.3: The governing body should govern compliance with laws and ensure consideration of adherence to non-binding rules, codes and standards.

- Principle 4.4: The governing body should ensure that the organisation remunerates fairly, responsibly and in a transparent manner that promotes the creation of value by the organisation in a sustainable manner.
Principle 5.1: The governing body should ensure that a stakeholder inclusive approach is adopted and that stakeholders’ legitimate and reasonable needs, interests and expectations are taken into account in the best interests of the organisation.

Principle 5.2: The governing body should ensure that the organisation exercises its rights, obligations, legitimate and reasonable needs, interests and expectations in another organisation or entity responsibly.
APPLY AND EXPLAIN

- 75 principles in King III
- Application register
- 16 principles in King IV
- Apply and explain
- Explain how achieved or striving
- User draws inference on quality
- And on achieving the outcomes
FOUR FUNDAMENTAL OUTCOMES

- Ethical culture and effective leadership
- Performance and value creation in a sustainable manner
- Adequate and effective controls
- Trust, good reputation and legitimacy
BASICS

- I C R A F T
- Incapacity
- Good faith, care, skill, diligence
- Heart, mind & soul
THE WORLD

- The world - not what it used to be
- Reporting – not what it used to be
- Strategy – not what it used to be
- Taxation – not what it used to be
- Stakeholders – not what they used to be
- Transparency – not what it used to be
- Value – not what it used to be
- Raising capital – not what it used to be
IDEAS

- Man and nations – idea of limited liability
- Idea of integrated reporting
- Helen Keller: “The only thing worse than being blind is having sight and no vision”
- We have the light
- Why grope in the dark?
THANK YOU

Prof Mervyn E King SC