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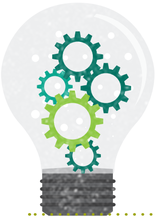
Board Directors put CEOs in the innovation driver's seat



We recently hosted an interactive innovation workshop for 29 independent directors in association with Appoint Better Boards.

The session explored whether or not innovation should be a fixed item on the Board agenda and if Boards and CEOs are well equipped to drive innovation.

With a mandate to drive strategy and manage risk, innovation seems to sit in the cross hairs of the Boards' governance role; so the workshop was designed to foster a conversation about how they might take a more active role in setting their innovation strategies and developing an innovation governance approach.

There was a strong appetite from the participants for driving an innovation agenda from Director and Board level, but the majority believed that the CEO must sit in the driver's seat.

It became evident from the discussion that CEOs need to lead innovation in the organisation, through having a transparent innovation process or methodology that is communicated and supported from the top down. They need to encourage creative, collaborative behaviours and the co-creation of a portfolio of initiatives with both the Board and potentially outside partners.

With only 50% of Boards represented at the workshop regularly reviewing innovation as part of their agenda and 62% having no set KPIs or reporting requirements around innovation initiatives, it is clear there is some more work to do to get innovation onto the Board agenda in New Zealand.

Directors also explored nine possible innovation models that included everything from appointing a Chief Innovation Officer, to enabling creative 'duos' within the organisation.

The adoption of a C-suite led steering committee supported by innovation champions was seen as the most effective way to fuel innovation in an organisation.

If New Zealand companies want to enable more innovation, CEOs need to send a clear signal that they have an appetite for experimentation and the unknown, and then empower accountable executives to pursue and test opportunities.

Key insights from Grant Thornton's innovation workshop

- **The greatest blocker for innovation** is a lack of dedicated time (outside of BAU) to focus on future growth opportunities, and having the right culture and skills to drive opportunities forward.
- **The greatest enabler for innovation** is strong C-suite level leadership (ideally the CEO), creating an environment that fosters rapid prototyping and open experimentation – in other words, an appetite to learn by failing fast.
- **Some of the main forces impacting growth and with potential for disruption** of New Zealand companies include political, regulatory and compliance constraints, offshoring and automation of low skilled jobs, and the changing requirements of customers.
- **For CEOs to increase innovation**, they need to actively design an innovation framework (of both process and behaviours) and augment existing talent with external specialists who are armed with the specific best-practice skills to fuel the ratio of success. There is also a view that a mandated management agenda and a KPI on innovation are needed in more New Zealand companies.
- **Aligning strategy, risk and investment is seen as critical,** and requires a stronger risk appetite from a more diverse set of Board Directors.
- **Adopting a governance model that includes** an Innovation Steering Committee and Innovation Champions within the organisation is key. By combining C-suite level support with active and dedicated producers within the organisation, innovation is more likely to flourish.

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Global survey finds split in export outlook across Asia Pacific

A global survey by Grant Thornton of 2,500 businesses in 36 economies reveals a marked split in the export expectations of businesses across the Asia Pacific region. While the region as a whole is expecting an increase in export activity over the next 12 months, mirroring the global outlook, a handful of Asia Pacific economies actually report radically reduced expectations as concerns over currency volatility and world trade take hold.

The Grant Thornton International Business Report (IBR) reveals that in Q2 2016, 15% of businesses across the Asia Pacific region expect exports to increase over the coming year, up from 8% in Q1. However, this masks sharp falls in the pockets of businesses across four major economies. The business outlook for exports in New Zealand has fallen from 40% in Q1 to 22% in Q2, while in Australia it has fallen from 39% to 28%; Singapore is down 12% to -6%, and in Malaysia the outlook has plummeted from 36% to 6%.

As the world becomes more interconnected, exports are an increasingly important source of growth for large parts of the Asia Pacific business community. That's why it is good to see that despite a global backdrop of economic, social and political uncertainty, for large parts of the community plans to export more are increasing. But that isn't the whole picture.

The reasons for the slump in export plans in these countries differ, but the steps businesses can take to remedy them are consistent.

Reduced commodity demand in China has weakened export prospects and lowered commodity prices, which creates depreciation for commodity exporting economies such as Malaysia and Australia. We are no doubt feeling the pinch in New Zealand as our currency appreciates against the Australian dollar and Singapore's status as a trade hub could be feeling the effects of global uncertainty slowing some trade flows.

The reasons for the slump in export plans in these countries differ, but the steps businesses can take to remedy them are consistent. By planning for long term scenarios and prioritising a diversity of revenue streams, firms will be in a better position to prosper even if the challenge on some parts of their business intensifies.

Overall business optimism increased across Asia Pacific in Q2 from 21% to 28% although this was measured before the UK voted to leave the European Union.

The IBR reveals that Australia, where the currency has weakened, has seen an increase in firms citing exchange rate fluctuations as a constraint on their ability to grow (up 4% to 16% in Q2). Similar increases are reported in New Zealand (up 8% to 20%) and Malaysia (up 2% to 64%).

Overall business optimism increased across Asia Pacific in Q2 from 21% to 28% although this was measured before the UK voted to leave the European Union.

Whilst the UK's decision to leave the European Union may not directly impact many businesses across Asia Pacific, it could do so indirectly – for example, if markets continue to be volatile as a result of the decision. Not enough is yet known to inform many of the biggest decisions facing businesses with European operations.

When thinking about the threats and opportunities Brexit could create, and planning how to create and protect value, it may be worth considering any short, medium and long term implications for issues like people and talent, exports and imports, strategic ambitions, financing, risk, operations and protecting investment. This will also help guard against unexpected shocks which could derail long-term growth prospects.

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Christchurch progress on less shaky ground

When modelling for economic growth it's difficult to compensate for your second largest city suddenly dropping off the balance sheet; yet that is exactly what happened for New Zealand in 2011 following the second Christchurch earthquake. Christchurch wasn't just an economic hub in its own right, but the gateway to the South Island.

The Christchurch recovery process is now officially at an end with the expiry of the Canterbury Earthquake Recovery Act, and the transfer to local leadership. The final major tranche of Government expenditure on the rebuild was announced in Budget 2016; the Government's commitment aggregating to $17b in total since the earthquakes, some $700m more than originally forecasted. The Government has signalled its intention to enter a new phase in the recovery process to one of renewal with Minister Gerry Brownlee's portfolio title changing to "Minister supporting Greater Christchurch Regeneration".

The return of Christchurch to a mood of prosperity is encouraging. Statistics New Zealand says that in the year ended March 2014, Canterbury's contribution to total GDP grew to 13.1 per cent, narrowly behind Wellington (13.2 per cent). By the year ended March 2015, Canterbury was once again the country's second largest economy at 13.6 per cent, ahead of Wellington (13.5 per cent). Not surprisingly, Statistics New Zealand notes that these improvements were driven by agriculture and, of course, by the ongoing Canterbury rebuild. In addition to the Government's financial package of $17b, insurance money has boosted the financial stimulus to the economy to $40b.

However, Christchurch and New Zealand can't rely on rebuild stimulated growth forever. Westpac Chief Economist Dominick Stephens estimates that the rebuild is 50% complete. Sooner or later the growth generated by the rebuild effort will need to be replaced by the Christchurch economy shifting back into a higher gear. Marking the exact point when that happens will be difficult, but we need to determine if that is happening yet, or whether this new surge of growth remains in front of us. Taking the foot off the pedal of economic development by simply handing back the reigns of control to local leadership won't be sufficient to ensure Canterbury's ongoing financial contribution to New Zealand as a whole.

In 2015 Canterbury Development Corporation confirmed that underlying economic activity was slowly taking over from rebuild outputs as the key impetus in the growth of Christchurch GDP, with only 11% of Christchurch GDP relating to construction activities.

The Government recognises the importance of Canterbury to New Zealand and believes the new regeneration phase is not just about rebuilding Christchurch, but also fulfilling the long-held potential of one of New Zealand's largest cities. Regardless of how or when it is achieved, the country needs the Canterbury economy back online.

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NFPs' funding concerns increase

The Not for Profit sector in New Zealand and Australia is now more concerned than ever about funding their operations, according to the latest Grant Thornton Not for Profit sector report: The Challenge of Change.

Funding, sponsorships and donations were cited as a major concern for 33 per cent of NFPs surveyed on both sides of the Tasman.

This figure has skyrocketed from 14 per cent in our 2013 survey. Fifty one percent of New Zealand and Australian participants also said that financing the activities of their organisations was a significant concern compared to 14 per cent in 2013.

Over a third of all organisations surveyed can't plan beyond a year under their current funding arrangements; New Zealand NFPs reported significantly greater difficulty sourcing regular and consistent sources of funding compared to their Australian counterparts.

Collaboration is key

While potentially challenging for some, collaboration with other organisations ranging from sharing resources to merging and amalgamating is a good way to alleviate financial pressures, but it needs to happen with some urgency to ensure the survival of those organisations affected.

The number of respondents who have considered setting up a trading organisation or social enterprise remained constant (35 per cent), however, the approach has changed dramatically. In 2013, 86 per cent of survey participants considered setting up a new operation and 25 per cent thought about purchasing an existing business; in the latest report, these figures have dropped to 66 per cent and 20 per cent respectively.

The focus for a lot of organisations – 9 per cent in 2013 and 59 percent in 2015 - has shifted to growing their current business; but to achieve the growth needed for survival, it's vital for NFPs to understand the opportunities and benefits of collaborating with other like-minded organisations that share similar goals or visions, rather than competing for a limited pool of money.

Collaboration fosters sharing of ideas and resources, and learning opportunities for all involved.

Is there untapped potential in your director group?

Another avenue of increasing fundraising that appears to be under-utilised by those surveyed is the director group. Over two thirds indicated they had independent directors, but only 11 per cent said that Board members are encouraged to donate or secure funds for their cause.

Some organisations may find this option too challenging, but there's still a lot of opportunity to generate more revenue by involving their directors more. To view the full report visit bit.ly/gtnznfp.

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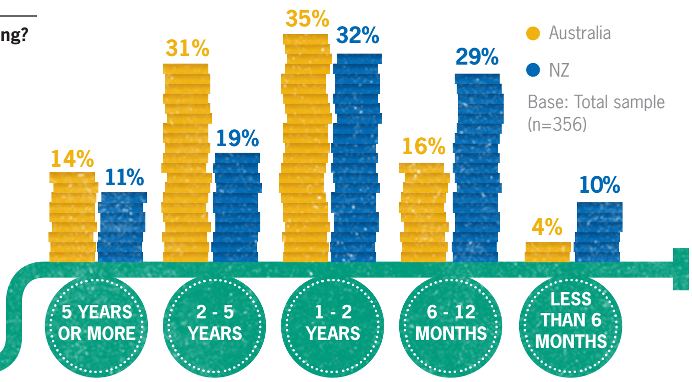
How many months/years of activity can you budget for based on your current funding?



Over a third of NFPs don't have a risk management plan in place

The latest Grant Thornton Australia and New Zealand Not for Profit sector report, The Challenge of Change, has revealed that over a third of organisations surveyed do not have a risk management plan in place.

According to the report, Australian organisations are more likely to have a plan (73 per cent) than those in New Zealand (45 per cent). The survey indicates that larger organisations that are generally better resourced are more likely to have risk management plans in place compared to those with smaller turnovers.

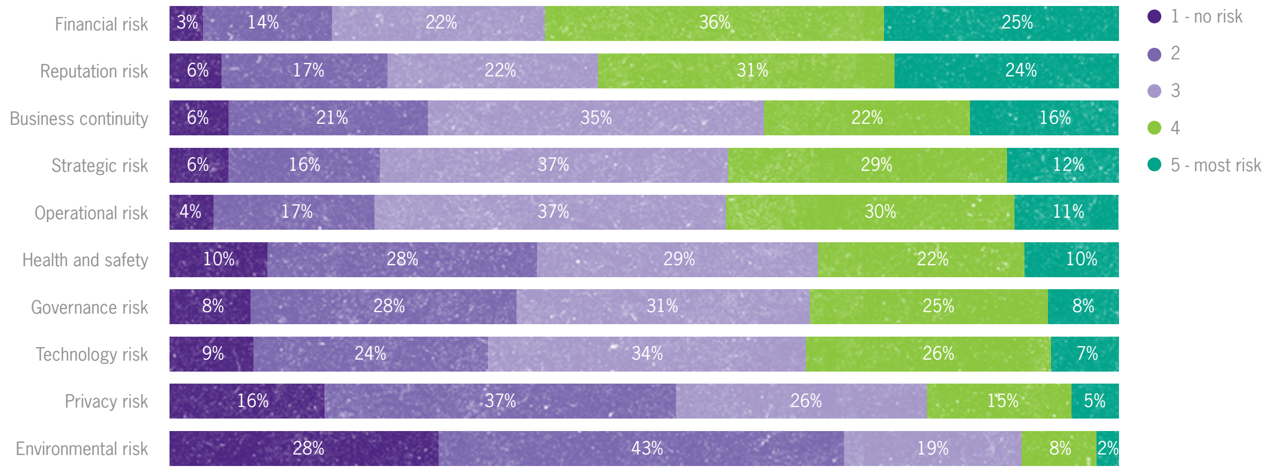
Organisations that don't have a risk management plan in place need to be aware that recovery from a risk-related event can be difficult; for example, many organisations provide care or counselling services that require the maintenance of detailed client history files, while others obtain credit card information when they receive donations.

Identity theft and fraud is materialising rapidly and more often in today's business environment; the risks associated with storing this information and the legislative penalties and potential reputational damage from failing to protect it are severe.

Another major concern identified in the report is how infrequently disaster recovery or business continuity plans are updated, tested for compliance and circulated to staff.

While there is room for improvement in these areas, there are some positives. A risk management plan is the foundation of a risk framework, and it isn't effective unless risks are monitored and reported on regularly.

For your organisation overall, what areas do you consider to hold the most risk (where 1 is no risk and 5 is the most risk)?



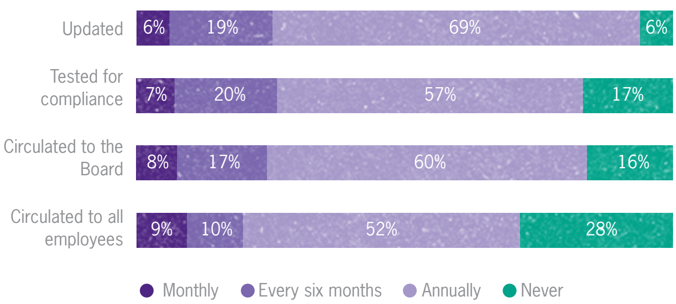
Base: Total sample (n=356)

Of the organisations that do have a risk management plan in place, over 70 per cent both monitor and report their risks at least quarterly.

It's also encouraging to see that survey participants identified strategic and operational risks as areas that require a lot of attention.

The survey results demonstrate that NFPs are starting to recognise the importance of identifying risks so they can develop appropriate strategies for implementation into the day to day management of their organisations; this can improve their chances of long term survival. To view the full report visit bit.ly/gtnznfp

Thinking specifically about the disaster recovery or business continuity plan, how often is it ...



Base: Organisation with a disaster recovery/business continuity plan in place (n=173)

To download a copy of Grant Thornton's latest NFP report visit bit.ly/gtnznfp

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How to reduce the risk of **valuation disputes** in business agreements

New business relationships are formed with hope and optimism for the future. But what happens when things just don't work out?

We're regularly asked to provide valuation advice when a business relationship breaks down. Our instructions are typically based on exit clauses agreed between the parties at the start of their venture.

Exit clauses establish procedures for transferring ownership interests. They may be clauses in joint venture and shareholder agreements, or in the company constitution, and are usually trigged by specific events like the termination of a joint venture, or the exit of an employee shareholder.

Unfortunately, the valuation aspects of these clauses can sometimes hinder rather than help the exit process.

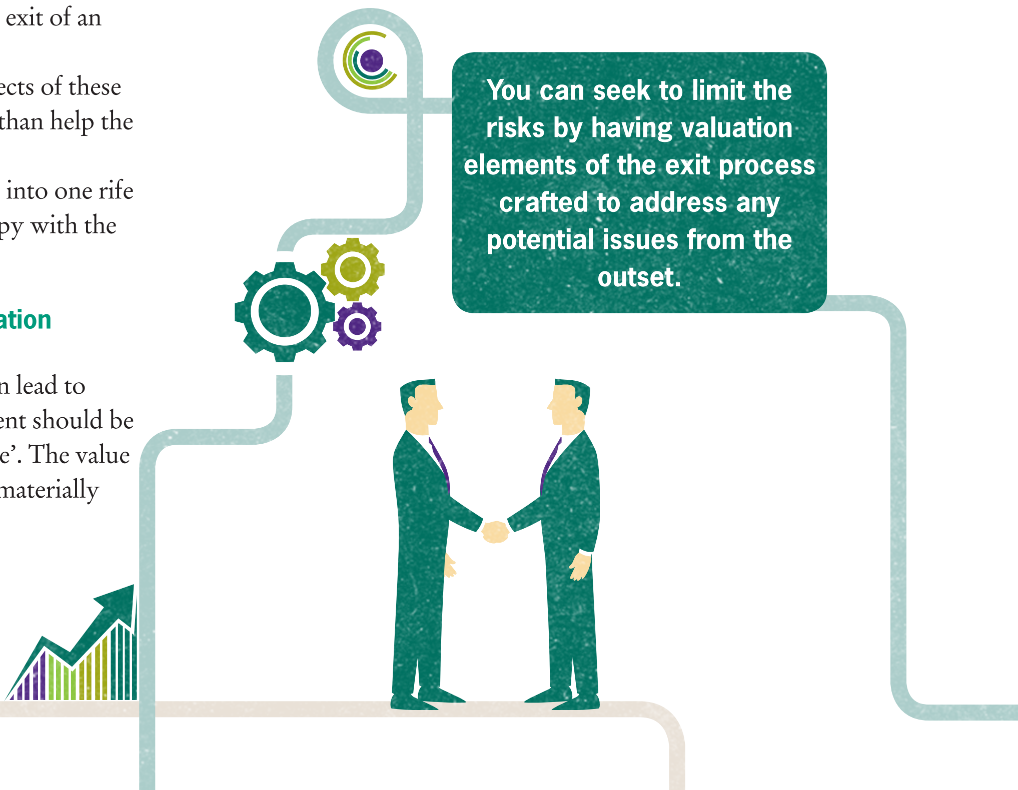
They can also turn a friendly exit into one rife with conflict, with neither party happy with the final outcome.

Six common problems with valuation elements in exit clauses

1 **No definition of 'value'.** This can lead to debate over whether the assessment should be of 'fair value' or 'fair market value'. The value under each of these bases can be materially different.

2 **Unspecified valuation date.** Parties often have different opinions about whether the valuation date should be the date of the triggering event (such as an employee leaving), or at the current date.

3 **Inappropriate methodology specified.** For example, a mandate to value the interest using an earnings based approach may not be suitable if the business has run into financial difficulties.



You can seek to limit the risks by having valuation elements of the exit process crafted to address any potential issues from the outset.

4 **Uncertainty in the wording** about whether control and liquidity adjustments should be applied, particularly for minority share interests.

5 **The mandated process outweighs the benefit.** Where the expense and effort mandated by the valuation clauses is not justified relative to the size of the interest being valued.

6 **Inadequate, unrealistic or non-existent** planning and timetabling requirements or an ill-thought out process that forces the valuer to take a counter-intuitive approach.

What are the options?

You can seek to limit the risks by having valuation elements of the exit process crafted to address any potential issues from the outset, and tailored to the relevant business and intentions of the parties. There are two opposing ways to achieve this:

1 A rigid, 'belts and braces' approach, where valuation clauses are heavily prescribed and leave little or no room for judgement on the part of the valuer. At its most extreme, set valuation formulas are used.

2 A more conceptual approach, where a high level valuation framework is established. It is then left to the valuer to apply their expertise and experience in delivering an appropriate valuation opinion.

A conceptual approach tends to be effective in most commercial situations, and allows room for changing circumstances between the agreement and valuation dates. This approach recognises there are always subjective elements to a valuation, and gives the valuer flexibility to deliver a full and appropriate opinion.

What to include in your agreement

As a minimum, the following value elements should be covered:

- The value definition (usually fair value or fair market value)
- The basis on which the valuation date is to be determined
- The valuation process to be followed (including number of valuers, timing and costs)
- The status of the valuer's decision (ie, binding or advisory)

Other factors to consider

How many valuers?

When dealing with high value interests, there is a tendency to increase the number of valuers involved. Using a single valuer may deliver a more cost effective and efficient outcome, albeit a greater degree of trust by the parties relying on the valuation is required.

Who to appoint?

It's important that all parties trust the valuation, so it may be worth including minimum requirements for the qualifications, expertise and experience of the valuer.

Should minority discounts be applied?

Because it's such a common point of difference, if the valuation is to be of a minority interest you should think about whether any minority discount should be applied in the valuation clauses.

Existing agreements

If an existing agreement appears unlikely to deliver a successful transfer, it's wise to seek legal advice and valuation guidance right away. And it's certainly easier to get consent from all parties and change the agreement in advance, than to resolve differences that arise once the valuation clause is triggered.

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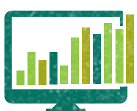

Reduced disclosure regime presents challenges for NZ organisations

For-profit and Not for Profit organisations can no longer use differential reporting to support financial statement filings with the New Zealand Companies Office or Department of Internal Affairs (DIA) Charities Services.

Differential reporting was replaced with a reduced disclosure regime (RDR) as of 31 March 2016. This was jointly developed with Australia so that organisations in both countries can adhere to the same reporting rules given the significant levels of mutual investment on both sides of the Tasman. And like differential reporting, RDR has also been designed to keep compliance costs to a minimum.

However, companies and registered charities will still be presented with financial reporting challenges.

All this change will increase the burden on those who have to prepare annual financial statements to meet their tax, filing requirements or financing obligations being imposed on them by their bankers, investors or donors.

Disclosures in the notes support the dollar amounts included in primary financial statements and are there for good reason - they enable readers and investors to understand complex transactions. However, the financial statements often end up becoming cluttered and the truly important information is often hard to find.

This can be avoided by taking a fresh look at your financial statements. Organisations should refocus their financial statements as an effective communication tool without losing sight of complying with technical requirements.

An excellent set of financial statements should focus on four areas:

- comply, but also communicate
- omit the immaterial
- rethink what's included in the notes
- prioritise the accounting policies and notes by putting the important material first.

To help organisations across all industries with these four key tips, Grant Thornton has produced: *Telling your story: making your financial statements an effective communication tool*, visit bit.ly/gt_tellyourstory to download your copy.

For the more than 400,000 organisations not required to prepare financial statements using RDR or full NZ GAAP, special purpose financial statements can be prepared. These entities are afforded the flexibility to select the most appropriate accounting policies that produce the best financial statements for their organisation.

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