

board room

JUNE / JULY 2019



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Magazine of the Institute of Directors in New Zealand



**Caught between:
NZ in the trade war**

**Measuring board
capability. What
comes up short?**

A note from the editor

In this issue of *BoardRoom* we explore the US-China trade war and other trade-related issues that should be at the front of directors' minds.

Tensions between the US, led by an impulsive and combative President, and China, led by a President who last year removed the two-term limit on his presidency, are high. These are the world's two largest economies by GDP. What they do can send ripples through the world's economy that could look like tsunamis from the perspective of a small country like New Zealand.

IoD Chartered Member Charles Finny offers a Kiwi perspective. A former trade negotiator, Finny suggests US-China tensions could rise further over the next six months, perhaps threatening global growth. But he sees hope that the willingness of many nations to establish trade agreements with New Zealand can offer certainty to exporters and importers even as the World Trade Organization becomes increasingly impotent.

John Pomfret, Sinophile and former Washington Post bureau chief in Beijing, offers insights into Chinese perspective on international trade. Pomfret reminds us that tensions with the West are part of that country's historical consciousness and that trade is sometimes seen as part of a broader geopolitical strategy. For directors, it is this later point that must be considered when considering a board position with a Chinese company, or when bringing a China-based director onto a New Zealand board.

The world economy faces uncertain times. How changes in the trading system could impact local firms is something every director should think about.

Aaron Watson
BoardRoom editor



BoardRoom is the magazine of the Institute of Directors in New Zealand iod.org.nz

The Agenda

JUNE / JULY 2019



AGRI-FOOD TRADE
– the power of relationships / KPMG



THE CHINESE VIEW OF TRADE



THE DIGITAL TALENT GAP
– commodity traders / Marsh

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boardroom

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EDITOR

Aaron Watson
+64 4 470 2647
aaron.watson@iod.org.nz

Please contact the editor for any advertising queries.

INSTITUTE OF DIRECTORS IN NEW ZEALAND (INC)
Mezzanine Floor, 50 Customhouse Quay
PO Box 25253, Wellington 6146
New Zealand
Tel: 04 499 0076
Fax: 04 499 9488
mail@iod.org.nz
iod.org.nz

The Institute of Directors has staff based at the National Office in Wellington, an office in Auckland and eight branches. For National Office, phone 04 499 0076.

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Trade and international relations



KIRSTEN PATTERSON
CEO, INSTITUTE OF DIRECTORS

Nimén hǎo,

Master 9 has been selected for his local Club's Under-11 rugby trip to Australia next year. His first "representative" team and what he considers the first step in his plan towards his All Blacks playing career.

Attached to the notice of his selection was a note, or a warning, for parents. Selection is dependent on parental participation in fundraising. I now suspect that I will spend more hours fundraising than he will spend training.

The big fundraiser for the season is a naming rights raffle – aimed at local companies with the winner having their name on team jerseys etc for the tour. Trying to get Master 9 involved in the process, we asked him which companies we have a relationship with and who he thought we should approach. He was able to identify a list quite quickly – Google, Facebook, Apple, Netflix, Air NZ and The Warehouse.

If Facebook was a country it would apparently be the third-largest in the world. How do you get the leader of the third-largest country in the world to sponsor your local rugby team?

Asking him to identify companies that he personally has a relationship with via his pocket money didn't help narrow down any reasonable prospects – all big box or online retailers, YouTube influencers, or companies selling digital products. Trade sure has changed, even at the pocket-money level.

This edition of BoardRoom launches our second "What Matters" theme for the year – the future of trade.

During my high school education in 1990s small-town New Zealand we were all encouraged to learn Japanese because they were the economic export powerhouse, the technology leaders and the source of our in-bound tourists. Mandarin or Cantonese were not even options. Yet a review of the monthly movements for our top export partners for April 2019 (ranked by total annual good exports) has Japan in fifth place.

China – up \$327m (29%) to \$1.4b.

The rise was led by milk powder (up \$87m), beef (up \$71m) and lamb (up \$38m).

Australia – down \$27m (3.9%) to 680m.

EU – down \$7m (1.1%) to \$614m.

The fall was led by lamb (down \$17m).

USA – up \$86m (18%) to \$557m,

led by milk powder, butter, and cheese (up \$42m) and wine (up \$22m). The rise was partially offset by a fall in beef (down \$27m).

Japan – up \$29m (8.5%) to \$368m.

The rise was led by gold kiwifruit (up \$25m).

Who we have relationships with and what trade looks like internationally has transformed, and it's not just the internet's fault.

There was a great metaphor about the trade war used at the World Economic Forum "Meeting of the New Champions" in September last year:

"The analogy I use is football. One team shows up on one side of the field. They are the World Cup champions. And on the other side of the field you have the Super Bowl champions. They're both there to play football but they have very different ideas... each team plays a very good game but the rules they play are designed to showcase different skill sets.

"The World Cup football team is very agile, they move very quickly, they adjust rapidly. The American football team is more deliberate – every play is planned, every player on the field has a coordinated role, they wear protective gear. Basically the US and Chinese economies are like these two teams, playing on the same field." – Timothy P Stratford, Covington & Burling (international law firm)

The sports analogy is one here in New Zealand we understand well but we need a global response to ensure it's not just two teams on the field, and we all get a say in picking the referees.

Zàijian

Kirsten (KP)



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Closing date: 28 June 2019

KIRK ROBERTS CONSULTING

Role: Chairperson
Location: Christchurch
Closing date: 28 June 2019

AUCKLAND NETBALL

Role: Appointed board member
Location: Auckland
Closing date: 28 June 2019

CANCER SOCIETY OF NZ AUCKLAND NORTHLAND INC

Role: Directors (9)
Location: Auckland
Closing date: 30 June 2019

TRUST INVESTMENTS MANAGEMENT LIMITED

Role: Director
Location: Auckland
Closing date: 5 July 2019

NEW ZEALAND RIDING FOR THE DISABLED ASSOCIATION

Role: Board member
Location: National
Closing date: 12 July 2019

THE WELLINGTON NIGHT SHELTER

Role: Board Members (3)
Location: Wellington
Closing date: 19 July 2019

EASTLAND GROUP

Role: Non-executive directors (3)
Location: Gisborne
Closing date: 27 July 2019

Q: True or false: A company can legally indemnify a director even though this is not expressly authorised by the company constitution?

A. FALSE. See section 162 of the Companies Act 1993 that covers director indemnities and insurance. The section provides that a company may indemnify directors only if this is expressly authorised by the company constitution. The section also restricts the extent to which the company may indemnify directors (ie for certain liabilities and related costs). An indemnity given in breach of the section is void.

Q &A



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APPOINTMENTS

DIRECTOR SEARCH

Rachel Farrant

Chartered Member, has been appointed via the IoD's Director Search as an independent director on The Property Group board.

FUTURE DIRECTORS

Alexia Hilbertidou

Has been appointed a Future Director on the board of Simplicity.

Michelle Kong

Has been appointed a Future Director on the board of Auckland International Airport.

Claire Neville

Has been appointed a Future Director on the board of Ports of Auckland.

Anna Scott

Has been appointed a Future Director on the board of the NZX.

GENERAL

Philip Broughton

Chartered Member, has been appointed to the NZ on Air board.

Sara Brownlie

Chartered Member, has been appointed to Upper Hutt City Council's Risk and Assurance Committee as an independent member.

Gillian Goodwin

Member, has been appointed a deputy chairperson of the Human Rights Review Tribunal.

Richard Young

Chartered Member, has been appointed chairman of Silver Fern Farms.

UpFront QB honours

The Institute of Directors congratulates the following members who were recognised in the Queen's Birthday Honours.

Knight Companion of the NZ Order of Merit (KNZM)

Paul Adams

CFinStD of Tauranga
For services to philanthropy and the community.

Companion of the NZ Order of Merit (CNZM)

Professor Charles Thomas Eason

CMinStD of Nelson
For services to science and wildlife conservation.

Officer of the NZ Order of Merit (ONZM)

Major General Peter Te Aroha Emile Kelly

MInStD of Wellington
For services to the New Zealand Defence Force.

Member of the NZ Order of Merit (MNZM)

Rachael Kathleen Dean

MInStD of Masterton
For services to the New Zealand Defence Force.

Dr Hinemoa Elder

MInStD of Auckland
For services to psychiatry and Māori.

Nicola Jean Williams

MInStD of Taupo
For services to arts governance.

Queen's Service Medal (QSM)

Peter Antony Cox

CFinStD of Christchurch
For services to sport, particularly hockey.

Philip Ivan Redmond

MInStD of Christchurch
For services to the community.

Welcome

In the first instalment of a new feature in *BoardRoom*, we would like to congratulate our newest Members.

New Members March-April

AUCKLAND

Catherine Abel-Pattinson
Simon Bainbridge
Kim Bennett
Jim Bibby
Jacob Bignell
Scott Bishop
Hadleigh Bognuda
Glen Bond
Andrew Bonner
Megan Brice
Kate Bromfield
Sarah Burke
Bruce Cromie
Robert Croot
Brent Devlin
Merepaea Dunn
Sarah Dunn
Brad Dunstan
Ralph Elika
Elizabeth Elkins
Nick Engelmann
Joehan Ewen
Lisa Flynn
Matthew Foster
Sandy Foster
Andrew Fraser
Ilze Gotelli
Russell Haines
Sarah Hamilton
Michael Harper
Adam Hughes
Penny Hulse
Guy Hunt
Joe Jakicevich
Amanda Johnston
Simon Jordan
Lisa Kagan
Natalia Kaihau
Kester Ko
Murali Kumar
Katheren Leitner
Julien Leys
Callum Liefiting
Owen Loeffelchener
Petra Luciolli

Kirsten Magnusson
Katy Mandeno
John Mazerier
Anthony McNaughten
Ewan Morris
Ruth Nelson
Joe Newton
Peter Newton
Anne-Maree O'Connor
Neil Oliver
James Oliver-Roche
Amelia Pais Rodriguez
Mike Paki
Wayne Percival
Tony Pervan
Rebecca Piek
Sam Porath
Ruwan Premathilaka
Doreen Retimana
Dave Rosenberg
Mats Rosenkvist
Silvana Schenone
Dave Scott
Sharon Scott
Isa Seow
Penny Sheerin
Nicolette Sheridan
Shanu Subbiah
Dave Tilton
Brendon Vincent
Vincent Vuillard
Tim Wake
Adam Williams
Philip Wright
Chen Yang
Andrew Young

NELSON MARLBOROUGH

Patrick Green
Cam Haring
Gemma Newburn
David Porter
Andrew Spittal

BAY OF PLENTY

Gary Allis
Ratahi Cross
Matthew Davis
Riri Ellis
Mark Fraundorfer
Ngawa Hall
Simon Hunt
Kirikowhai Mikaere
Sam Newbury
Graeme Niao
Dan Pepperell
Peter Stone
Shirley Trumper
John van der Zwan
Duncan Walker

CANTERBURY

Scott Adams
Senthil Murugan
Arumugam
Mat Bayliss
Graham Black
Michaela Blacklock
Ian Bourke
Kam Cheng
Paul Commons
Vicki Corner
Paul Croft
Neil Jorgensen
Brian Ko
Hadley McLachlan
Dayle Parris
Mark Petrie
Warren Poh
Anna Ryan
Eric Scheepbouwer
Lisa Stamp
Leanne Stapylton-Smith
Juliette Stevenson
Aru Strickland
Richmond Tait
John Watt
Bruce White

OTAGO SOUTHLAND

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Catherine Day
Todd Grave
Mike Healy
Dean Macaulay
Will Moffett
Jess Stall
Tom Sweeney

TARANAKI

Jason Boyle
Catherine Clennett
Cathy Katene
Kristy Kelly
Philip Luscombe
Andrew Revfeim
Chris Ussher

WAIKATO

Kahl Betham
Blair Bowcott
Korina Burne-Vaughn
Nick Edgar
Bernard Endres
Jacqueline Griffin
Scott Griffin
Hamish Hobson
Dee Holmes
Bronwyn Koroheke
Matthew Marshall
Andrew Matheson
Jamie Mikkelson
Adam Norman
Samantha Samuel
Anver Sheha
Damian Sicely
Jamie Simpson
Linda Te Aho
Steve van Wonderen
Emily Zhang

WELLINGTON

Elise Adams
Mark Benseman
Shane Bidois
Alexander Brunt
Rebecca Clarke
Sarah Cotgreave
Li Day
Rena Day
Ray Di Leva
Andy Ellis
Rachael Fouhy
Jackie Hatchwell
Amber Hone
Liping Jiang
Vanessa Johnson
Annette Karepa
Istvan Lengyel
Jil Leong
Rose Anne MacLeod
Lisa Matena
Matthew McKenzie
Iain McLachlan
Stefan Michie
AJ Millward
Ray Mudgway
Samantha Murton
Stephen Nelson
Moira Paewai
Michael Paku
Jane Parker
Richard Patete
Cat Pause
Edwin Perera
Allan Pollard
Stephen Pool
John Shackleton
Christine Shriane
Steve Stuart
Matt Tod

New Associate Members

AUCKLAND

Cori Barkle
Gavin Bennett
Shireen Chetty
Mary-Anne Dehar
Ralph Ellis
Petrina Grib
Tom Hill
Lauren Mackenzie
Monica Mathis
Nicola Mirza
Diego Nievas
Kate O'Brien
Alice Pettigrew
Gabrielle Pritchard
Matt Sommers
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— Royal Commission into Misconduct in the Banking, Superannuation and Financial Services, Final Report, February 2019, pg 400.

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Caught between

There is no reason New Zealand cannot continue to work with both the US and China, despite trade tensions between the two superpowers, says Charles Finny CFIInstD.

AUTHOR
AARON WATSON



The US-China trade war is becoming very risky for New Zealand, says former Kiwi trade negotiator Charles Finny CFIInstD.

“What we are seeing now is an intensification of a trend which was very much apparent in the latter part of the Obama administration,” Finny says.

“Things have intensified under Donald Trump. He is certainly taking things further and more quickly than anyone was anticipating. And he has a unique negotiating style which is basically punch first and start negotiating later. I think the jury is still out on how effective that is going to be.”

As a primary producer, New Zealand should be concerned by the tit-for-tat tariffs on agricultural products that have been introduced by the two superpowers. These have to date mainly impacted producers and consumers in

the home nations, but the US\$16b subsidy announced for US agriculture in May could see further US product displaced and impact global prices.

“That’s going to have flow-on effects to global stockpiles and global prices. China is about to retaliate against the latest increases in tariffs. That will make it more difficult for some US exports to get into China.”

In some product lines, there could be an opportunity - a hole that maybe New Zealand exporters could fill, he says.

“But then where is that US product that was going to go to China going to end up? It is either going to go back into the US and be sold at cheaper prices or it is going to go into other markets. These things tend to be negative and to have a range of direct and indirect effects.”

SYSTEM FAILURE

New Zealand relies on larger countries operating according to international trade rules in order to trade with certainty. But Finny warns the Trump government is no longer operating by World Trade Organization (WTO) rules and notes the US has vetoed the appointment of judges to the WTO Appellate Body.

With the US-China dispute already creating uncertainty in global markets, the June announcement – by Trump tweet – the US would impose tariffs on all goods from Mexico raised fears for global growth.

The automotive industry in particular is concerned at the gradually rising tariffs on goods from Mexico – the country is a hub of automotive production. Trump had previously delayed imposing tariffs on automotive imports to the US to give carmakers time to reduce their exports.



BREXIT

The current uncertainties around the WTO and global trade should give politicians in the UK pause for thought, Finny says.

“The UK is a member of the WTO and if Brexit were to occur then immediately the EU most favoured tariff rate as bound in the WTO would be the rate applying to the UK.

“That’s the same rate that applies to New Zealand at present. There are some in the UK who are saying that if New Zealand and Australia and the US are able to trade so well into the EU then what is the problem with the UK operating on the same basis? But they miss the point that they have actually got a better position now than we have. We are trying hard to get a free trade agreement with the EU to improve our market access.

“I think they are talking about falling back onto WTO commitments [in the event of a hard Brexit]. I would be recommending that they negotiate a free trade agreement with the EU as quickly as possible. Of course they are not able to do that right now because they have not Brexited.”

“He is talking about voluntary export restraints, which are not legal in terms of the WTO,” says Finny.

“It doesn’t look like the Japanese or the EU are particularly happy about what he is proposing. If he was in six months to impose major tariffs on automobiles as he has on steel and China then expect a major retaliation by the EU and perhaps some others.

“If this keeps going the way it is going. It could have an impact on global growth. It could get bad.”

NEW PARTNERSHIPS

For New Zealand, bilateral and multilateral free trade agreements are likely to provide more certainty than the current WTO order in the near future.

Finny says the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP – formerly known as the TPP) is an example of how we can encourage stability of rules for our exporters and importers. Neither the US or China is currently a member of the CPTPP.

“It’s early days but we do have new access opportunities that are exporters are taking advantage of into Japan, into Canada and into Mexico. That is a very good thing.

“Longer term I expect the CPTPP to expand and as part of that expansion you will get a bigger benefit not just in terms of market access but through the certainty that a large number of our trading partners are acting according to the same rules. With the WTO system under real pressure, under threat, from another set of Trump’s actions it is good that we have so much of our trade covered under the CPTPP.”

“There is a wider concern, and I think we see this most obviously in the technology space, that the US is trying to decouple the Chinese economy from the global supply chain and potentially create a parallel China-focused supply chain.”



“New Zealand relies on larger countries operating according to international trade rules in order to trade with certainty. But Finny warns the Trump government is no longer operating by World Trade Organization (WTO) rules...”

STRATEGY

Boards need to be vigilant and monitor geopolitical activities on trade very closely at this time, Finny says.

“Get your management teams to do that and, where necessary, buy in external advice. If you are looking at a particular market I would look very closely at risks the current environment might pose. You wouldn’t want to enter a market if there was enormous risk – or you should try to mitigate that risk.”

He also suggests companies seek to diversify their markets to reduce the risk of a trade shock.

“Many of us can recall what happened when New Zealand was too dependent on a particular market [the UK] in the 1960s and early 1970s and how long it took us to get out of that situation. At companies, that type of discussion needs to be held. I hope it doesn’t mean that companies are less willing to engage in international activity, export activity or investment activity. But this has to be very well considered and they shouldn’t rush into anything.”

SUPPLY CHAINS

Board should consider how an increasing global focus on eliminating slavery could impact their supply chains and there are local companies setting good examples of how to manage this risk, Finny says.

“There is a team of people at The Warehouse, for example, who focus just on that issue and make sure that there is real integrity around the products they are importing. I think other New Zealand companies should be investing in a similar way.”

Importers may be able to take advantage of the US-China dispute if they keep are quick, he says.

“It may well be that some of the displaced product is product we would like to buy, and it may be available at cheaper prices. Companies need to be vigilant and seize those opportunities when they emerge.”

But such short-term gains are less important to a trade strategy than the long-term risks and uncertainties arising across supply chains from the flow-on effects of ongoing US-China tensions.

“There is a wider concern, and I think we see this most obviously in the technology space, that the US is trying to decouple the Chinese economy from the global supply chain and potentially create a parallel China-focused supply chain.

“I think that will have major implications for all economies. Particularly New Zealand, which is an FTA (free trade agreement) partner with China. Companies need to get their heads around what this might mean for them and how they should react. I am not sure we are there yet, but there is a risk there that companies should be monitoring.

“If you are a company with an international focus, whether that be import or export, you really need to have a rigorous risk process running as a board.”

CAUGHT BETWEEN TWO POWERS

New Zealand seems to have got its relationship with China back on track after a bumpy patch earlier in 2019, Finny says. And at official levels the relationship between the New Zealand and US remains strong. So he does not see a conflict between our US and China relationships.

“I don’t see why New Zealand can’t keep walking that tightrope,” he says.

“In both cases it is very important to try to not just have a good trading relationship but to have a relationship as close as possible. Which is a bit challenging right now given the nature of the current US administration. I hope New Zealand officials are working as closely as possible to maintain the relationship, and it seems they are.” **b**

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Agri-food trade: the power of relationships

There are signs that the rules-based international trading system the New Zealand economy relies on is under threat.



AUTHOR
IAN PROUDFOOT
 KPMG GLOBAL HEAD OF AGRIBUSINESS
 IPROUDFOOT@KPMG.CO.NZ

New Zealand is unique as a developed nation – we generate over 70% of our tradeable export earnings from the food, fibre and timber products that we grow and sell to the world.

Despite biological products being expected to account for a record \$45b of export revenues in 2019, there are signs that the rules-based trading system New Zealand companies have relied on for decades is coming under increasing threat.

Governors of agri-food companies can no longer afford to be passive on trade, delegating much to the government, they need to take proactive steps to secure long-term positions.

The reality we are faced with is that trade is often seen as a contributor to the increased inequality between the haves and have nots that societies, including our own, are recognising and struggling to address. Trade is being seen as a mechanism that has resulted in the export of jobs and wealth and provided little to the majority of the population in return.

Farmers around the world have always appealed to their governments for protections from imports through tariffs, phytosanitary requirements and other non-tariff barriers. These calls are growing louder as concerns in the wider population become more apparent.

With trade wars breaking out between many of our major trading partners, now is the time for directors to be more active in understanding the trade strategies that their organisations have developed.

POLITICS, TARIFFS AND FAIRNESS

We would expect agri-food organisations to have identified market access and trade in their enterprise risk management exercises. And we believe that the likelihood of issues arising, and the assessment of their impact, is likely to have increased over the last year.

Given our agri-food industries have the capability to produce far more than we can eat, trade will always be central to the success of the industry.

Negotiating market access for agricultural and horticulture products remains a government to government activity. However, we would expect organisations to be engaging proactively with the Ministry for Primary Industries (MPI) to stay informed about changes in regulation (which can quite literally change overnight in the current environment) and to ensure that MPI always has all the information that it needs to keep its government counterparties informed to avoid surprises.

Any supply chain glitch could shut a market, making it critical that organisations view the government as a key collaborator in their export strategy.

Successive New Zealand governments, including the current Government, have done a massive amount of work securing free-trade access to many markets around the world and protecting the position of our exporters. As a small trading nation, we account for less than

0.5% of all agricultural products traded across borders, we have relied heavily on every country playing by the rules of the global trading system to secure access. We have played fair, opening our borders to imports and have expected countries around the world to offer similar access to our products, but we have done little to demonstrate that trading with us is mutually beneficial to the countries we are selling to.

In a world where trade is increasingly seen as a problem, as it has not been mutually beneficial, our historic approach to markets needs to evolve.

Organisations need to recognise that gaining access to a market will no longer be assessed solely on economic benefit. A wider assessment of the impacts of two-way trade will occur, which will undoubtedly encompass social and environmental benefits.

We believe securing access for biological products will become more challenging unless companies have invested ahead of the free-trade discussions in demonstrating their long term commitment to mutually beneficial trade.

APPLES TO INDIA

A good example of this is the apple sector's current initiative in India. The Indian market presents a massive opportunity for New Zealand agri-food exporters but it has been one that successive governments have failed to make any real progress in securing access to, in part due to the influence that farmer lobby groups have in Indian state and national politics.

The New Zealand apple industry has recognised the opportunity and the associated challenge and is proactively investing in helping Indian growers to improve their orchard practices and produce a better, more valuable crop.

This type of investment demonstrates our industry is not seeking to replace domestic growers but that they want to build mutually beneficial partnerships that will be more valuable to everybody, should the import of our products be permitted. The apple sector is leading the way in recognising that securing market access is too important to be left to solely to the government.

MUTUALLY BENEFICIAL TRADE

Mutually beneficial trade relies on strong relationships being developed with the customers and consumers of products. Historically, we have traded with intermediaries and distributors and not invested heavily in developing close relationships with the end user or consumer. In a more volatile trading environment, we believe that it is more important than ever to have on-the-ground representation in market to build deeper relationships and capture key market insights that can inform product development.

It is difficult to demonstrate the two-way benefits of trade if the sale is being made remotely from a desk in Palmerston North or Timaru. It is also difficult to do anything more than sell on price when trade is done remotely.

The benefits of embedding people in market are becoming increasingly apparent as more organisations make this investment. The benefits we are observing include companies being able to capture more value for their products through better pricing strategies, improved processing of products across the border and closer engagement with consumers through social media platforms.

Given our agri-food industries have the capability to produce far more than we can eat, trade will always be central to the success of the industry. The reality is that most organisations have historically taken passive positions in relation to trade; it has just happened.

As a result of politics and changes in market dynamics, directors should be ensuring that market access and trade issues are being proactively managed by their executive teams as there are benefits to be gained from doing so and growing risks if the approach remains passive. **🗣️**



The Chinese view of trade

How China sees its trading relationship with the West.

AUTHOR
AARON WATSON



John Pomfret

Don't be fooled by the size difference – New Zealand companies can influence the way Chinese companies do business, says John Pomfret.

An award-winning journalist and former Beijing bureau chief for the *Washington Post*, Pomfret has spent more than 20 years observing and writing about the evolving relationship between China and the West. He was a keynote speaker at the IoD's BeyondNow19 conference this year.

"I think it's important for any New Zealand company, as it engages with China, to be mindful of the values that you have and that the values that you have in New Zealand are exportable," he says.

This is because Chinese companies tend to see Western corporations as role models.

"I think that the Chinese look to Western companies to really be the gold standard for behaviour in their country. It's important to maintain your values when you do business in China because, if you don't and if you begin to kind of cut corners and to do things the Chinese way etc, you put yourself on a trajectory of a real reputational risk. That could ruin your brand overseas and ruin your brand in China as well."

UNDERSTAND YOUR BUSINESS PARTNER

Directors need to take time to learn about the culture and political goals of our largest trading partner in order to assess the risks and benefits that doing business with Chinese companies can bring.

"You have to have a deep understanding not simply of Chinese culture but also of the challenges faced in China and Chinese potential goals," says Pomfret.

"I think there are significantly important conversations to be had along values issues. That's important for New Zealand society as there is more Chinese investment coming into your country. There are values issues that are different between the two societies. The Chinese have to understand as they come here – they should be welcomed – that they have to do business practices according to the law here."

Labour exploitation is one example of perspective difference between China and the West that has already harmed the reputation of Western companies, he says.

For directors, it's not good enough to simply say, "well this is a cultural difference and we just have to embrace it".

"When you begin to kind of cut the legs out from under that you actually cut the legs out of your company and your potential ability to compete in the Chinese market." ❧

CHINESE BOARD GAMES

Directors who are approached to sit on the board of a Chinese-controlled company should weigh the risks carefully.

“The Chinese government clearly has a policy of what is known as lead capture. They’ve done it in the United States – Henry Kissinger would be an example. They’ve done it in New Zealand where a former prime minister of yours was involved in a Chinese corporate situation. We also had a former prime minister in Australia, a former prime minister of the UK in addition to other government leaders from Europe as well.”

“When you’re dealing with major state-owned companies in China, in addition to the board you also have the party committee and the party committee is actually extremely important.”

Potential directors should do their homework on the political – and economic – pressures they may face should they take a seat at the board table.

“What is the relationship between the communist party committee in these big state-owned companies and the board? I think it’s an important thing for any prominent Kiwi, Aussie or American to be interested in.”

On the flipside, bringing Chinese expertise onto a Kiwi board is also something that should be approached with caution, he says.

“What happens when Chinese directors start to join boards of Western companies – specifically as part of a programme that the Western company might have to increase their profile in China?”

“I think that in taking those steps, which are going to be natural because China is a big country and it has a lot of important people, and they should be on our boards, but in taking those steps there has to be an understanding in these firms of the reputational risk of embracing the way of Chinese business.”



GEOPOLITICS AND TRADE

“If you’re looking for a significant potential medium-term geopolitical risk you have to look at what’s going to happen with the future of China’s leadership,” says Pomfret.

“The activities of President Xi Jinping last year in declaring himself president for life, in my opinion, have set his country on a trajectory towards real, significant political instability once he begins to get old.”

“I think, really, all bets are off in the next succession to become the next leader of the Communist Party.”

The Chinese believe trade is a critical part of their economic development. But they like what Pomfret describes as “managed” trading relationships.

“You have to a deep understanding not simply of Chinese culture but also of the challenges faced in China and Chinese potential goals”

“They want to protect their economy, protect industries in their economy, so they don’t embrace free trade per se.”

“They want to be able to replace that product with a Chinese-made product. If they can’t, they also seek to own the whole supply chain of that product overseas. So you see a massive amount of Chinese investments in the oil industry across the globe as part of, sort of, a Chinese gambit to be able to control those supplies of oil which are so critical to the functioning of China’s economy.”

This has implications for New Zealand’s dairy industry as China is likely to “massively increase” its consumption of milk over the next 10 to 15 years, Pomfret says.

“They will want to guarantee that supply and to have Chinese money overseas making a profit on the Chinese domestic market.”

RISK OF WAR?

As the trade war between the US and China continues to heat up, military tensions also remain high over Chinese claims of sovereignty in the South China Sea. While war appears unlikely, Pomfret says the possibility must be considered.

“I think there’s always going to be a risk of war just because people can do stupid things and we can have dumb leadership.”

In order to understand why the Chinese might risk war, it pays to understand the strategic situation that has led it to building up small islands with reclaimed land in the South China Sea.

“One of the reasons why they’ve created these islands out of nothing is strategic. If you look at the coast of China, it is boxed in tight. The Japanese, there’s Taiwan, the Philippines... they all basically form kind of a barrier to China’s access into the western Pacific. So the Chinese, I think justifiably, have a sense of being trapped.”

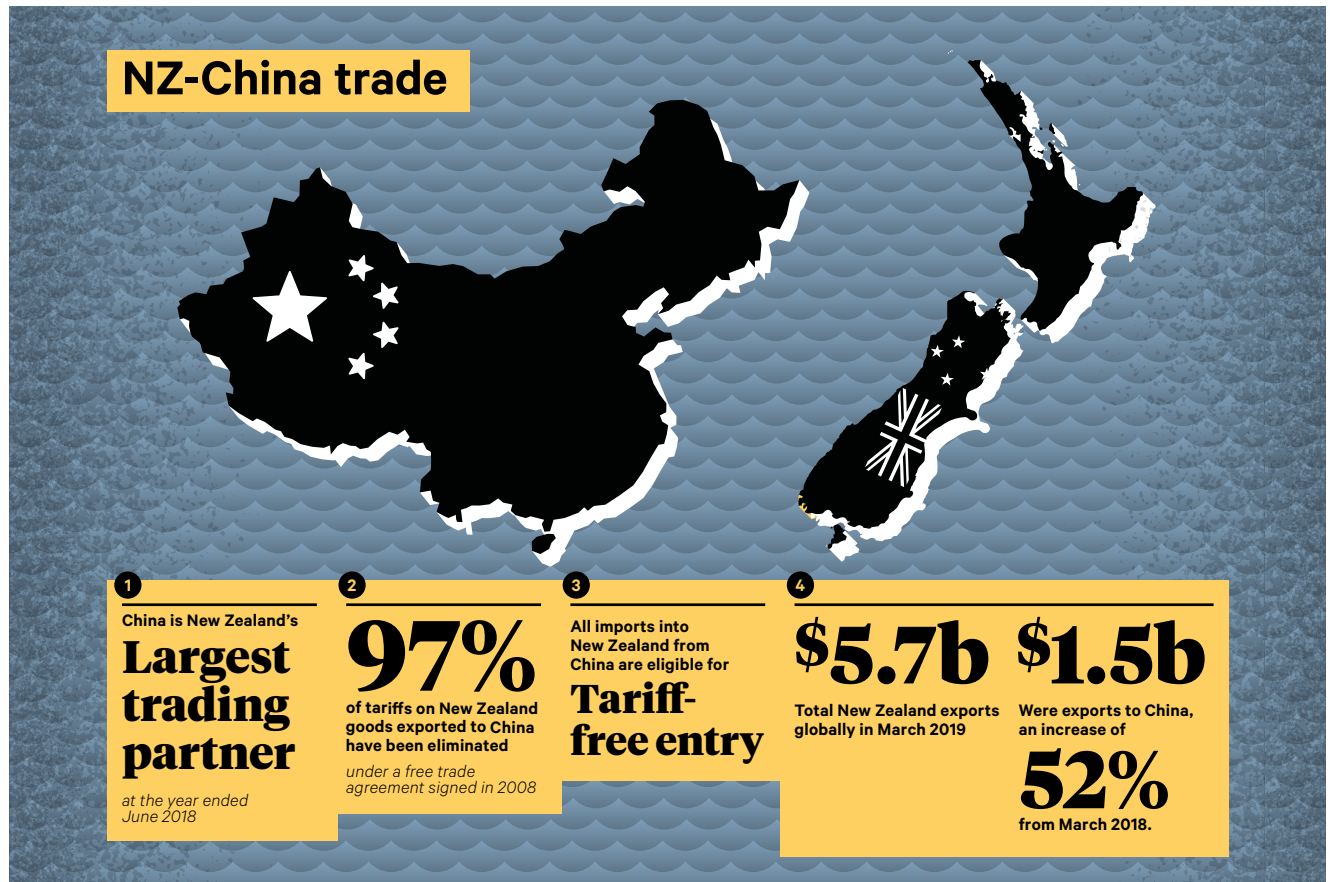
This barrier of Western-friendly states poses a problem for China’s nuclear deterrence policy, he says.

“They have nuclear missiles on submarines that need to get out into the open ocean so that China can have a legitimate deterrent.”

And that area in the South China Sea is a natural trench that could allow China to move its submarines out in relative safety.

“The Chinese look at this as an important part of the strategic architecture in order to be able to have a second strike capability on the United States should madness erupt, right? We see China making a land grab and it’s taking over etc, but there are strategic reasons for them to do it. That’s not to justify their behaviour, but it’s saying we need to understand.”





A HISTORY OF ATTITUDES

When a British trade mission in 1792 sought greater access to the Chinese market, the Qing Dynasty Emperor Quinlong was clear in his view: “Our Celestial Empire possesses all things in prolific abundance and lacks no product within its borders. There is therefore no need to import the manufactures of outside barbarians in exchange for our own produce.”

“That’s been considered illustrative of the fact that the Chinese did not like trade,” says Pomfret.

“I think there’s a somewhat of a misconception in the West about the early Chinese views of trade,” he says, noting that trade provided a key portion of the Emperor’s revenue and the Chinese had an enormous trade surplus into the late 1700s.

“We Americans brought massive quantities of Mexican silver to the Chinese to trade for tea – of course the Boston Tea Party involved tea from Xiamen.”

In order to balance their trade deficit, the British shipped opium into southern China against the decrees of the Chinese palace. When Chinese authorities seized contraband opium in 1839, the British resorted to gunboat diplomacy. The Royal Navy shelled Chinese ports into submission in the first of two conflicts known as the Opium Wars. And the British opium smuggling was resumed.

“That was a way for the British to begin to right the balance of trade to be able to get more silver out of China than they would actually send into China. The Americans cottoned on to the British scheme as well – the British moved in about three-quarters of the opium and the Americans about a quarter.

“At that point the Chinese view of the trade became an opposition to, openly, smuggling opium. So it’s a natural evolution to a view of trade not as a profitable enterprise but as something that could basically rot out the core of their society.

“So China’s view of trade has been closely associated with the drug trade and closely associated, obviously, with Western imperialism in China.”

China’s current communist government has faced opposition from Western governments afraid of emboldening communist or socialist movements in their own countries. But over the past 50 years trading relationships have strengthened.

Japan became a major trading partner in the 1960s and Hong Kong served as a transit port for Chinese goods to the world. It was not until the late 1970s, after the death of Mao, that China began to emerge as a global trading behemoth, with its international trade growing between 10% and 27% per annum from 1981-2008 (according to the World Trade Organization).

It is now New Zealand’s largest trading partner and our exports to China reached \$1.5b in March 2019 (a 52% increase from March 2018). **b**



AI for traders

AUTHOR
AARON WATSON

Artificial intelligence (AI) is touted to help global traders manage risk, predict future consumer demand and coordinate dispersed manufacturing and distribution operations. But it can also harm people.



Dr Ayesha Khanna
CEO, ADDO AI

Artificial intelligence (AI) can boost trade through unexpected means.

A 2018 study “Does Machine Translation Affect International Trade? Evidence from a Large Digital Platform” found AI-driven translation services had boosted exports from the US to Latin America via eBay by 17.5%. Not by crunching big market data or predicting future trends. Simply through translation services.

What could that mean for a small English-speaking country like New Zealand when it is trying to sell into Asian markets?

Dr Ayesha Khanna is the CEO of ADDO AI, an artificial intelligence solutions firm based in Singapore. In 2017, ADDO AI was named by *Forbes* magazine as one of four AI companies that could change the world.

She says modern businesses need to appoint a chief AI officer – alongside their

chief technology officer and/or chief data officer – if they wish to take advantage of the myriad business opportunities that AI can offer.

“Yes, I really believe AI is that kind of technology,” Khanna says. “We must have a chief AI officer.”

The eBay experience with AI translation services offers an example of how this technology can be applied to business operations in profitable ways – if it is understood by people who also know the business. Leaders need to see AI as more than a data-crunching tool and see it as a way to find solutions.

“I would just encourage everyone not to treat AI as a black box, not to treat it as something that only AI engineers, such as myself, know. Empower yourself to learn some basics so that you can both leverage it for its innovative power, but also probe it for any biases and manipulation.”

Intelligent machines

At the present time, Khanna says, AI is primarily used to manage routine tasks quickly.

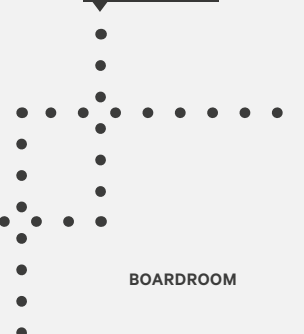
“It can do that much faster than any human can – it can go through hundreds and millions of data points and no human or group of humans is capable of that.”

AI is not currently capable of being strategic or of having empathy. That may change as the technology becomes ever more powerful.

“In the long run, as it becomes more cognitively enhanced, it may be a partner to us and then comes a danger. It won’t be like a human but it will have intelligence. If behind that intelligence we have people who are malevolent or have malevolent intentions then we need to be very careful.”



“I would just encourage everyone not to treat AI as a black box, not to treat it as something that only AI engineers, such as myself, know. Empower yourself to learn some basics so that you can both leverage it for its innovative power, but also probe it for any biases and manipulation.”



THE DARK SIDE

Her last point about bias and manipulation is a natural one for AI experts. AI is only as neutral as it is programmed to be. It can be programmed with human-like biases to discriminate against sections of society. It can even give the appearance of being alive to mislead real humans for fraudulent purposes.

Just consider, the same technology that is being used for predictive maintenance in manufacturing processes is also capable of analysing text to create fake news or robo-journalism.

“The intersection of human beings and artificial intelligence is something that we need to think about,” Khanna says. “The technology must be regulated to avoid negative externalities. The same technology that is used for early diagnosis of cancer can be used to give you the right information at the right time. But the same technology can also be used to discriminate against you.”

She advocates that strong governance frameworks should be developed – both in organisations and internationally.

“Singapore has a framework for ethical

governance of artificial intelligence which, I think provides business stakeholders and technical stakeholders a roadmap on how to ethically review what is right and what is wrong.

“One of the things we can do is coordinate better between countries and states, have regional standards and more sharing of information about bad actors. Another thing is much more awareness and education of everyone about recognising bias about securing yourself against cyber hacking.

ETHICAL RULES FOR CUSTOMER DATA

Personalisation is one of AI's great triumphs. By analysing data, it can allow customers to get the most relevant information at the right time that they need it. At least that's the vision for it.

“By understanding what our customers preferences may be, or what like-minded people like him or her prefer to have, then a customer can get information that is very specific to them. For example we see that in Amazon a lot of personalisation is used constantly to recommend other books that you may like,” Khanna says.

Personalisation can also be used by governments to provide services to their citizens. In theory, this could cut down on red tape.

“But what are the privacy implications of capturing somebody's personal preferences, somebody's personal data, and then perhaps using it for purposes other than it was originally captured? I think there are privacy implications to this.”


Khanna says businesses must ensure they are fully authorised by their customers to use personal data.

“I don't mean some very complicated license agreement that we as human beings tend to say ‘yes’ to out of convenience. We should try to really make it simple for people to understand.”

She also believes that people have a right to know what data is associated with them.

“All of this data should be accessible to the customer. Oftentimes this is not that easy to do.

“And we [the customer] should be able to delete all our data, as well. Finally, we should have control of whether this data is sold to other people.

“We need governance and regulation around that.” 



Getting to **page 2**
of **The CEO Report** and

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Look outward

New Zealand companies should think about how they can access a global market, says start-up guru Kaila Colbin MInstD, because products that are successful here may also have potential overseas.

Colbin is a co-founder of Boma, a global network that supports business leaders, politicians and educators to understand how to create a human-centred future in our rapidly-changing world.

Technology is an enabler of international trade, she says, and New Zealand businesses are as well-placed to develop products for the global market as anyone else.

“New Zealand is the prototype. It’s the first iteration. It’s the test bed and once we’ve solved it here then we can use that as our testimonial to go to the rest of the world,” she says.

This is particularly true in the tech space, where products and software solutions can be scaled globally.

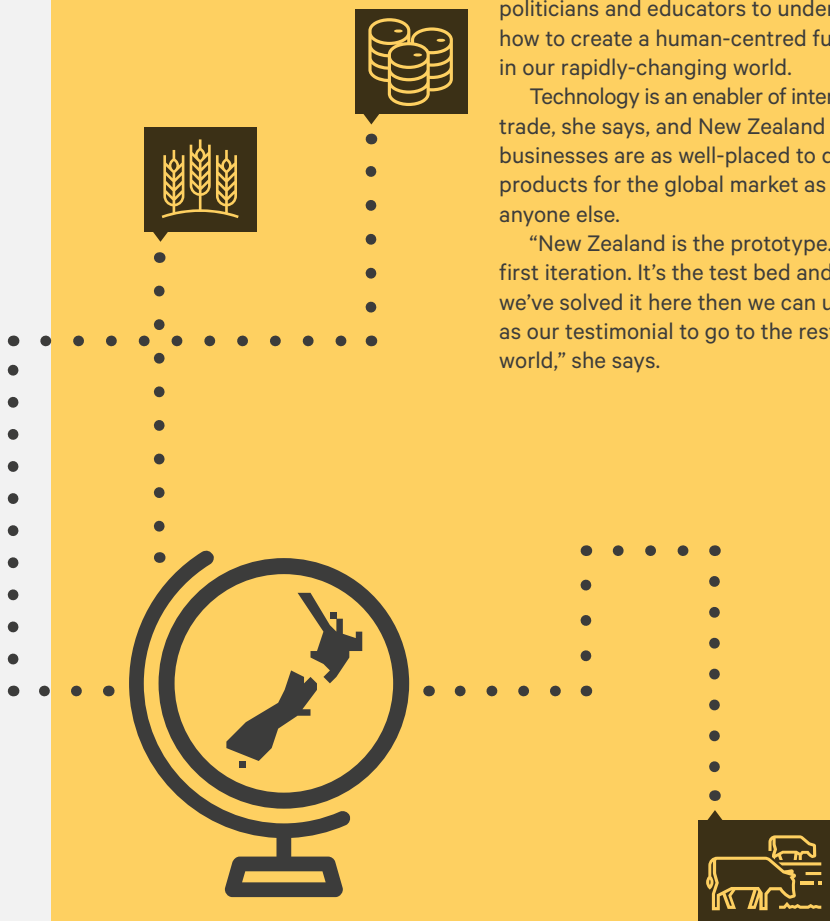
“The Holy Grail that we’re after is businesses that have the potential to scale but that leverage our unique advantages of being in New Zealand. You might start a company that leverages geography or scenery. You might start a company that leverages existing skillsets in terms of graphics and computer graphics. You might start a company that leverages our extensive expertise in the primary sector.

“You wouldn’t start an airplane manufacturing company here because we have no access to the supply chain and none of the skillset necessary to start an airplane manufacturing company.”

The internet offers opportunities to reach Colbin markets in any part of the world, but she warns against developing a reliance on any one of the major technology platforms – Amazon, Facebook, Google, YouTube – that support global trade.

“Be constantly mindful of the fact that your destiny is in someone else’s hands and, as a result, you should be constantly trying to do whatever you can to diversify that risk.”

Where possible, drive traffic to your own platform rather than the platform controlled by somebody else so you start to grow direct connections with your customer base.



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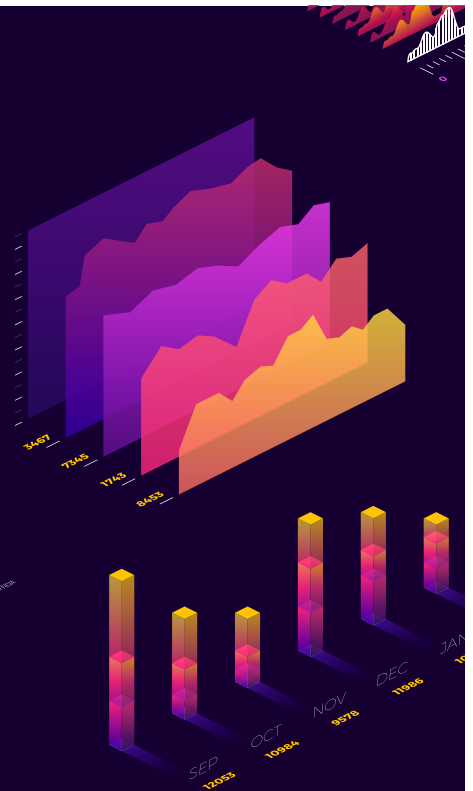
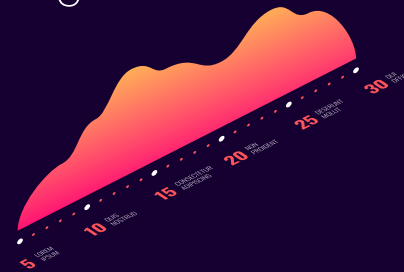


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The digital talent gap

Commodity traders need to make maximising the potential of information advantages their top priority.

Commodity trading margins have fallen by more than 20% from their recent peak in 2015.



Signs of the coming dramatic shakeout that will result from the commodity trading margin squeeze are already at hand.

The most important driver of the shakeout of the industry is trading giants' investments in predictive analytics, which provide them with significant information advantages.

When commodity trading firms as we recognise them today were first established in the 1970s and 1980s, top traders relied primarily on privileged information to outperform their peers. More recently, players have tried to gain an edge by focusing on ways that advanced technologies can improve their efficiency primarily through automation. Large commodity traders once again consider proprietary intelligence critical.

Commodity traders are going back to the future – instead of relying on extensive traditional information networks to gain advantages from proprietary data, traders who are large enough to invest in the sophisticated systems and dedicated teams required to compete are focusing on how to use predictive analytics to draw valuable proprietary insights from common data sources.

DATA SCIENTISTS

Commercially-driven quantitative traders have worked in commodity trading organisations for decades. But to gain a competitive edge, commodity traders increasingly need data scientists in addition to their usual quant teams to transform much more complex and varied digital data feeds into trading strategies.

Commodity traders have to find new ways to attract and keep this new talent in an increasingly digital workplace.

The challenge is that dedicated data scientists are universally in high demand. Generally, these digital data problem solvers prefer to work for prestigious tech giants and high paying hedge funds rather than commodity traders.

So commodity traders need to recalibrate their recruiting strategies to attract data scientists primarily by interesting them in pioneering digital solutions for seemingly impossible complex problems. After that, commodity traders need to make sure there is a steady flow of such challenges to retain their interest.

MONETISING DATA

Commodity traders must also revamp their organisations so that the expertise of their data scientists can be spread broadly.

For example, commodity traders should set up core teams of data scientists in data labs to tackle their toughest challenges and empower them to bring in external talent to supplement when necessary.

However, this team will not be as commercially driven as traders and analysts. As a result, in order to transform theoretical solutions into the practical profits, traders also need a deep “bench” of quants with commodity trading expertise who are fluent in the language and application of data science to partner with and be guided by a core team of data scientists.

These data science-infused quants should be deployed to work on developing or monetising cutting-edge analytics with the data scientists.

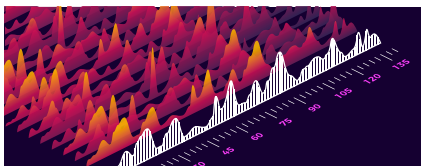
Much like banks, law firms and consultancies recruit and train generalists, traders will hire quants for their raw capabilities and then assign them to the task where they display the greatest aptitude.



CULTURE OF ANALYSIS

The growing importance of these generalist quants will require a cultural shift for trading companies who will need to hire them at an entry level and have their bench become part of the standard rotations of newly hired college graduates.

Members of the core team of data scientists will also have to be moved through different parts of the organisation so that they can interact with the larger group of existing top quantitative analysts and traders.



They can then mentor others who are just starting out on what will eventually become a broader shift for the industry from developing analyses in spreadsheets to working them out in code.

Once this happens, analysts with coding capabilities will be able to abstract and reuse solutions to improve traders' strategies across the board or even move themselves into the front office, trading on the back of their models.

MIXED APPROACH

To compete, commodity producers, national oil companies, large commodity consumers, and mid-sized traders will need to reassess their strengths and invest in them. They will have to be sure to optimise any advantages they have in terms of their access to assets, equity flows, proprietary data, niche trading capabilities or differentiated business models.

Advanced analytics may even enable players with sufficient scale in their niche to strengthen and defend their position. However, to do so, many may need to enter joint ventures or partnerships in order to reach a large enough size to be able to monetise their advantage.

At the same time, these traders will have to continue to lower costs and investigate operating and commercial models that give them an even bigger bang for their buck. That means midsized players must shed noncore businesses, strike alliances to gain access to larger portfolios, and automate back-office functions.

By relying more on robots to conduct basic tasks such as reconciling data and blockchain to manage intercompany paperwork exchanges, some commodity traders have lowered their costs by as much as 30%. But it's clear from the past several years that, like other industries, commodity traders cannot simply cost cut their way to success.

The combination of unprecedented political uncertainty, trade wars and rapidly evolving technologies is making commodity markets almost as unpredictable as they were during the financial crisis. But the chances of repeating the industry's most profitable year to date are remote.

Previously unthinkable digital capabilities will determine who will be the industry's leaders in the long term. **B**

This article is an extract from "Commodity Trading Goes Back to the Future" by Oliver Wyman (a Marsh & McLennan Company). For a full copy of the report please contact Steve Walsh, chief client officer, stephen.walsh@marsh.com

New targets

International franchising to leverage local intellectual property.

AUTHOR
DR CALLUM FLOYD MINSTD
 MANAGING DIRECTOR OF FRANCHISE
 CONSULTANTS AND CHAIR OF THE
 FRANCHISE ASSOCIATION OF NEW ZEALAND

Harcourts, Fastway Couriers, BurgerFuel and Link are all examples of New Zealand-founded companies franchising internationally.

International franchising enables companies like these to efficiently leverage their most valuable assets, like brands, business models, manufacturing facilities, technologies and associated IP assets, in return for upfront franchise fees and a range of ongoing revenue streams (eg royalties, product sales and training fees).

It is an organisational form that has enabled many global companies – like McDonalds, Coca Cola, Snap-on Tools, InterContinental Hotels Group and IKEA – to achieve a level of global penetration, investment returns and sustainability

unobtainable by pure company-owned expansion and management.

For New Zealand companies, it reduces the requirement to invest high levels of resources in expansion by, instead, recruiting international franchise/license partners who provide the capital to establish local operations, are more motivated than employees to succeed, and have important knowledge and networks within their own local markets.

The partners may also need and have, as a prerequisite, a proven track record of achievement with a similar type of business. In turn, those partners are required to operate within strict franchising, brand, business and operational guidelines. The partners are then rewarded by profits from their enterprise and the New Zealand franchisor, importantly, receives ongoing royalties and/or other revenue streams.

STEPS TO THE WORLD

Harnessing the potential of internationalisation is an exciting prospect. Yet it also presents a complex set of decisions and challenges that require addressing in a methodical and structured way.

Upfront early considerations should include an assessment of a company's readiness for international franchising, including available investment and human resources – areas that can often be underestimated.

Similarly, companies benefit from a strong domestic track record and compelling value-proposition.

Overseas consumers are rarely starved for choice, meaning an apparent niche may exist for good reason.



Finally, companies need to temper excitement from any early approaches – such as unsolicited requests from countries (and partners) that would otherwise rank low following a structured assessment.

EVALUATE YOUR TARGET MARKET

Attention then needs to move to evaluating and structuring an international franchising programme for a selected market.

Clearly many other preparations are then needed to market the international franchising opportunity, select and onboard successful franchising partners, and manage the international franchise network.

Here, three key strengths are needed:

Firstly, an appropriate international franchising structure needs to be established for the business and target market.

Secondly, a system for ensuring highly qualified partners are selected.

Thirdly, a strong leadership and management framework to support the development and success of international partners and their operations.

Many international franchising attempts fail to live up to their objectives due to weaknesses in one or more of these fundamental areas.

Feasibility assessment

International franchising can take a multitude of different organisational forms and may or may not prove a priority, or even be viable, based on closer inspection. It is therefore prudent to complete an international franchising feasibility and entry plan for any given market, using experienced advisors.

Such an assessment will consider a huge range of factors, including:



05 Functional role delineation between all relevant potential stakeholders



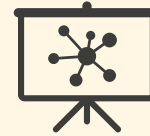
06 Territory planning and performance management



01 Existing company performance, plans, objectives and resourcing



02 The target country market size, including demand and potential units



03 The unit-level business model, including needed variations/adaptations



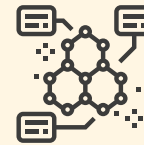
04 Relevant international and domestic forms of franchising expansion



07 Technology and information requirements



08 Required levels of franchising support for the target country and domestic franchisees/units



09 Franchising economic model and fee structure



10 Potential returns for all stakeholders, under different scenarios

Assuming the above yields a positive assessment, a range of other crucial developments are also sensible. Not least, agreements need to be prepared and manuals (and training documentation) written to formalise the franchising and business operating framework governing the international franchising model.

As is so often the case, planning is absolutely key. Overall, a well-planned and structured international franchising and licensing programme has the potential to provide many successful domestic companies with an intelligent and efficient method to leverage returns from the intellectual property associated with their businesses.

Aligned, there are many New Zealand companies that could and should consider the benefits of international franchising, whether they are currently franchised domestically or not. Some New Zealand companies also have international distribution networks that could benefit from a more full-format and professional international franchising approach. **1**

Fraud and corruption risks and laws in an era of trade diversity

The evolution of international anti-corruption laws has put more onus on individuals, including directors.

AUTHOR
JULIE READ
DIRECTOR OF THE SERIOUS FRAUD OFFICE

The world has changed remarkably in the last 50 years and New Zealand, as an export-reliant nation, has had to adjust. The country's economy has been reformed and legislation enacted to enable New Zealand businesses to compete and succeed both locally and internationally.

The United Kingdom was the most important market for this country for much of its history, with almost half of its exports being sent there until

1973 when the UK joined the European Economic Community. New Zealand was forced to change the way it did business, the government liberalised the economy in the 1980s and now, 30 years and two global financial crises later, the country's offshore trading profile looks radically different.

GOOD REPUTATION

One thing that has not changed is the nation's reputation for having low levels

of corruption. Transparency International has consistently ranked New Zealand as one of the least corrupt countries in the world. However, the risks of corruption occurring have increased as more of the nation's companies do business in countries where corruption is widespread and as the face of New Zealand itself changes.

New Zealand has free trade agreements with about 20 countries, most of which are ranked in the bottom two-thirds of the Transparency International Corruption Perceptions Index. The nation's top trading

partner, China, is ranked 87th while two other countries New Zealand has trade deals with, Malaysia and Indonesia, are ranked 61st and 89th respectively.

As this country expands its trade to different parts of the world, it is crucial that our reputation as one of the least corrupt countries is maintained. New Zealand businesses trade on our corruption-free reputation and that reputation brings considerable economic and social benefits to this country.

NEW RULES

In parallel to the trade expansion in recent years, New Zealand has introduced new laws to combat corruption and large-scale fraud. One of the first responses was the *Serious Fraud Act 1990* which established the Serious Fraud Office (SFO) to investigate and prosecute serious or complex fraud.

More recently, the Organised Crime and Anti-Corruption Bill was passed in 2015. In addition to updating New Zealand's legislative framework in this area, its passage also enabled New Zealand to ratify the United Nations Convention against Corruption.

INDIVIDUAL RESPONSIBILITY

Importantly, all New Zealand's bribery and corruption offences now apply to individuals and legal persons. This means that an act of bribery or corruption committed by an employee, agent or other intermediary on behalf of an organisation may result in a prosecution against the individual in their personal capacity, as well as a prosecution against the organisation.

Under the Crimes Act, an "employee" is broadly defined and includes an agent, director or officer of the company. This definition is broad enough to capture the actions of foreign intermediaries even where they take place entirely outside of New Zealand.

In addition, a business could find itself liable for the actions of those who work for it, but are not directly employed by it.

Further, an organisation's liability is dependent on an employee engaging in conduct that amounts to foreign bribery, but it is irrelevant whether an individual

has been convicted or even charged with this offence.

ENSURING COMPLIANCE

All bribery and corruption offences under the Crimes Act apply both domestically and extraterritorially. This means New Zealand citizens residents, and entities incorporated here can be prosecuted for acts of bribery and corruption that occur wholly outside of the country, including when the bribe is paid through a foreign intermediary.

The Ministry of Justice has issued guidelines for corporations seeking to manage corruption risk, based on best practice in overseas jurisdictions (available at justice.govt.nz). They are intended to encourage and assist New Zealand businesses to establish, implement, monitor and improve their anti-corruption compliance procedures.

Courts can impose a fine of up to \$5 million, or three times the value of any commercial gain (whichever is greater), and/or a term of imprisonment of up to seven years, where a person is found to have bribed a foreign public official.

The legislation does recognise that

towards preventing the occurrence of corruption in the first place.

GLOBAL JURISDICTION

New Zealand businesses, particularly those operating abroad, need to be aware of the overlapping laws that may apply to their operations. In addition to New Zealand legislation, businesses should familiarise themselves with the laws of the jurisdictions in which they operate, and any applicable 'long-arm' laws, such as the United States Foreign Corrupt Practices Act 1977 and the United Kingdom Bribery Act 2010.

In New Zealand, the government established an Anti-Corruption Work Programme (ACWP) in mid-2018, which is being led by the SFO and Ministry of Justice. The ACWP has two goals in mind: to coordinate engagement on fraud and corruption vulnerabilities, and to and support proactive and consistent actions by the public, private and not-for-profit sectors of the economy.

Taking this approach is strengthening our shared understanding of the vulnerabilities we face in relation to corruption, both here and for

“As this country expands its trade to different parts of the world, it is crucial that our reputation as one of the least corrupt countries is maintained.”

even the most robust anti-corruption compliance programme is not going to be capable of completely eliminating corrupt conduct, and that there will always be a risk that a well-run business is afflicted by the one-off actions of a rogue employee.

To take that into account, if a company can show that it has taken "reasonable steps" to prevent the commission of the offence, it may have a defence. The onus is on the company to raise and establish this defence.

Of course, any assessment of what is reasonable will be judged on the individual circumstances of each case, and implementing the guidelines in the Ministry of Justice best-practice guide is likely to support a "reasonable steps" defence being advanced. More importantly, it should go a long way

New Zealanders working in, or with, businesses overseas. By building our understanding, we will be able to focus on reducing those vulnerabilities. **b**



You can't manage what you don't know about

Whistleblowers are a board's best source of information on hidden conduct or non-financial risks.

AUTHOR
AARON WATSON

“There’s no way a director can be on top of everything that’s happening in every corner of the organisation. So what they need to rely on is very good information flow.”



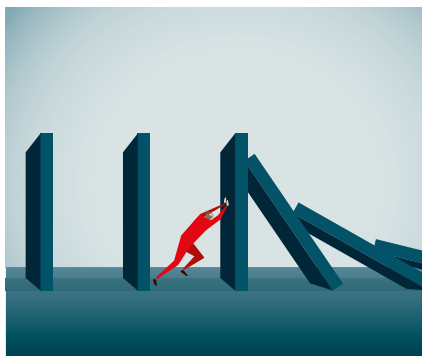
The best chance directors have of identifying and addressing conduct risk and non-financial risk in their organisation is when someone points it out, says Dennis Gentilin, specialist director, assurance and advisory with Deloitte Australia.

Gentilin was a whistleblower in a foreign exchange trading scandal at the NAB in 2004. The subsequent investigation led to convictions and prison sentences. He has since become a respected adviser and author on ethical issues, and an honorary fellow of the Centre for Ethical Leadership.

Dennis Gentilin
Specialist Director – Assurance and Advisory,
Deloitte Australia

Speaking to BoardRoom during the IoD's BeyondNow 2019 conference, Gentilin said that people will take great pains to hide misconduct, which therefore can seldom be identified through regular reports to the board.

“You rely on someone pointing a finger over where the issue is and saying, ‘we’ve got a problem here that needs to be addressed’. If you don’t rely on that then there are not many ways you can actually address potential conduct risk or non-financial risk issues,” Gentilin says. ☞



Human nature

When it comes to managing conduct and non-financial risk, directors need to understand more than just their legal responsibilities, Gentilin says.

“You need to supplement your reading in areas like behavioural economics and evolutionary psychology to really understand the human condition. The majority of us, although we like to think we’re good people, if you put us in situations where there are those social pressures, and there appears to be whether explicit or implicit endorsement for bad behaviour by leaders, we too can be seduced and behave in our own unethical ways.”

The board should understand and model the organisation’s purpose, its values and its principles.

“That is, what are the standards of behaviour it is going to hold itself accountable to as it pursues its purpose, which should be more than just making money.

“The board needs to think about how to create a system within the organisation that promotes behaviours that elevate, and are aligned to values and principles. They need to look at both the formal mechanisms of governance and things like the accountability framework, set performance and reward frameworks, and risk management frameworks. They also need to look at the informal systems, things like ethical leadership. Are your leaders displaying the right behaviours?”

“Looking at the board and making sure you’re displaying the right behaviours and then looking at the organisation through the both these formal and informal mechanisms will reduce the likelihood – you’ll never be fool proof – but you’ll reduce the likelihood that you’ll experience some kind of ethical issue.”



THE RIGHT REPORTS

Getting the good information on conduct risk is one of the perennial challenges for boards, he says, especially in large organisations.

“There’s no way a director can be on top of everything that’s happening in every corner of the organisation. So what they need to rely on is very good information flow.”

He recommends that boards review the content and structure of board reports to ensure there is enough information to make sound decisions.

“They need to make sure that it is sufficiently granular for them to get a view into the pockets of the organisation because, in any large organisation, you won’t have a monoculture where everyone feels the same way. There will be different pockets of culture.”

“But, perhaps most importantly, they need to make sure that information flows up through the organisation to the board. There’s a tendency among managers to sugarcoat things, not because they’re bad people but that’s what we do as management. Boards need to be able to see through that and ask the right questions.”

SUPPORTING WHISTLEBLOWERS

An effective whistleblower policy should include a clear mechanism for raising and investigating concerns, and protections for the whistleblower and staff potentially implicated in wrongdoing.

Rules on both sides of the Tasman are changing to provide more protection for employees who blow the whistle.

New Zealand’s Protected Disclosure’s Act is under review, with the government expected to beef up provisions to protect private sector employees who blow the whistle on improper conduct. The IoD has supported the overall intent of the review but warned that some proposals, including that all organisations be required to have internal whistleblowing procedures and to collect information on protected disclosures, could place a disproportionate burden on small- and medium-sized businesses.

In Australia, new regulations that come into force on 1 July require companies to develop an internal whistleblowing policy by the end of 2019.

“That policy should outline how they’re going to protect whistleblowers and keep them anonymous and make sure they don’t experience retaliation,” says Gentilin.



ANONYMITY

“My interest in governance, conduct, ethics and culture came from a very personal career experience where I was publicly named as one of the whistleblowers in a big FX trading scandal,” Gentilin says.

“There’s a tendency among managers to sugarcoat things [...] Boards need to be able to see through that and ask the right questions.”

“Since then, I’ve devoted a lot of my time trying to understand why organisations experience ethical failure and why good people can sometimes behave in unethical ways.”

“We hear a lot about the incidents where it ended poorly for whistle blowers, and our heart goes out to those people because they’re really difficult situations to deal with, but I’d like to think there’s a lot of stories out there where people have raised concerns and they’ve been appropriately dealt with. And that person hasn’t suffered as a consequence of raising concerns.”

One of the core reasons that whistleblowers survive and go on to have a successful career within their organisation is they can remain anonymous, he says.

“It took me a lot, actually, to come out as the whistleblower from the incident at the National Australia Bank. I wanted to

put it behind me. I didn’t want that to be central to who I was. When I decided to author my book [The Origins of Ethical Failures] I realised I’d have to draw on that experience and mention it. That was a big decision for me.”

No one joins an organisation to become a whistleblower, he says.

“And, if you do become one, you just want to put it behind you and get on with your career.” **b**



Fear and futility

Gentilin says the two main reasons people do not raise concerns in an organisation are fear and futility.

“That is, they don’t speak up because they fear there will be consequences associated speaking up or because they feel that doing so will ultimately be futile.”

One of the common themes across all ethical failures, regardless of the industry, is that there are always people who have tried to raise concerns along the way – and for one reason or another they haven’t been listened to.

“In worst-case scenarios they’ve been ostracised and forced to leave the organisation.”



Measuring board capability

More boards than ever before are benchmarking their performance through our board evaluations service.

“Many thanks for your assistance during the board evaluation with our client. We have taken note of the valuable feedback provided in the Analysis Report and we are already in the process of addressing the relevant issues raised, together with working on succession planning for the board.”

TRACY HICKMAN,
STAPLES RODWAY LIMITED

The IoD's board evaluations team had its busiest year to date in 2018.

The team conducted 65 board evaluations with a wide cross-section of organisations from small community-funded trusts to large entities in the public and private sectors. This was up from 51 evaluations in 2017.

“The total reflects heightened interest among directors in ensuring their boards take a professional approach to governance in an increasingly challenging environment, and to improving their capability as a board. Our evaluations measure the confidence a board has in itself – across categories including performance, capability, culture and purpose,” says Cameron McCulloch, the board evaluations service manager.

Capability has been a consistent focus for boards over the past five years and it was again the category in which board expressed the least self-confidence. In 2018, four questions received overall averages indicating significant concerns by many boards. Questions in this section are not just about the current governance capability of the board, but also about ensuring the ongoing capability to ensure the board meets the needs of the organisation.

“We came in feeling strong as a board, yet left with a robust action plan that will really move our governance objectives forward.”

KAILA COLBIN,
DEPUTY CHAIR, CORE EDUCATION

The four capability challenges identified in the evaluations were around:

board succession planning, where 44.24% advised the board had not recently discussed succession planning

board performance shortfalls, where 40.2% did not feel that the board could effectively address performance shortfalls of the board

board performance evaluation, with 38.74% saying their board did not conduct regular evaluations or use the lessons learned to improve board effectiveness

the induction process, where 33.5% felt their board did not have a comprehensive and effective induction process. ▶

The IoD's board evaluations appraise effectiveness in nine categories:

- 1 Role of the board
- 2 Meetings
procedures and practice aspects
- 3 Purpose
– strategy
- 4 Stakeholders
- 5 Conformance
– risk and compliance
- 6 Performance
managing performance of the organisation, ie how the board ensures good performance
- 7 Management and board
like performance, but holding the CEO and management to account
- 8 Culture
boardroom culture, especially around diversity of thought and ensuring good debate to reach sound conclusions
- 9 Capability
does the board have the right make up and what are they doing to ensure it does in the future?

“It’s the most comprehensive and in-depth board evaluation that we have undertaken to date and I’m sure will contribute significantly to our ongoing growth and development as a Trust and for the important work we govern.”

CHARLES FLANAGAN,
CHAIRPERSON OF HAMILTON CHRISTIAN
NIGHTSHELTER TRUST

While there were some differences across individual boards, organisation types and industries, the evaluation team found that the 2018 cohort showed a general trend of having stronger confidence in boardroom culture. There was also improved confidence in the relationship between the board and management, and in understanding of the board’s role. However, 34% of respondents felt that their board did not effectively oversee management succession planning and the development of future leaders in the organisation.

Thirty-five of the 2018 boards identified that the board papers could be improved to ensure more effective meetings. The agenda is the responsibility of the board, so it is important that the board provide input.

Questions regarding health and safety requirements tended to receive high average ratings, but when boards were asked about general requirements (legal, regulatory, constitution and

internal policy), respondents were less confident in their governance practice. Only 55% of respondents felt their board was familiar with the legal, regulatory and constitutional requirements applying specifically to their organisation.

“These evaluations provide a robust, neutral benchmark of a board’s performance and can be a good basis on which to develop a plan for improving board capability and performance,” says McCulloch.

A regular performance evaluation and appraisal of a board is a key feature of best-practice governance. Improving board and director performance adds value to companies and is in the best interests of the organisation and stakeholders. **b**

“We found your independent support helped us focus on our meeting and agenda for future board meetings and secondly to fix on purpose.”

DAVID O’CONNOR,
CHAIR, BDO



Capability:

Board capability is a key measure of a board’s potential effectiveness and has been tracked in three key areas through the Director Sentiment Survey (prepared by the IoD and ASB). In 2018, the Survey found a mixed picture. Health and safety capability was measured at 75%, down 1% from a year earlier but still an improvement from 68% in 2016. Business complexity and risk capability was 57% in 2018, static from a year earlier and up only slightly from 56% in 2016. Digital capability remained a concern with just 33% of boards considering they had the right capability to lead their organisation’s digital future, up from 30% in 2017 but down from 35% in 2016.



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GLC Update



FELICITY CAIRD
GENERAL MANAGER,
GOVERNANCE LEADERSHIP
CENTRE (GLC)

In this update we focus on governance in charities. We have called for a voluntary governance code for charities in our submission to Internal Affairs on its plan to review and modernise the Charities Act 2005.

» An opportunity to raise the standards of governance in charities

Charity and not-for-profit (NFP) governance are of core interest to the IoD, with 51% of our members serving on a NFP. In May, we submitted on the Department of Internal Affairs' discussion document on modernising the Charities Act 2005, the first public consultation on the Act in 14 years.

This review is one of many relevant to the NFP sector (eg trusts, Te Ture Whenua Māori, incorporated societies and education reforms). Reform of the Charities Act should take into account these wider reforms to ensure that there is cohesion across the sector, and NFPs will need to refocus their attention on their governance arrangements.

The review of the Charities Act is limited in scope and some stakeholders in the sector have called for a more comprehensive review to be undertaken by the Law Commission. We supported this in our submission, but we still see the current review as an opportunity to help raise the standards of governance in charities.

» Charities in New Zealand

The Charities Act provides a registration, reporting and monitoring system for over 27,000 charities in New Zealand. Charities spend around \$17b annually, manage \$58b in total assets, and are supported by more than 230,000 volunteers and 180,000 paid staff.

We understand that 3.5% of charities are companies, 25% are subject to the Incorporated Societies Act 1908, 38% are subject to the Charitable Trusts Act 1957, and most of the remaining charities are unincorporated societies and trusts.

New Zealand has significantly more charities per capita than other similar commonwealth countries such as Australia and Canada. This adds to the challenges in the sector around competition for resources, funding and service provision.

Key challenges for charities

A recent Charities Services' survey highlighted the following key challenges for boards and committees (beginning with the biggest challenges):

- obtaining funding
- strategic planning for the future of the charity
- identifying people with the right skill mix to come on boards
- compliance with requirements from government
- managing risk to the charity
- recruiting staff and managing volunteers
- understanding health and safety obligations
- difference between the board's role and management/volunteers
- how to keep and report financial information
- how to run a meeting

» Should New Zealand introduce governance standards?

The Department asked in its consultation whether governance standards would help charities to be more effective and whether the Australian governance standards could be adapted to work in New Zealand.

In Australia, charities must meet core, minimum governance standards that essentially require them to remain charitable, operate lawfully, and to be run in an accountable manner. They are set out in law and are relatively high level. The Australian charities regulator can take action against charities for breaching standards.

New Zealand doesn't have governance standards or a code specifically for charities or not-for-profits and is out of step in this regard with other similar jurisdictions. However, there are several governance codes in New Zealand relevant to NFPs including the FMA's *Corporate Governance in New Zealand: Principles and Guidelines* and the IoD's *Code of Practice for Directors*.

In our submission, we said that there is considerable benefit in introducing governance standards through a specific governance code for the charitable/NFP sector that is fit for purpose and value adding to help raise the standard of governance.

A key challenge will be to balance raising standards without burdening organisations and deterring people from getting involved in leadership.

Rather than having legislative governance standards, we support the establishment of a voluntary governance code. This can provide flexibility and more comprehensive guidance (for instance through principles, recommendations, commentary and examples). It would be important to strongly promote take up of the code and charities that adhere to the code would have the considerable benefits of improved governance including through recognition from stakeholders (eg funders).

As part of assessing what would be most effective in New Zealand, we encouraged the Department to consider the effectiveness of charity/NFP governance standards/codes in similar jurisdictions overseas including the following.

	Governance standards/codes	Status
England and Wales	Charity Governance Code	Voluntary
Scotland	The Scottish Governance Code for the Third Sector	Voluntary
Ireland	Charities Governance Code	Mandatory
South Africa	King IV Report on Corporate Governance for South Africa (this includes a supplement for non-profits) IoDSA	Apply and explain
Australia	ACNC Governance Standards	Mandatory
	Not-For-Profit Governance Principles (AICD)	Voluntary

» Key considerations for a New Zealand code include whether it should:

be solely for charities, or other NFPs and impact/purpose driven organisations and

have differential requirements for large and small organisations (eg as in England and Wales)

A new governance code for charities and/or NFPs may be able to address some other issues highlighted in the discussion document for example, in relation to the accumulation of funds and managing conflicts of interest (which we discuss further in our submission).

» Should there be greater restrictions on who can be officers of charities?

The Department asked whether people with convictions for serious offences (eg serious drug offences, murder, or sexual offences) should also be disqualified from being officers (eg board members). In our submission, we supported the Department looking at options to strengthen who can be officers including disqualifying people who have been banned from governance roles overseas from being officers of charities in New Zealand.

» Is a new 'micro entity' reporting tier needed?

Charities have annual reporting obligations to Charities Services and data shows that many charities are not complying with minimum reporting requirements and especially Tier 4 charities (who must attach performance reports to their annual return).

Some stakeholders have proposed that a new micro-entity reporting tier should be created for charities with \$10,000 or less operating expenditure under which they wouldn't need to comply with the current XRB reporting standards (eg they could just complete a fill-in-the-box financial statement).

There are good reasons for the standard of compliance in the current regime, including the need for transparency and accountability for public funds. However, this needs to be balanced against other factors including the compliance time, cost, capability and risks to the sector. On balance, we thought that there is merit in creating a new reporting tier with simpler reporting requirements for the smallest charities.

We will keep members updated as the review progresses. The IoD's submission is available at iod.org.nz

Ask an expert

In this new “ask an expert” feature we will answer governance questions each issue, with assistance from subject matter experts.

DIRECTORS’ CONFIDENTIALITY OBLIGATIONS AFTER BOARD TERM ENDS

WITH MARK STUART

PARTNER AT MINTERELLISONRUDDWATTS

Directors are privy to confidential company information in their board roles and have obligations to keep this confidential while acting as directors, subject to certain exceptions (see section 4.2.1 of *The Four Pillars of Governance Best Practice* and 3.1 of the IoD’s *Code of Practice for Directors*). In New Zealand, it is not unusual for directors to step down from a board role and soon after that take on another board role in the same industry. They will often have been privy to information in their former board role/s that may be relevant to the new organisation.

Q: What are directors’ ongoing confidentiality obligations in relation to confidentiality/using information gained in their former board role?

The starting point will be the terms of confidentiality as contained in the director’s terms of appointment (if any). The director may also have entered into a separate confidentiality/non-disclosure agreement. It would be usual for these contracts to contain continuing obligations of confidentiality after a director’s board term has ended, though in many cases such contracts are not entered into. If the director was also an employee (eg an executive director), then there may be additional obligations of restraints and confidentiality in his or her employment agreement.

In addition to contractual terms, common law duties may also arise. In particular, former directors should be aware of the duty of confidence. An action for breach of confidence can arise in relation to the unauthorised disclosure, or threatened disclosure, of information which can be considered as having “the necessary quality of confidence about it”. In the context of information held by a director, this would usually extend to information that is considered commercially valuable to the company and that is not otherwise in the public domain. An action for breach of confidence also requires the information to have been shared in circumstances where there

is an obligation of confidence, which will be the case where a director receives information about the company in his or her role as a director.

Former directors also have an obligation not to profit personally from economic opportunities of the company that have arisen from information that was obtained through their role as a director.

Q: What information can directors use from their former role/s?

Directors should consider what confidential information is defined to mean in their terms of appointment and/or confidentiality/non-disclosure agreement, and in the case of executive directors, their employment agreement. These contracts may also specify who owns the intellectual property rights in any company material that the director has contributed to during his or her board term.

From a practical perspective, information that is genuinely secret, confidential, or can be used to compete with, or otherwise damage the interests of, the company concerned is likely to be protected by contract or, failing that, by the duty of confidence. Examples of such information include trade secrets, customer/client lists, marketing plans, formulas or manufacturing processes, business strategies, terms of material contracts and other commercially sensitive information that is specific to the company and that is not otherwise in the public domain.

However, general know-how about a particular industry, how that industry operates, and skills that the director has gained during his or her term on the board are not generally seen as information that is protected, and may be used by the director after his or her term has ended. A key question directors would need to ask themselves is whether the former company would be concerned if the relevant information was made public. If the answer is yes, then it is likely that the information would be protected.

Prior to accepting another appointment in the same industry, a director should ideally discuss with the new company its expectations around what information obtained in the director’s former role he or she would be able to share, so that there are no surprises once the director is appointed. The period of time that has passed since the director left the former company will also be relevant to any assessment of whether the information remains commercially sensitive.

Directors should also consider potential conflicts and the need to abstain themselves from board discussions where they consider that they do hold information about a former company that is relevant to decisions being made by the company.

Out & about



01

Auckland

Peter Bailey, GM of Aura Information Security, talked about how a business can make a smooth transition to the cloud, and how to ensure that remains secure. And a panel facilitated by KPMG's Karl Arndt explored the challenges associated with a digital workforce.



04



05



06



07



09



10



11



02

Auckland

- 01 Jennifer Johnson, Ferne Mansell, Peter Bailey and Rebecca Gadsdon-Green.
- 02 Nalin Wijetilleke and John Journee.
- 03 Lisa Marusich and Cowan Pettigrew.
- 04 George Peacock and Richard Upton.
- 05 Catherine Harland, Gayle Haber, John Haber and Cathy Parker.
- 06 Ben Collingwood, Daryl Webb and David Boshier.
- 07 Louise Ward.
- 08 Jono Soo and Tony Pervan.
- 09 Katie Macdiarmid and Nicola Mitchell.
- 10 Rich Easton and Bronwyn Rhynd.
- 11 Donnamaree Pakinga and Ruwan Wikerama.



08

Out & about

Wellington

Wolfram Hedrich of Marsh & McLennan Insights shared highlights from the World Economic Forum Global Risks Report and how these will impact New Zealand business in 2019.



12

Wellington

- 12 Wolfram Hedrich.
- 13 Samantha Sharif and Shelley Major.
- 14 Dr Helen Anderson.
- 15 Anne Urlwin, Dr Nicki Crauford and IoD President Alan Isaac.



13



14



15

Out & about



Canterbury

Professor Michaela Balzarova, Rhys Boswell and Oliver Hunt reminded directors that they must anticipate a more “sustainable” future, so that their organisations can adapt in time. And the AGM was held in an unusual location – the GCH Aviation Emergency Air Centre.

Canterbury

- 16 Barry Bragg, Peter Bosworth and David Duns.
- 17 Paul Ballantine and Lloyd Mander.
- 18 Geordie Hooft and Michaela Balzarova.
- 19 Dr Caroline Christie receives her Chartered Member certificate.
- 20 Dr Kara Scally-Irvine and Kathryn Ruge.
- 21 Abby Foote and Jane Montgomery.
- 22 Brian Wood and Rhys Boswell.



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June

- 20** New Plymouth
Power breakfast
with Richard Krogh,
Pauline Lockett and
Liana Poutu
- 24** Wellington
Next Generation Director
evening workshop
- 25** North Shore
Next Generation Director
evening workshop

- 26** Christchurch
Directors Deep Dive
lunch with Marsh
- 27** Tauranga
New Members
welcome cocktails

- 3** Dunedin
Lunch event with
Steven Fyfe
- 3** West Auckland
How to Build Your
Board Career

- 23** Tauranga
Intangible Assets – the
most valuable assets
and the biggest risks in
modern companies
- 25** Wellington
New Members Welcome
After 5pm event

July

- 3** Whakatane
Communicate with
Confidence and be
Memorable with
Nicki McClintock

- 8** Auckland
Workshop with Professor
Ingemar Dierickx
- 11** Tauranga
Fellows-Only Dinner
with Margaret Devlin

Branch manager contact details

Auckland
Jill Steffert
P: 027 403 0148
auckland.branch@iod.org.nz

Otago Southland
Philippa Murrell
P: 027 772 2013
otago.branch@iod.org.nz

Bay of Plenty
Laura Gaveika
P: 027 588 8118
bop.branch@iod.org.nz

Taranaki
Theresa Cayley
P: 027 559 5951
taranaki.branch@iod.org.nz

Canterbury
Sharynn Johnson
P: 03 355 6650
F: 03 355 6850
canterbury.branch@iod.org.nz

Waikato
Megan Beveridge
P: 021 358 772
waikato.branch@iod.org.nz

Nelson Marlborough
Karen Goodger
P: 027 525 7400
nelson.branch@iod.org.nz

Wellington
Pauline Prince
P: 021 577 031
wellington.branch@iod.org.nz

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