Director Sentiment Survey

2016

Contents

Survey key findings

Background

This is the third annual Director Sentiment Survey and this year the Institute of Directors (IoD) is delighted to partner with ASB. Each year we take the pulse of the New Zealand director community to identify issues and challenges that matter to IoD members. With three consecutive surveys we are now able to track enduring issues and trends.

The survey was conducted during October 2016 and we achieved our highest response rate yet with 883 responses. The survey provides insight from a broad range of entities about what's top-of-mind for directors on business, economic and governance issues.

This year we included some additional questions on ethics and conduct to better understand board oversight and practices in relation to conduct risk.

Business optimism – strong economy sees labour shortages bite

Confidence among directors surged in 2016, for both the outlook for the economy as well as the outlook for their own businesses. Increased confidence comes on the back of a strong economic performance – one that most directors feel can be sustained or improved. As a result of this economic strength, the labour market has tightened. The effects of this were evident among directors, with almost half seeing a lack of labour capabilities as the biggest risk to their own companies' performance and a risk to New Zealand's economic performance more generally.

Regulatory red tape a barrier

Regulatory red tape was the second-highest concern of respondents in relation to both the economy (33%) and business performance (34%).

Time spent on compliance activities has continued to increase year-on-year for most directors. In 2016, 80% said they were spending more time on compliance related activities in the last 12 months, in 2015 78% said the same thing. Given that only half of directors said that their boards prioritised strategic discussions at every board meeting, some boards may need to think about rebalancing the time spent on performance and conformance matters.

Digital leadership critical in a disruptive world

Technological disruption was the third-highest concern of directors, with 33% seeing this as a risk to their businesses. Nearly half (47%) of directors expect their organisations will be impacted by major or disruptive change within the next two years, consistent with 2015. However, only 35% of boards have the right capability (skills and experience) to lead their organisation's digital future and 28% don't have the right digital capability (37% are unsure/neutral).

Boards should consider developing digital capability to meet their strategic context – to manage risks and maximise opportunities. Directors don't need to be digital experts but they do need a degree of digital literacy so that they can hold management to account – to ask the right questions, and to understand and probe the answers.

Cyber resilience must be a priority

In 2015 we reported that only 27% of boards were regularly discussing cyber risk and were confident about their company's capacity to respond to a cyber-attack or incident. Although this has increased to 32% of boards in 2016 this is still very low and a concern, especially as 29% are not confident and a further 39% are neutral/unsure.

Most businesses use or rely on technology to operate and cyber-security must be considered as part of enterprise-wide risk management. The IoD's *Cyber-Risk Practice Guide* provides a five-principle framework to help boards monitor cyber-risk, develop strategies for seeking assurance and oversee management.

The IoD's 2017 strategy includes a 'digital director' theme to focus a range of activities, such as branch events, courses and governance resources on digital issues, including cyber security, in early 2017.

Ethics and conduct advice to boards needs to improve

Boards have a key role in leading and overseeing ethics and conduct risk, however only 37% of boards receive comprehensive reporting from management about ethical matters and conduct incidents, and the actions taken to address them. The repercussions from bad conduct can be devastating to a business, the emissions scandal at Volkswagen being a prime example. Boards need to ensure that management provide comprehensive and timely advice on ethical matters and conduct risks. Follow through is critical to setting the right tone

Stakeholder interests top of mind

Governance is not just about shareholders but about all stakeholders. The majority of boards (86%) said that stakeholder interests are very important to their business, including almost all (97%) of publicly listed companies. The importance of stakeholder interests is a key global theme in corporate governance as businesses increasingly focus on long-term sustainability, including considering the impact they have on society and the environment. The rise of non-financial reporting such as ESG, the Global Reporting Initiative and Integrated Reporting in New Zealand and overseas are also indicators of this trend.

Extending the parliamentary term?

New Zealand is just one of seven countries with a three year parliamentary term. An overwhelming majority (84%) of directors agreed that extending that term to four years would improve the governance of New Zealand. A four-year term has the potential to promote longer-term thinking and planning among political parties and in the state service. It should mean a smaller proportion of the electoral term is devoted to political campaigning, and more time and energy is devoted to strategic issues and effective governance of the government's resources and activities.

Getting on board with diversity

70% of boards agree diversity is a key consideration in making board appointments – a significant increase from 60% in 2015. Boards are at their best when they are distinguished by diversity of thought and capability. In June 2016 the IoD celebrated five years of the Mentoring for Diversity programme and released a practical five-step guide for boards, *Getting on board with diversity: A guide to getting diverse talent on boards.*

Health and safety leadership

The Health and Safety at Work Act 2015 came into effect on 4 April 2016. The number of boards that say they have the capability to comply with their obligations under the new Act has risen steadily from 51% in 2014 to 60% in 2015 to a high of 68% in 2016. This is a welcome indicator about health and safety leadership in the boardroom.

Summary of survey results

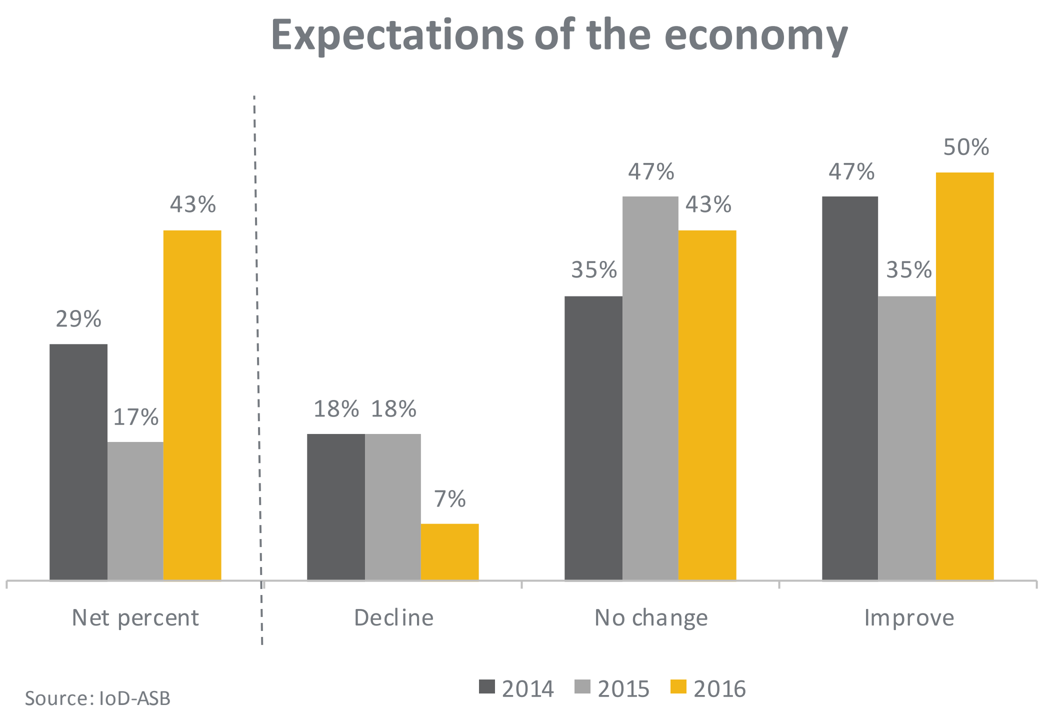
Question 1: How do you expect the performance of the New Zealand economy to trend in the next 12 months?

Directors are more upbeat about the general economic outlook this year. 50% expect New Zealand's economic performance to improve over the next year, 43% expect the economic performance to stay the same, while just 7% expect economic performance to decline.

The survey shows that directors' confidence in the economy improved sharply in 2016, following a fall in confidence the previous year. Indeed, confidence is now at a higher level than in the inaugural 2014 survey. Respondents are fairly split over whether economic performance will improve or trend sideways (50% vs 43%). However, the key take-out is that very few respondents expect a weaker economic performance, at just 7% in 2016 compared to 18% in the 2014 and 2015 surveys.

As a result of reduced pessimism, the net percentage* of respondents expecting improvement lifted strongly to 43% in 2016, compared to a more muted level of optimism in 2014 and 2015 (29% and 17% respectively).

New Zealand economic growth was 2.8% for the year ended June 2016 (compared to the previous year), a pick up in pace. Furthermore, growth performed exceptionally well over the first half of calendar 2016, recording growth of 0.9% per quarter. For directors to expect this momentum to be maintained, or even improve, is a very encouraging result.



The net percentage is a summary measure which subtracts the percent of respondents expecting a decrease from the percent of respondents expect an increase.

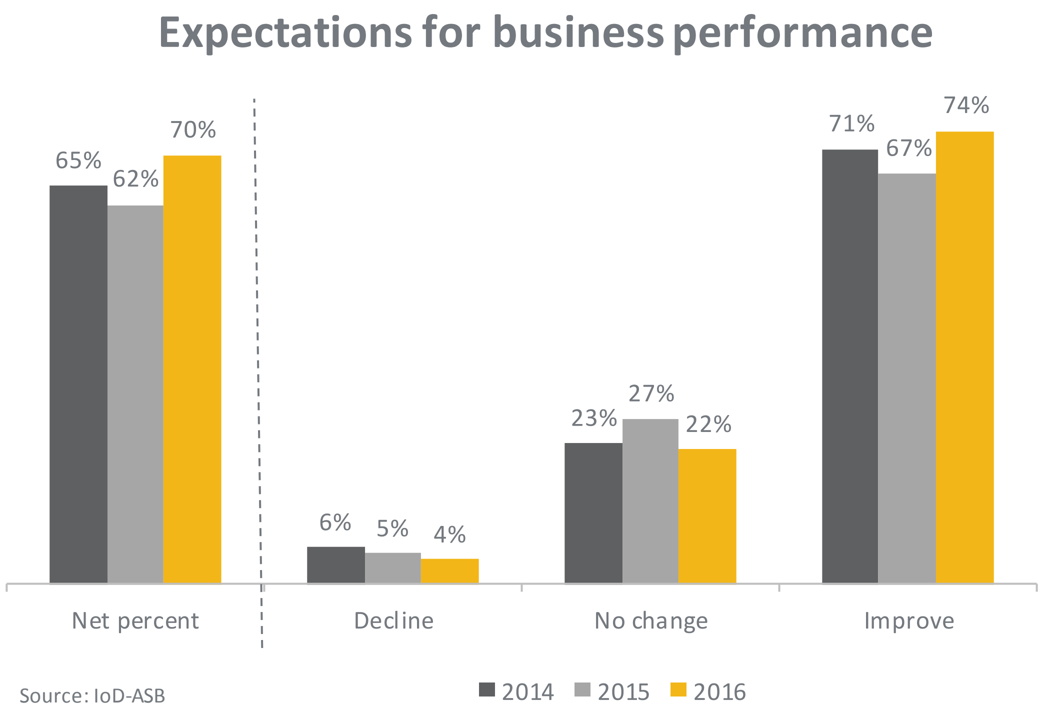
Question 2: How do you expect the performance of your organisation to trend in the next 12 months?

Directors are very upbeat on the outlook for their own organisation with 74% expecting an improved performance and just 22% expecting no change. Very few (4%) expect a decline. Confidence in their own businesses' performance has lifted to its highest since the survey began in 2014 following a dip in performance expectations in 2015.

Reflecting a lift in optimism in 2016, the net percentage* of directors increased to a new high of 70% from 62% and 65% in 2015 and 2014 respectively.

The improvement in business confidence is consistent with other business confidence surveys. Confidence has improved sharply from the second half of 2016. When businesses become more confident in the economy, particularly prospects for their own business, they are more likely to commit to new hires and investment plans.

Directors are generally more optimistic about the future performance of their own companies compared to the general economic outlook. A greater degree of confidence in company business performance relative to that in the broader economy is a usual feature of business surveys and for example can reflect the higher degree of knowledge and control directors have over their own businesses compared to the general economy.



**The net percentage is a summary measure which subtracts the percent of respondents expecting a decrease from the percent of respondents expect an increase.*

Question 3*: What, in your view, are the biggest impediments to national economic performance?

Almost half of respondents (46%) cited labour quality and capability as an impediment to general economic performance. Over the past year, the labour force has tightened significantly and firms have started to note increased difficulties in finding skilled labour.

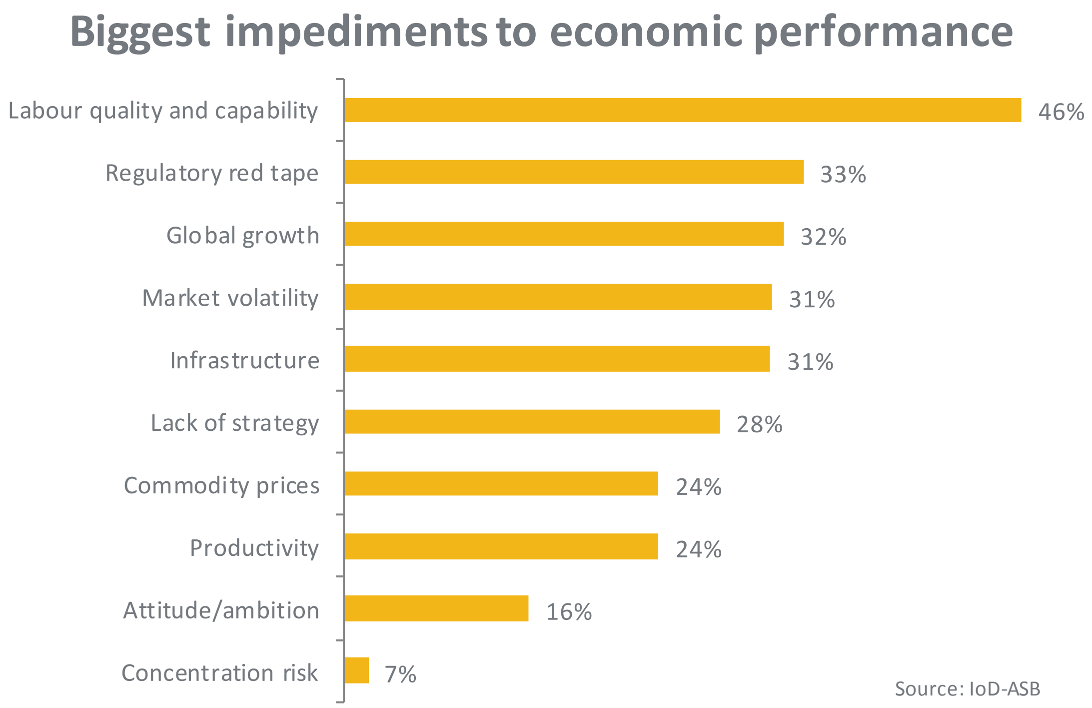
Regulatory red tape has again featured prominently this year, being the second highest concern of directors (33%) with regard to New Zealand's economic performance.

Broader economic concerns included global growth (32%) and market volatility (31%). The global economy remained on uneven footing over 2016. Furthermore, market volatility has increased sharply due to increased global economic uncertainty and a rise in geo-political risks.

Economic capability to grow was medium concern. 31% of directors cited infrastructure as a key constraint to growth while 24% of respondents were concerned about productivity. While New Zealand currently has one of the fastest growth rates in the OECD, historically-low productivity has been a key reason for our relatively weak per-capita growth performance among other developed countries.

Along with infrastructure and productivity concerns, directors were also worried about leadership of the New Zealand economy, with 28% of respondents concerned about lack of strategy and 16% of respondents concerned about lack of ambition.

Only 7% of respondents were concerned about concentration risk. Although dairy incomes have remained depressed, booming construction demand and the surge in non-dairy exports, including tourism and fruit, may have reassured directors that the New Zealand economy has more going for it beyond milking cows. Nonetheless, commodity prices still concerned 24% of respondents.



**In previous years this question was open ended. This year, respondents were asked to select up to 3 of 10 options (derived from issues that opened had been frequently noted in previous surveys), or to select 'other'.*

Question 4*: What, in your view, are the biggest risks facing your organisation?

Labour quality and capability was again the key concern for directors when asked about the biggest risk facing their own organisation (46%). As mentioned above, the labour market has tightened over the past year. Net migration has been strong over the past year, which has helped satiate labour demand to some extent. However, firms may not be finding the right skill mix, as significant parts of the net inflow are either students or New Zealanders returning from Australia.

Regulatory red tape was the second-highest concern, at 34% of respondents. Technological disruption was the third-highest concern of directors, with 33% seeing this as a risk to their own business.

Economic demand also featured highly, with 26% of respondents worried about local growth and 15% concerned about global growth. 23% of respondents selected “demand” more generally as being a key risk for their businesses. Meanwhile, 31% of respondents were worried about competition.

Commodity price concerns featured lower at the individual level, than at the economy-wide level. Just 12% of respondents saw commodity prices as a risk.

Funding and finance was not a significant concern, with just 13% of respondents seeing risks around cost of capital and availability. Interest rates fell over the past year and are likely to remain at low levels by historical standards for some time.

In previous years this question was open ended. This year, respondents were asked to select up to 3 of 10 options (derived from issues that had been frequently noted in previous surveys), or to select ‘other’.

Question 5: Do you agree that extending the parliamentary term from three years to four years would improve New Zealand's governance?

Lengthening the New Zealand parliamentary term from three years to four years has been mooted twice before, in 1967 and 1990, and was significantly rejected in public referendums both times – the shorter term was seen as a way to hold the government to account after the abolition of the Upper House of Parliament in 1950. MMP was voted in by referendum in 1993, which largely broke the pattern of the two-party system and resulted in a broader political party representation in the House.

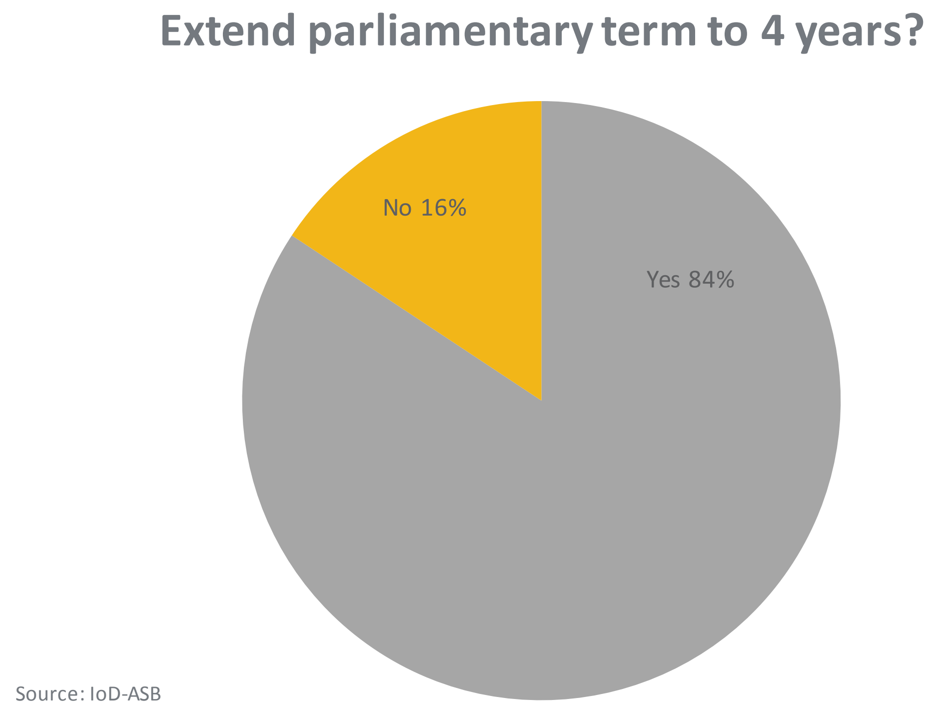
The Inter-Parliamentary Union lists just seven countries with a three-year parliamentary term: New Zealand, Australia (federal parliament, all states have four year terms), Nauru, the Philippines, Mexico, El Salvador and Qatar. Compare that with 91 countries with four-year terms, such as the US and Germany, and 129 countries with five-year terms, including the UK, France and Canada.

Taking a long-term view is at the heart of good governance. Long-term governance strategies underpin sustainable performance and the creation of long-term value.

Considering this in the light of national governance, this year we asked directors about extending the parliamentary term to four years* and an overwhelming 84% responded yes.

A longer term could allow for better governance through more effective parliamentary timetable planning including more certainty for parliamentary inquiries, committees and processes and more effective policy development and decision making.

A four-year term would also mean fewer elections with associated costs savings, including a longer period between elections so less time spent on electioneering, and more time and energy devoted to strategic issues and effective governance of the government's resources and activities.

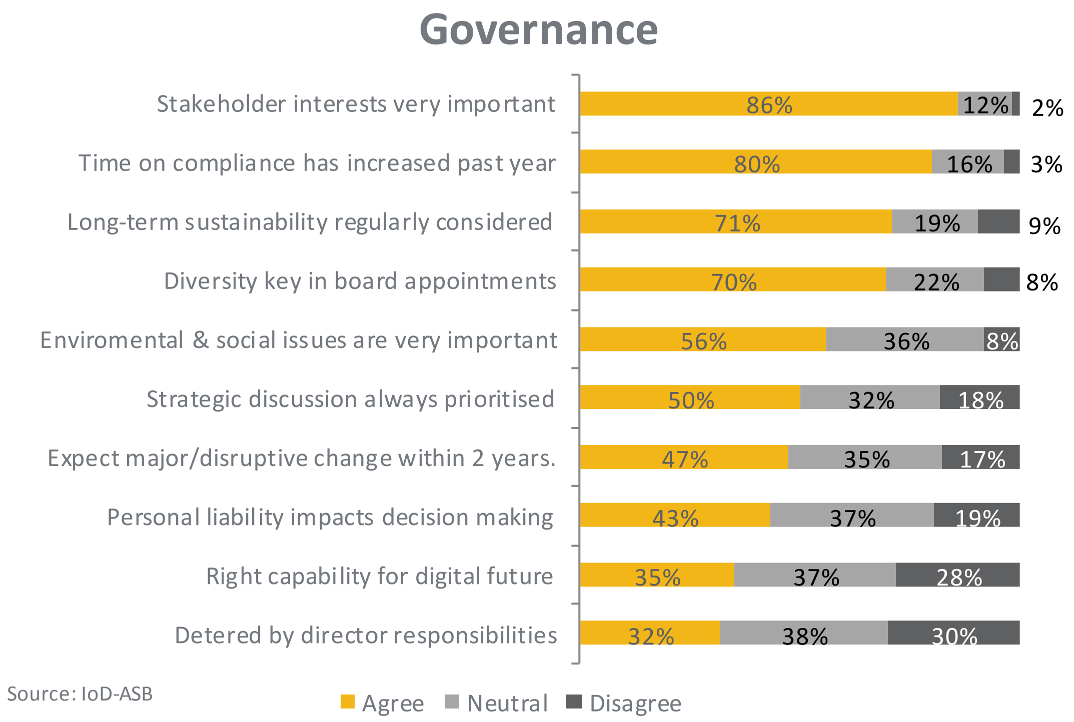


** The question focused solely on extending the parliamentary term and did not address the separate, often related, point of fixed terms of parliament.*

Question 6: Governance issues

Insights from the survey about key governance matters facing directors.

- The majority of boards (86%) consider stakeholder interests are very important to their business, including almost all (97%) of respondents of publicly listed companies. This indicates a strong alignment with global trends as stakeholder interests in corporate governance are attracting increasing attention.
- Over half (56%) of boards consider environmental and social issues are very important to their business – again reflecting global trends and developments in New Zealand, such as in the introduction of ESG commentary in the revised NZX Corporate Governance Code (due to be released in early 2017).
- 71% of boards (79% in 2015) regularly consider the long-term sustainability of their business model. Consistent with 2015, nearly half (47%) of directors expect to be impacted by major or disruptive change within the next two years. However, only 35% of directors said their boards have the right capability to lead their organisation's digital future, 28% don't have the capability and 37% are unsure/neutral. Developing digital literacy and leadership should be a priority for all boards so that they can manage risks and maximise opportunities in a disruptive and digital world.
- Time spent on compliance activities continues to increase year-on-year for most directors. In 2016, 80% said they were spending more time on compliance related activities in the last 12 months and in 2015 78% said the same thing. Given that only half of directors said that their boards prioritised strategic discussions at every board meeting, some boards may need to think about rebalancing the time spent on performance and conformance matters.
- Boards are at their best when they are distinguished by diversity of thought and capability. Diversity is a key consideration in making board appointments for 70% of boards in 2016 – a significant and welcome increase on 60% in 2015.



Question 7: Ethical conduct

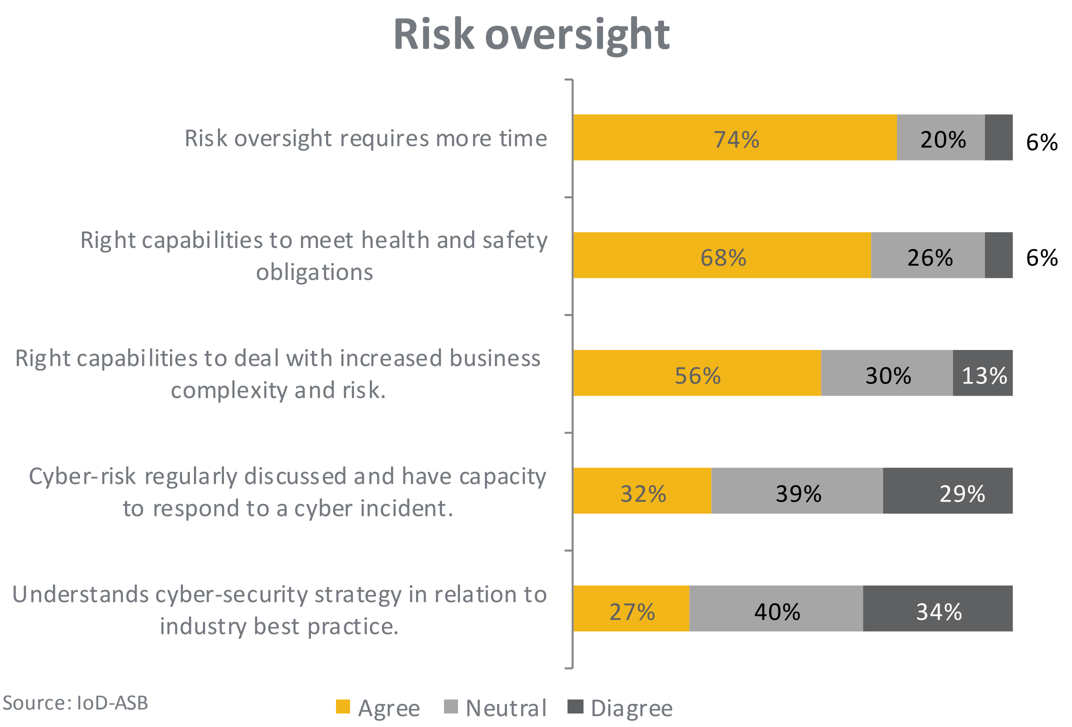
Insights from the survey about ethics and conduct.

- 78% of boards have an ethical framework that is aligned with their purpose and strategy but only 43% of boards had assessed ethics risks in their organisations in the last 12 months. 26% had not and 31% were unsure (neutral).
- Only 37% of boards receive comprehensive reporting on ethical matters, conduct incidents and the actions taken to address them. Conduct risk is a significant risk for any organisation. It's important that boards actively and regularly consider the risks in their organisations, ensure they are getting good information from management and that they hold management to account for addressing conduct incidents.
- 42% of boards consistently apply a written code of business ethics to board decision-making, down slightly from 45% of boards in 2015. This doesn't mean that boards are acting unethically but may indicate variability around board awareness and practice in considering ethics in decision-making.
- 48% of directors were confident that their board, staff, business partners and supply chains were adhered to the organisation's ethical standards but 13% did not and 39% weren't sure. Ensuring there is a good understanding of ethical standards and expectations is a key step in helping prevent conduct incidents.
- 71% of boards agreed that they set the tone and model values for their organisations.

Question 8: Risk oversight

Insights from the survey about board risk oversight.

- Board time spent on risk oversight continues to increase year-on-year for most directors. In 2016, 74% said they were spending more time on risk oversight in the last 12 months (73% said so in 2015). However more boards said they had the right capabilities to deal with increasing business complexity and risk, 56% in 2016 compared to 50% in 2015.
- The Health and Safety at Work Act 2015 came into effect on 4 April 2016 and the number of boards that consider they have the capability to comply with their obligations has increased year-on-year since the survey started in 2014. In 2016, 68% say they have the capability in 2016 up from 60% in 2015 and 51% in 2014.
- 32% of boards regularly discuss cyber-risks and are confident in their company's capacity to respond to a cyber-attack or incident. Although this is slightly up from 27% in 2015 it is still low, especially as 29% of boards did not. In addition, only 27% of boards had a clear picture of the organisations overall cyber-security strategy and how it relates to best practice. Managing cyber risk is part of doing business in our digital world. Boards need to put cyber on the agenda and ask the right questions of management to ensure they build and maintain cyber resilience.



Source: IoD-ASB

Detailed survey results

The online survey was conducted in October 2016. Results are summarised from 883 responses. Not all questions were answered by all respondents (the average skip rate per question was just 1.3%). Percentages may not add to 100% due to rounding.

	Question	Improve	No Change	Decline	Net %
Q1.	How do you expect the performance of the New Zealand economy to trend in the next 12 months?	50%	43%	7%	43%
Q2.	How do you expect the performance of your organisation to trend in the next 12 months?	74%	22%	4%	70%

Q3. What, in your view, are the biggest impediments to national economic performance? (you can choose up to three)	
Market volatility	31%
Regulatory red tape	33%
Labour quality and capability	46%
Concentration risk	7%
Commodity prices	24%
Global growth	32%
Productivity	24%
Lack of strategy	28%
Attitude/ambition	16%
Infrastructure	31%
Other	11%

Q4. What, in your view, are the biggest risks facing your organisation? (you can choose up to three)	
Labour quality and capability	46%
Regulatory red tape	34%
Local growth	26%
Global growth	15%
Competition	31%
Demand	23%
Commodity prices	12%
Cost of capital/availability	13%
Governance	14%
Technological disruption	33%
Other	8%

Q5. Do you agree that extending the parliamentary term from three years to four years would improve New Zealand's governance?	
Yes	84%
No	16%

Q6. Please indicate whether you agree or disagree with the following statements about governance in your organisation and issues facing boards:	Agree	Neutral	Disagree
Compliance related activities have increased in the last 12 months.	80%	16%	3%
The scope of director responsibilities is more likely to deter me from taking on governance roles now than 12 months ago.	32%	38%	30%
Increased personal liability has made me more cautious (risk averse) in business decision making in the last 12 months.	43%	37%	19%
Diversity is a key consideration in making board appointments.	70%	22%	8%
I think my industry will be affected by major/disruptive change in the next 2 years.	47%	35%	17%
My board has the right capability (skills and experience) to lead our organisation's digital future.	35%	37%	28%
My board prioritises strategic discussion at every board meeting.	50%	32%	18%
My board regularly (at least every two years) considers the long-term sustainability of our business model.	71%	19%	9%
My board considers environmental and social issues are very important to our business.	56%	36%	8%
My board considers stakeholder interests are very important to our business.	86%	12%	2%

Q7. Please indicate whether you agree or disagree with the following statements about ethics and conduct in your organisation:	Agree	Neutral	Disagree
My organisation has an ethical framework (e.g. code of ethics or values statement) that is aligned with our purpose and strategy.	78%	16%	6%
My board consistently applies a written code of business ethics (i.e. code of ethics/code of practice) to board decision-making.	42%	39%	19%
My board has assessed ethics risks in our organisation in the last 12 months.	43%	31%	26%
My board receives comprehensive reporting from management about ethical matters and conduct incidents, and the actions taken to address them.	37%	37%	26%
I am confident that our board, staff, business partners and supply chains are familiar with and adhere to our organisation's ethical standards.	48%	39%	13%
My board consciously and actively sets the tone and models our values for organisational behaviour, e.g. in the boardroom and when dealing with management.	71%	22%	7%

Q8. Please indicate whether you agree or disagree with the following statements about risk oversight:	Agree	Neutral	Disagree
The time my board spends on risk oversight has increased in the last 12 months.	74%	20%	6%
My board has the right capabilities (skills and experience) to deal with increasing business complexity and risk.	56%	30%	13%
My board has the right capabilities (skills and experience) to comply with director obligations under the Health and Safety at Work Act.	68%	26%	6%
My board regularly discusses cyber-risk, and is confident our organisation has the capacity to respond to a cyber-attack or incident.	32%	39%	29%
My board has a clear picture of our organisation's overall cyber-security strategy and how it relates to industry best practice.	27%	40%	34%

Q9. Please indicate the organisational category to which your most substantial directorship belongs (this is the organisation in respect of which you have answered the question above):	
Large private company (>$10 million turnover or 20+ employees)	36%
Not-for-profit organisation	23%
SME company (<20 employees)	15%
Other private company	7%
Government organisation	7%
Publicly listed company	8%
State-owned enterprise (SOE)	2%
Subsidiary of a publicly listed company	2%

Contacts

About the Institute of Directors

The Institute of Directors in New Zealand (IoD) promotes excellence in corporate governance, represents directors' interests and facilitates their professional development through education and governance training. The IoD is a membership organisation of around 8,000 individuals drawn from NZX-listed corporations, private companies, small to medium enterprises, public sector organisations, not-for-profits and charities.

The IoD aims to raise the standard of governance in all areas of New Zealand business and society.

The Chartered Membership pathway is a commitment to professional standards for directors. The Chartered designation offers stakeholders an assurance that directors have met professional standards of knowledge and skill that supports them to carry out their duties as a director. Their knowledge, background, character and experience make them role models for other members, their organisations and the community as a whole.

About ASB

ASB Bank is a leading provider of integrated financial services in New Zealand including retail, business and rural banking, funds management and insurance. A member of the Commonwealth Bank of Australia (CBA) Group, ASB has carved a name for itself in the New Zealand banking landscape, looking after the financial wellbeing of more than 1 million customers. Committed to being an unbeatable team providing an unbeatable customer experience, ASB staff are passionate about helping our customers stay one step ahead.

In keeping with this spirit, the ASB Economics Team is focused on providing quality research and commentary on the New Zealand economy and financial markets. Led by Chief Economist, Nick Tuffley, the team aim to deliver timely analysis and up-to-the-minute accounts of market trends and developments. For two consecutive years (2013 and 2014), ASB's economics team has been the recipient of the Consensus Economics Forecast Accuracy Award – a testament to the quality of their research and economic forecasts.

Authorship

This report has been jointly prepared by the IoD and ASB.

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