Board Matters Quarterly offers thought-provoking perspectives and insights into leadership and governance issues for boards and audit committees, supporting them to navigate the increasingly complex business environment.

Is your board prioritizing right? Read more in our discussions in this issue.
The future of risk: tone from the top

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Companies today are under tremendous pressure to reinvent themselves as traditional barriers of entries are redefined through innovative use of technology. Businesses – new and old alike – swoop in to fill the gaps in consumer need for accessibility of information, speed of transaction and competitive pricing, sometimes achieved solely through an online presence.

Many established businesses are in a dilemma; there is a huge risk of becoming irrelevant if they do not disrupt themselves to compete with new entrants that are chipping away at their customer base, yet they may not have the necessary skills and agility to review their business critically and rebuild a secure business model as they continue serving their customers.

Traditional point-in-time risk snapshots through quarterly self-assessments or annual audits seem to be in the magnitude of lifetimes compared with the speed at which new entrants are emerging. Essentially, organizations need to embrace and be nimble in managing risks at the same time as they are seizing opportunities and refining plans.

As Prime Minister Lee Hsien Loong described in his keynote speech at GovTech’s Stack Developer Conference 2018, “We do not know if all of our initiatives will go as we plan, but as a GovTech officer said to me recently, we are rebuilding the aeroplane even as it is mid-flight!”

To deal with the future of risks, there are five areas that boards can help in setting the right tone from the top in order to change the organizational culture and DNA.

**Responsibility of risk**

It is already established that everybody in the organization and its ecosystem of third-parties need to be responsible for risk management. However, beyond the awareness sessions and campaigns that are run, many companies have not been achieving the desired impact. Take for example instances where a potential security breach has been identified, and escalation was not made because it was not deemed to be part of the individual’s job scope to have done so.

A possible, but not immediately obvious approach, is to involve the company's talent management team to look into culture-building programs that boost staff engagement and belonging so that they feel a sense of ownership of the company issues and concerns. All individuals involved in the business should feel that they have an important part in risk management, and not simply because they have been told to do so and are obliged to.

**Risk ownership**

Risk ownership is currently centralized at the risk management function and this notion will no longer be as relevant when business units start to disrupt themselves.

When it comes to risk management, there are generally three types of risks: upside risks that offer benefits to the business; downside risks that do not bring about any rewards; and outside risks that offer either negative or positive benefits and are beyond the organization’s controls.
As companies start digitalizing their business, there needs to be more collaboration between the business units and risk functions (and this can be the cybersecurity, risk, or audit functions). The business units enjoying the potential upside risks must also take ownership of any associated downside risks rather than viewing it as the responsibility of someone else.

**Scale versus agility**

The structures that have served well in providing strong governance over a company’s activities may now be the shackles that prevent it from innovating with speed. Boards should transition from their well-defined governance structures towards greater decentralization through ownership of downside risks, and institute the right culture, environment and tools for business units to identify, own and address risks in their quest for innovation.

This needs to be supported by better use of data platforms and intelligence to speed up the reporting of relevant metrics to the right stakeholders, so as to respond in a timely manner to areas that may be outside the established tolerable risk appetite.

**Investing in upskilling human capital**

While we often see organizations investing in technology and process changes, many overlook training its employees to understand and leverage new technologies. This either results in a sub-optimal attempt to disrupt the business as the full potential of technological gains are not achieved, or introduces additional cyber risks to the organization as employees and third parties may not fully appreciate the increased surface area of attacks.

Traditional point-in-time risk snapshots through quarterly self-assessments or annual audits seem to be in the magnitude of lifetimes compared with the speed at which new entrants are emerging. Organizations need to be nimble in managing risks at the same time as they are seizing opportunities and refining plans.

The EY Global Information Security Survey 2018-2019 found that 34% of organizations see careless and unaware employees as the biggest vulnerability, and 42% of the top cyber threats relate to phishing and malware attacks targeting this group of users.

To remain digitally relevant, there are certain skill sets that should extend beyond the silos of specializations, including cybersecurity, automation, data science and visualization, and design thinking. Boards should drive management to encourage further upskilling of employees in these areas and make these talents accessible to the board committees.

**Compliance does not equate to risk management**

Boards should take the lead in broadening risk management conversations rather than accepting compliance reporting as the sole indicator of how well the business has identified and managed its risks. While compliance is an important activity, it has generally been misused as the main indicator of risk, and businesses are often blindsided to other potential hazardous cyber situations that result in hackers laying hands on the organization’s “crown jewels”, or disrupting the means to effectively provide critical services to customers.

The days of monitoring and reacting to threats after they occur are over. A dynamic, predictive and data-driven approach to risk management is now fundamental to surviving and thriving in the transformative age. To prepare for tomorrow, businesses must disrupt themselves and break down structures, if necessary, to compete with greater agility.

The time to act is now – the pace of change is relentless and businesses cannot afford to procrastinate.
Steering growth in the middle market

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Singapore’s dynamic middle market is among the fastest-growing in the world, outpacing global peers, found the annual EY Growth Barometer 2018.

Middle market company leaders are targeting robust double-digit revenue growth while expanding full-time headcount and investing in new cognitive technologies and machine learning to create process efficiencies. The survey found that Singapore has the third-highest adoption rate of artificial intelligence (AI), following closely behind China and Netherlands. A vast majority of Singapore companies also said they plan to introduce AI within two years.

Despite readily embracing AI, the Singapore middle market is yet a leader in the mature application of new technologies. Many businesses still identify technologies with the traditional roles of improving process efficiencies and financial data, before the more innovative roles of improving customer experience and creating new business models.

This is concerning: while it is important to drive “lean and mean” operations, it is the focus on customer that will predominantly deliver dollars and growth to the business. As technology reinvents the way customers live, work and play, leaders will need to reimagine the future consumer. This will require companies to challenge and stress-test their assumptions of customer needs by asking: What will customers value and where will your future customer come from?

The boundaries for future customer markets will increasingly extend far beyond Singapore’s shores in today’s interconnected economy. The borderless opportunities that digital brings is particularly important for Singapore companies.

Not surprisingly, the survey found that Singapore middle market companies view overseas expansion as the most important growth priority to overcome the limitations of the small domestic market, with M&A being a key growth strategy. They too are not shy to divest, if by selling part of their business to an external partner meant greater agility in accessing new markets and opportunities.

For many companies, having overseas ambitions also means being particularly sensitive to slow or flat global growth as a key external risk. However, this has not dampened the M&A appetite of Singapore companies, which has remained fairly resilient amid geopolitical disruption. According to the 19th EY Global Capital Confidence Barometer report released in October this year, 40% of Singapore respondents expected their companies to actively pursue M&A in the next 12 months, and for the M&A pipeline to increase.

Singapore middle market companies also want to grow its headcount along with its revenues. Three in 10 companies in Singapore said that attracting talent with the right skills tops the list of growth accelerators. The C-suite has a clear idea of the optimum skill sets. For more than half of the respondents to the Growth Barometer survey, the ideal organization is one that attracts younger, digitally native talent.
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Clearly, to secure the double-digit revenue growth planned, Singapore middle market companies will have to balance their growth ambitions with managing the geopolitical, market and talent risks on the horizon. In steering the boardroom agenda, here are some questions that boards should consider:

• How aligned is the board with management with regards to the assessment of the largest strategic and economic threats facing the organization over the next year?

• Does management use appropriate short- and long-term metrics to measure the company’s success?

• How does the board evaluate the effectiveness of these metrics, and continuously challenge and improve these in line with changing internal and external dynamics?

• Does the organization have a robust plan to identify emerging skill sets in line with its business objectives, and recruit and access talent accordingly?

• How much time does the board spend discussing strategy, the competitive landscape and the effects of disruption versus traditional corporate governance matters?
Family business succession: getting the talent strategy right

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Disruption is changing the way the world works with technology being one of the primary drivers. Many businesses scramble to keep pace with change and uncertainty, yet family businesses seem to have been able to keep it together.

The *EY global family business survey 2019* revealed that large family businesses thrive by creating cultures that are agile, foster innovation and reward fresh thinking. In other words, they develop cultures with great capacity to harness disruption from one generation to the next.

The study also found that family businesses view disruption as both a threat and opportunity, with 53% of the respondents identifying human capital as one of the top areas for investment over the next three years. Many also recognize the role that the next generation can play in identifying disruptive threats and trends that could reshape the marketplace.

Having said that, the respondents also conceded that more can be done when it comes to harnessing the talent of their next-generation or younger family members. Based on our experience working with business families in recent years, there are several areas that family businesses can focus on.

**Prioritize succession planning**

With such a potentially important role that the next generation can play in countering or capitalizing on disruption, family business leaders are beginning to place a higher priority on succession planning.

In many families, we see the lead generation engaging on issues relating to succession with urgency and being more willing to involve the next generation in such discussions. This means making plans together, working together to determine how and when the next generation will take over.

Having a shared dialogue brings comfort and confidence to the family, as family members are no longer kept in the dark about what comes next. In these sessions where the fear of losing (or losing out) is no longer an overriding factor, family members are more willing to participate and put forth creative solutions.

Through this participative approach, some families have come up with funds that encourage entrepreneurship and the creation of new business lines within the family, as well as family trusts that not only look after basic health and housing for family members, but also provides for family retreats and holidays where there were none previously.

**Woo the next generation proactively**

Family business should not assume that the next generation will be willing to succeed the business, given that interests of family member may not always be aligned with the interest of the family business. When next-generation family members are not keen to join the family business, it greatly increases the difficulty of finding capable family successors.

In a global study by EY in 2015, *Coming home or breaking free*, the succession intentions of next-generation members of family businesses were found to be low and even in decline. Only 3.5% of the students surveyed, whose parents have a family business, intend to become a successor directly after graduation, whilst 4.9% intend to take over five years after graduation. This could be attributed to a variety of factors, including the availability of more attractive career options elsewhere.
For many next-generation members, working and leading the family’s business is no longer the only option available to them. Just like how they would manage external talents, family businesses too, have to develop and nurture their next generation in order to retain them in the long-term.

Recognize the talents of the next generation
The next generation represents the first truly digital generation. Their comfort in an ever-changing digital climate could be a huge asset as family businesses explore how they can create and embrace long-term digital strategies and enhance their innovation agenda. Engaging the next generation early in the family business can help to maintain continuity and increase family cohesion for superior operational performance.

Have a clear development framework
As competition for talent intensifies, family business leaders intending to eventually find a suitable successor amongst family members will need to ensure that their succession planning includes putting in place a framework to adequately nurture and reward next-gen family members.

One aspect of the framework could involve developing policies for young family members to enter the family business as well as putting in place structured training or education programs to nurture and develop them into high-performers who will live the core values of the family and the business.

Establish a sound reward strategy
It is important to develop and implement strategies to reward family members based on their roles in the family business and their contributions to performance. Such reward strategies have to be consistent and sustainable as well as provide an appropriate degree of differentiation between family members and non-family management.

The rewards strategy should consider how it will co-support the family business’ strategy and business unit strategy, and whether it is relevant and resonates with the family members. As well, the overarching objective, key performance measures and governance, review and management of the reward program must be clearly articulated. It is also important to consider how professionals playing the same roles will be paid.

Keeping it in the family
“30:10:3” is a commonly quoted family business survival ratio, whereby 30% of firms survive into the second generation, 10% last into the third generation and only 3% survive beyond that point.

Family businesses must continue to adapt and innovate to survive in an ever-changing business landscape – and the talents of next-generation leaders may well hold the key to unlock the many challenges that the disruptive future presents.

As summed up by Georges Bougaud, President of Recamier and one of the winners of the EY 2016-2017 Family Business Award of Excellence: “It is so important to pass on the culture of the family business to the next generation. You have to create a commitment to the family to continue this incredible journey.”
Leadership in a superfluid world

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For as long as globalization has entered the world’s lexicon, it has created tremendous opportunity for economic growth to improve the quality of life. Economies have become interdependent through trade and investment, driving the impetus for tighter policy coordination among nations and resilient supply chains for companies operating in this environment.

Notwithstanding, domestic interests have been countering the forces of globalization, manifesting in various forms including trade and currency protectionism, imposition of sanctions for geopolitical gains, and other anti-globalization protests.

Amid the progress and pushbacks on globalization, Asia has emerged as a key fulcrum of global trade architecture and is at the center of the world’s fastest-growing trade routes. This rebalancing of economic influence from the West to the East has been a defining feature of Globalization 2.0.

**Rise of superfluid markets**

Now, with digital reshaping almost all things possible and shifting power to the hands of individuals and consumers, a new world order of globalization is upon us. Businesses in Asia and around the world find themselves operating in superfluid markets, where technology advances are reducing barriers to entry, market friction and transaction costs, making commerce easier, borderless and less expensive.

This level of superfluidity varies from market to market and industry to industry. The commonalities are that in superfluid markets, products or services are digital or have digital value drivers embedded. Also, these are often delivered between buyers and sellers via digital infrastructure.

Such a market is also intermediary-light where transactions are either free of intermediaries and direct-to-consumers, or has digital intermediaries that add significant value for industry participants such as through aggregating demand.

The companies that have participated successfully in such a market are investing in and leveraging technologies such as artificial intelligence, robotics, Internet of Things, data analytics, 3D printing or blockchain to vastly improve their business interactions with partners, suppliers, customers, regulators and other stakeholders.

What this new digitally disrupted market order means for business leaders in Asia is that a paradigm shift in strategic leadership and thinking is needed. It also points to the increasingly complex role of the board, who will now need to be minded about the evolving impact of digital transformation on strategy, corporate governance, risks and opportunities.

Yet, while the market and operating conditions can — and will — change continuously, clarity of and commitment to the organizational purpose must remain.

**Purpose at the core**

Purpose can be described as an aspirational reason for being that is grounded in humanity and inspires a call to action. Defining a company’s purpose is not always easy. However it is worded, the underlying concept is that by acting on this purpose, companies can create more value for their shareholders and society over the long term than by pursuing purely financial goals or a narrowly defined self-interest.
In the face of continuous change, intense competition and increasing regulations, purpose is akin to a strategic “North Star” that helps leaders think holistically—from their strategy and business model to how they manage and engage their employees and other stakeholders. Purpose also channels innovation. By focusing innovation on a compelling “bigger picture”, purpose empowers people to think beyond incremental product or service improvement, and seek solutions that will deliver durable value and returns. At the same time, it sets clear boundaries on the space the company wants to operate in, keeping innovative energy focused on what really matters.

**Diversity and inclusion**

In navigating globalized and superfluid markets, companies will likely need to holistically review their corporate structures. Multinational companies will have to adapt their global strategies for local markets as they address the different—and at times competing—needs of the global versus local market, customers, and employees.

To do so effectively, companies must be intentional about allowing local participation in decision-making; building diverse teams on boards, management teams to working levels; enabling virtual, cross-country and cross-functional collaboration; and finally harness the merits of all through inclusive leadership.

**Technology agenda oversight**

At a time when consumers are more empowered with choices and advocacy given the proliferation of social media, leaders must ensure that the customer experience is a key priority. Increasingly, market competitions are won and lost on how well companies deploy big data to predict customer behavior, use algorithms to smooth logistical kink, and monitor multiple social feeds to respond to feedback quickly.

Technology no longer just enables strategy execution—it is a key component of the strategy. To that end, boards should examine how their companies are leveraging the up sides of transformational technology, while keeping an eye on potentially new digital risks.

In overseeing digital strategies, boards must consider how technology is aligned with the company’s purpose and business and customer goals, embed security at each stage, and effectively navigate the path of modernizing legacy technology and consolidating systems and applications.

Leading boards ensure that they understand the rapidly evolving digital landscape so as to serve as a strategic partner to management. This may call for a rethinking of board composition, structure and meeting cadence and design.

For example, how can the board ensure that it has ample expertise to review the business’ digital plans? For some boards, that may mean appointing digital directors, although such an appointment may have a limited tenure due to the pace of technological change. For other boards, they may regularly consult with management and external experts to build board awareness and digital competency.

Establishing technology committees that meet between board meetings to drive focus and momentum on long-term, technology-focused strategic initiatives can also help even as strategy remains a full-board responsibility. These technology committees will then serve to provide governance of the company’s evolving risks and strategic opportunities specific to technology.

Beyond the creation of committees, leading boards are also strengthening the nexus between technology and strategy by discussing the two as an integrated focus at board meetings, and increasing the frequency of such board meetings and communications as appropriate. The standard once-a-year, off-site, deep-dive strategy sessions for the board may have worked well in the past but is unlikely to be adequate in current times.

Superfluid markets demand superagile leaders. Truly benefitting from this phenomenon will depend in part on their ability to develop perspectives that combine extensive experience with purpose and fresh knowledge. The iterative challenge for all is: what’s after what’s next?
Revised Code of Corporate Governance: what boards must know

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In August 2018, the Monetary Authority of Singapore issued the revised Code of Corporate Governance (the Code) for companies listed on the Singapore Exchange (SGX). This 2018 version of the Code supersedes earlier versions and will apply to annual reports issued for financial years commencing 1 January 2019.

The current edition is a result of an 18-month process. Despite the introduction of new principles and provisions in the 2018 Code, there is an almost 50% reduction in the page count from earlier versions, which most practitioners would welcome.

Strengthening corporate governance fundamentals

The “comply-or-explain” regime featured in the earlier Codes remains in the 2018 Code. A key change to the 2018 Code is the moving of some guidelines to the SGX-ST Listing Rules (Mainboard) and SGX Listing Rules (Catalist) (collectively, SGX LR) of which the latter requires mandatory compliance and do not operate on a “comply-or-explain” basis like the Code.

The majority of these guidelines involve considerations relating to director matters, which reflects the important role that directors play in ensuring effective corporate governance, as well as the evolving expectations of what the core and fundamental governance standards should be for all listed companies.

As a result, the need for independent directors to make up at least one-third of the board will now become a baseline listing requirement. Likewise, having an effective internal audit function has been recognized as a key component for boards to exercise sufficient oversight on the system of risk management and internal controls maintained by the executive management, and has been proposed for inclusion in the SGX LR.

While many of these proposed additions from the Code to the SGX LR remain unchanged in substance, some have become more stringent.

For instance, the reappointment of independent directors who have served for more than nine years now requires a two-tier shareholder voting process in order to continue serving on the board as an independent director. Notwithstanding, this does not preclude such a director, who has not been voted in as an independent director, to continue to serve on the board as a non-independent director.

A clearer and more holistic Code

The 2018 Code also introduced several additional provisions to enhance governance practices.

It is recommended that non-executive directors make up the majority of the board, so as to help ensure an appropriate balance of objectivity in board deliberations for better business decisions. With regards to shareholder rights and the conduct of general meetings, “bundling” of resolutions is discouraged, and explanations in the notice of meeting are required should such “bundled” resolutions be tabled.
The 2018 Code also works to foster better communication and transparency between the company and shareholders by encouraging companies to establish an investor relations policy as well as a dividend policy that is made known to shareholders.

A principle dedicated to considering the needs and interest of material stakeholders is also included in the 2018 Code. This is in line with global governance developments for companies to embrace a wider social and ethical mandate rather than narrowly focusing only on its shareholders. This aligns with the SGX’s recent drive for companies to adopt sustainability reporting.

In addition, the 2018 Code is clearer. With the removal of areas that are already cited in the SGX LR, it helps to reduce previous confusion caused by repetition.

Greater clarity is also achieved with the creation of the Practice Guidelines as a companion document distinct from the Code – a new feature of the 2018 Code. The Practice Guidelines contain more detailed implementation considerations relating to the principles and provisions of the 2018 Code. Many of these were previously included as guidelines within the previous Code.

For example, guidelines relating to specific remuneration schemes like the use of shares to align the interests of non-executive directors with that of shareholders, or the use of “claw-back” in management employee contracts, no longer feature in the 2018 Code, but are shifted to the Practice Guidelines as a means to illustrate potential ways to align the relationship between remuneration, performance and value creation.

By doing so, the 2018 Code is more principle-based and avoids being overly prescriptive, so as to enable a more flexible and thoughtful application of governance principles.

**Governance to what end?**

An interesting recommendation arising from the Corporate Governance Council’s deliberations is not related to changes in the Code itself, but on enabling the corporate ecosystem to help build better governance practices.

The proposal to set up an industry-led Corporate Governance Advisory Committee is a first step towards this direction. While details of the specific mandate and composition have yet to be determined, this initiative could allow for greater positive reinforcement and support, rather than improvements only by threat of the regulatory “whip”.

While specific wordings, principles or expected standards may change and develop over time, the core objective of the Code remains the same: to promote the structures and processes necessary for directing the affairs of a company to enhance its long-term value.

The effectiveness of the Code remains dependent on its application by companies. Boards and management should take the opportunity to embrace the spirit of the 2018 Code and capitalize on the potential benefits arising from the recommended practices. Substance is key; it will be near-sighted to merely implement the form of the Code provisions for the sake of compliance.
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