



Ocean IV by Michael Whitehead

DIRECTIONS 2022

Navigating uncertainty in the search for growth

July 2022

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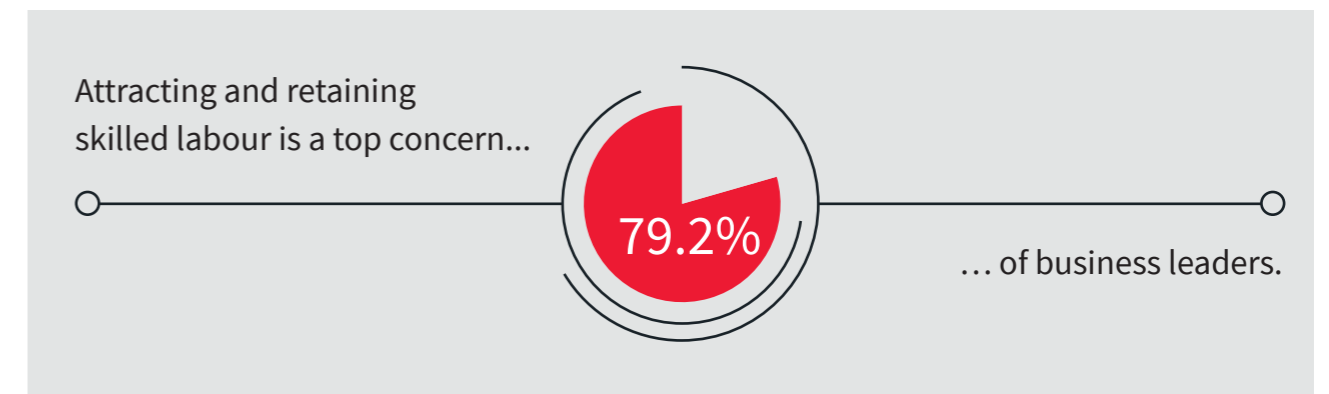
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ENGAGING PEOPLE TO BUILD FOR THE FUTURE

Welcome to KWM's Directions Report for 2022.

This year, we explore how Australia's senior business leaders and their organisations are identifying and pursuing opportunities for growth, and becoming more resilient in responding to new and evolving challenges in uncertain times.

A singular theme emerged from the responses to our *Directions* survey - in 2022, Australian business is overwhelmingly focussed on people.



Our 2022 *Directions* survey was conducted in April 2022 against the backdrop of technology transformation and evolution across all industries, the energy transition, shifting markets and trade opportunities, and Environmental, Social and Governance (ESG) considerations. These issues create enormous opportunities for businesses to drive growth and positive engagement with investors and other stakeholders.

In addition, Australian business is also needing to tackle challenges posed by the Russo-Ukraine war and broader geopolitical tensions, inflationary pressures, interest rate risks and supply chain disruptions that are adding fresh uncertainties to strategic decision-making, either directly or through ripple effects.

Across the survey responses, a common people-focussed thread stands out, highlighting:

- A “back to basics” reset by many Australian organisations and their senior leaders to focus on what they can realistically control and influence. This involves determining what is critical to operational performance, and the connection to their customers and communities.
- Two critical people-focussed priorities:
 1. Needing to meaningfully re-connect with their people and re-establish how they work (and want to work) post-COVID
 2. Attracting and retaining a skilled workforce in the face of widespread labour shortages.

This overriding people focus recognises the critical importance of human skills and capability to build and harness data, technology and infrastructure and to achieve fundamental business objectives, including:

- Directly contribute to the management and profitability of businesses
- Develop and implement strategies and solutions to achieve productivity improvements, innovate and achieve growth
- Deliver on an organisation's ESG commitments, manage its impact within its supply chains, and on the communities in which it operates, and on the environment more broadly.

Below, we analyse these findings in further detail.





OVERVIEW OF KEY FINDINGS



Attracting and retaining skilled labour is the top concern over both the short-term and the medium-term. Challenges from wider labour market constraints and skills shortages is the second ranking issue of concern for the short-term, but ranked 14th for the medium term.



Managing IT/cyber risks continues to be a key top-of-mind short-term concern. For the medium-term, it ranks alongside developing new business models, promoting innovation, harnessing opportunities in digital ecosystems and developing strategies to use data as (arguably interlinked) top ranking concerns, after attracting and retaining skilled labour and maintaining an appropriate corporate culture.



Organic growth in existing or adjacent business lines/sectors and technology transformation are the top ranking opportunities for short-term growth, followed by M&A opportunities within existing or adjacent business lines/sectors.



Key issues driving supply chain interactions are skills shortages/attracting and retaining skilled labour, rising costs and/or scarcity of materials, and managing the impact of COVID-related disruptions.



Current ESG priorities are focused on creating and maintaining a diverse and inclusive workforce, building/improving sustainability capability, and making/satisfying public commitments to address greenhouse gas (GHG) emissions. Stakeholder management issues and lack of specialised personnel/lack of knowledge to implement are the biggest ESG challenges.

2019

Navigating a new order – ‘Can we/should we?’ replaces ‘disrupt or die’ decision making

2020

Responding to crisis: What lies ahead? – How was business surviving and adapting to COVID?

2021

Your Reform Agenda – Looking ahead to the ‘new normal,’ cyber and culture critical, business calls for climate action

2022

Engaging people to build for the future – Business focusses on its people and an expanded understanding of ESG

‘TOP OF MIND’ IN 2022 – IT’S ALL ABOUT PEOPLE

For 2022, we were curious to understand views on areas of potential opportunity and concern over the short term (next 6 months) and the medium term (next 3-5 years). The results are fascinating.

In the short term (next 6 months)

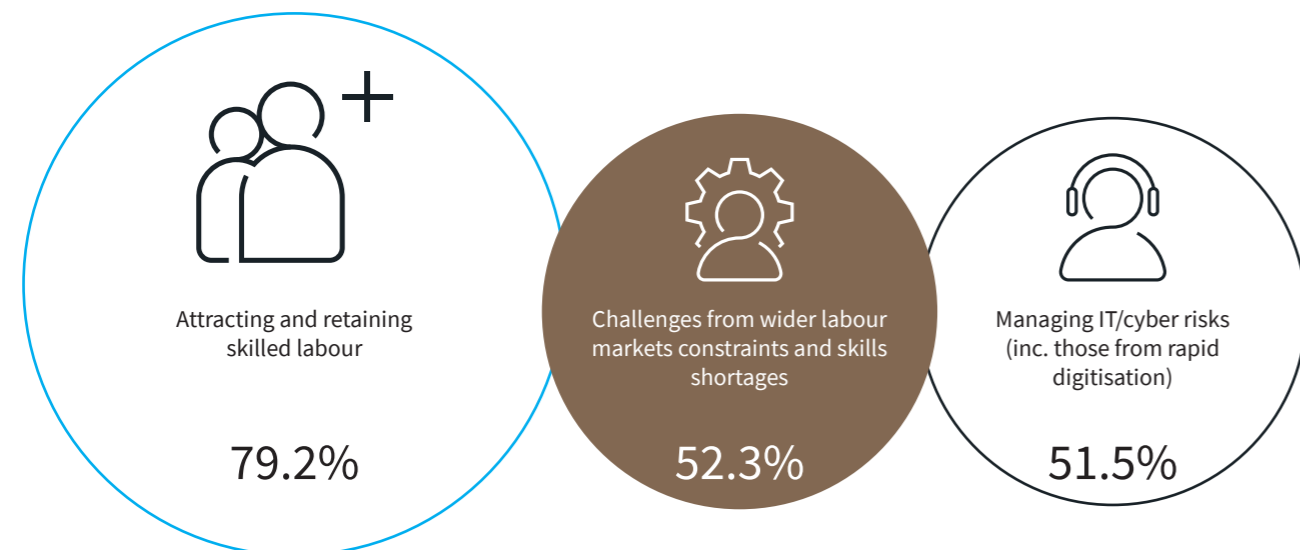
In a marked departure from previous *Directions* surveys, attracting and retaining skilled labour (79.2%) was clearly identified as the area of greatest opportunity or concern for organisations in the short-term, followed by challenges for wider labour markets constraints and skills shortages (52.3%).

These 2 critical people-related issues were followed by:

- managing IT/cyber risks (inc. those from rapid digitisation) (51.5%), which has been a consistently high-ranking concern in recent years
- pursuing and maintaining profitability (including as a result of the easing of COVID-related restrictions) (46.9%)
- developing new business models to deliver products/services to customers and/or deliver business outcomes (46.2%).

Interestingly, despite the widespread disruptions to production, trade and investment flows that have been triggered in recent years by a combination of pandemic-related shutdowns and geopolitical tensions, challenges from the geopolitical environment (including war and sanctions) (30.8%) and diversifying sourcing in and/or shortening supply chains (20.8%) both ranked as issues of significantly less concern.

Short term (next 6 months)



In the medium term (next 3 to 5 years)

In the medium term, attracting and retaining skilled labour (44.2%) was similarly identified as the area of greatest opportunity or concern for organisations, but was more closely followed by:

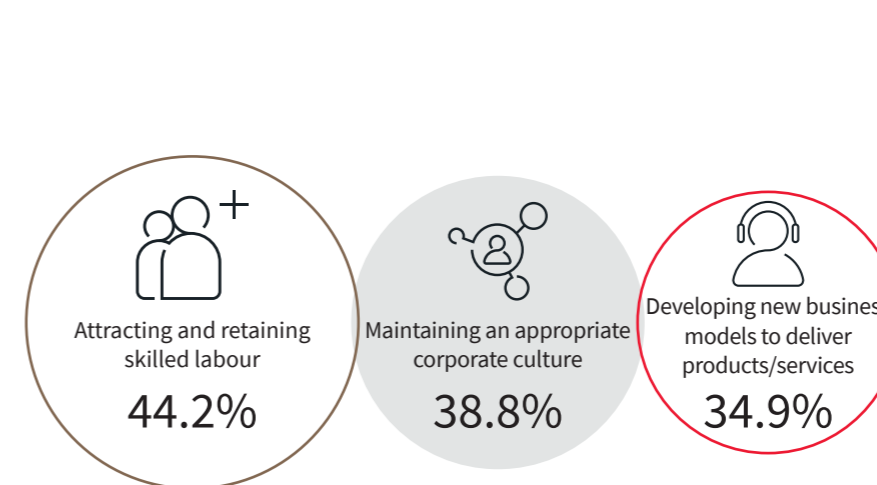
- maintaining an appropriate corporate culture (38.8%) – a consistently top-ranking issue in recent years, reflecting a more deliberate focus by senior leaders to set an appropriate ‘tone from the top’ and articulate and support an expression of ‘how we do things around here’, in order to support improved compliance and socially responsible decision-making
- developing new business models to deliver products/services to customers and/or deliver business outcomes (34.9%)
- the closely inter-related issues of promoting innovation in the organisation (28.7%), harnessing opportunities in digital ecosystems (e.g., digital platforms, digital assets, and virtual assets) (27.9%) and managing IT/cyber risks (inc. those from rapid digitisation) (27.9%).

These results highlight the singular dominating issue of attracting and retaining skilled labour for Australian businesses in 2022. In the short term, organisations are grappling with the immediate threats of weakened connectivity and loyalty within their teams after years of pandemic-related upheaval and stress, together with re-opened borders enabling restless staff to travel to new opportunities offshore, and limited inbound migration as a source of new talent.

Over the medium term, organisations are recognising the need for their people to develop skills in order to enhance performance, and to achieve productivity improvements and growth.

The change in focus and priorities over recent years reflects the need to be ‘nimble’. The sands move quickly, and there is a need to adopt a mindset that draws on lessons from the pandemic - control what you can control.

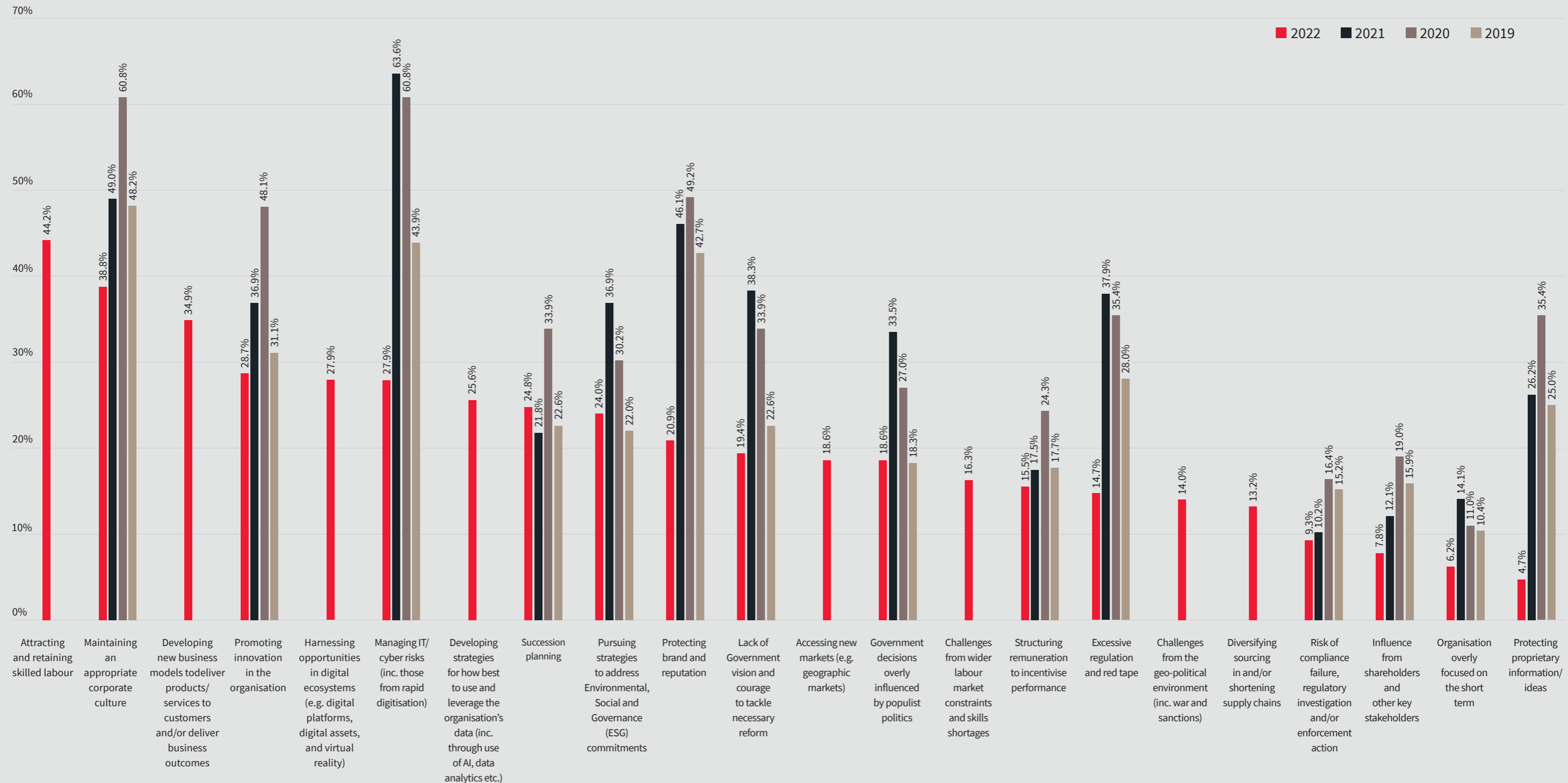
Medium term (next 3 - 5 years)



ISSUES OF CONCERN OVER THE YEARS

Issues of concern over the medium term - comparison with previous years

This chart represents items polled since 2019. The list is updated year-on-year to reflect current issues. It is also important to note that 2022 is the first year the question has asked respondents to consider their top concerns over 'the medium term'.



SKILLED LABOUR A TOP PRIORITY IN SUPPLY CHAINS TOO

Survey respondents see the availability of a skilled workforce as being critical to managing their supply chains and solving supply chain challenges. Nearly 61% of survey respondents cited skills shortages/attracting and retaining skilled labour as a key issue driving their supply chain interactions, followed by rising costs and/or scarcity of materials/inputs (56%) and managing the impact of COVID-related disruptions (inc. shutdowns and border closures) (55.2%).

Issues driving supply chain interaction



THE BEST OPPORTUNITIES FOR GROWTH IN THE SHORT TO MEDIUM TERM

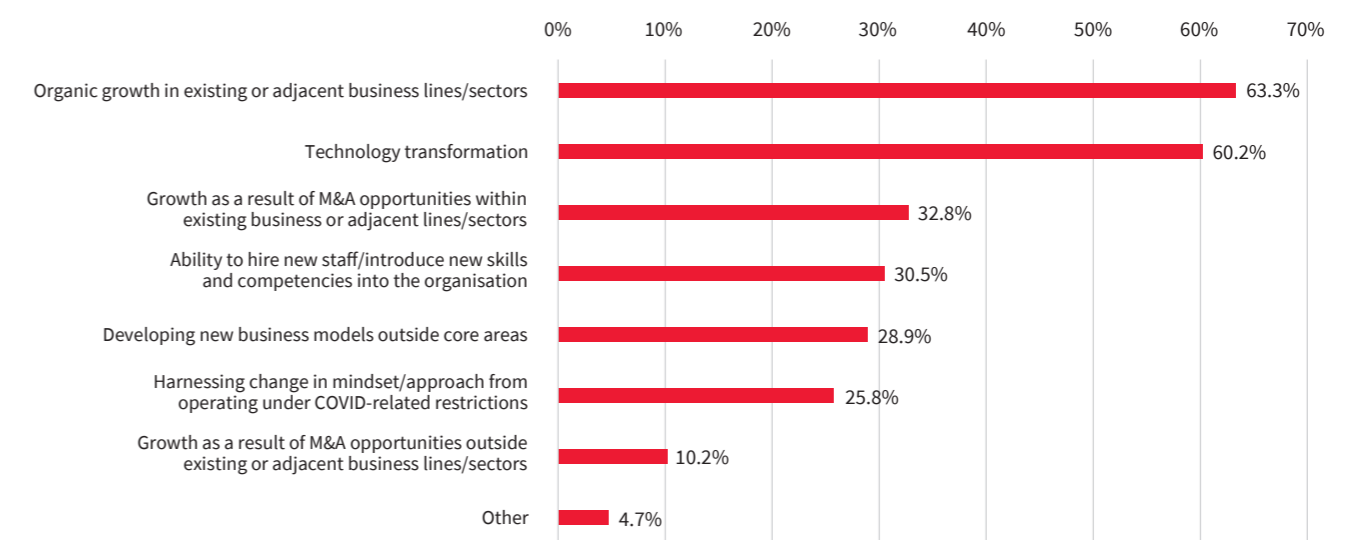
The people focus is also evident from what survey respondents identify as the best opportunities for growing their organisations in the short to medium term, following 2 years of COVID-related restrictions.

Interestingly, organic growth in existing or adjacent business lines ranked highest (63.3%), closely followed by technology transformation (60.2%). Each of these opportunities require organisational capacity (that is, an appropriately skilled and capable team). The fourth ranked opportunity was the ability to hire new staff/introduce new skills and competencies into the organisation.

By contrast, M&A-driven growth opportunities ranked relatively lower, with a strong preference to M&A being within, rather than outside, existing or adjacent business lines/sectors.

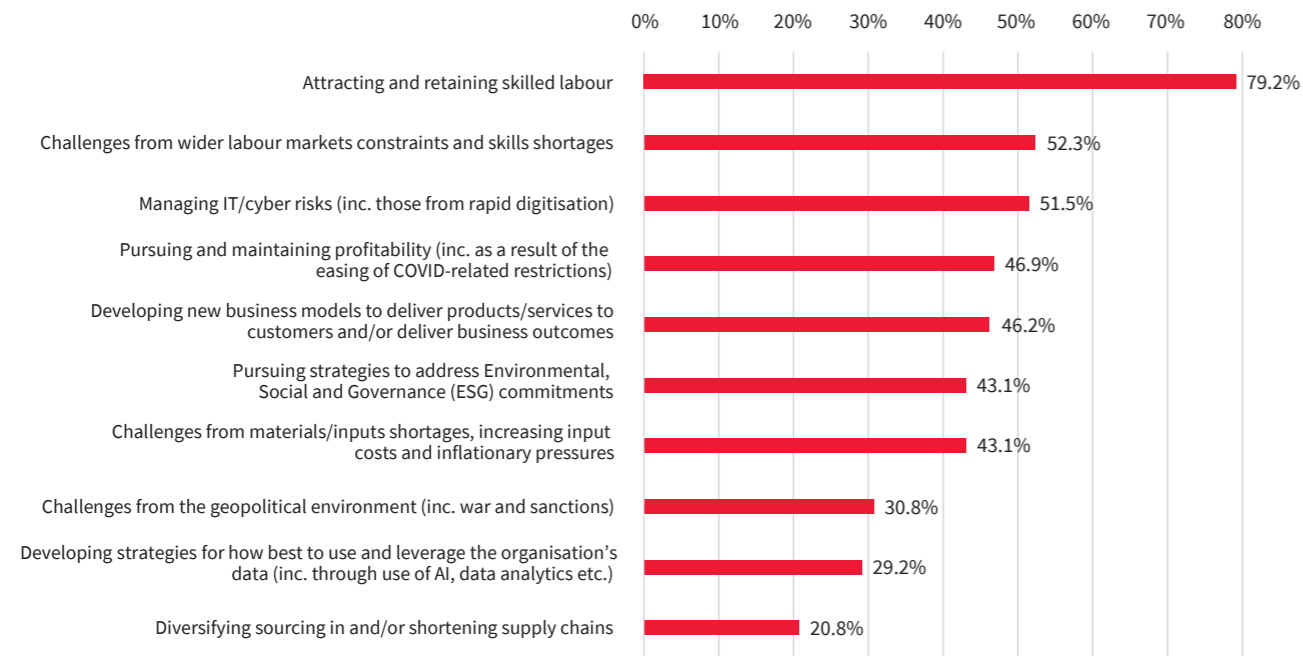
Business leaders may know the recipe for success – but the key challenge now is assembling the ingredients. Organisations able to communicate a clear purpose and values that people believe in, and demonstrated trust, respect and concern for worker wellbeing, will attract an engaged and productive workforce with the skills to drive them forward. Supply will still be an issue, but advocacy for immigration and continued global connectivity are important initiatives for addressing labour issues.

Best opportunities for short-term growth



HARNESSING DATA AND TECHNOLOGY AND ATTITUDES TO COMBATING RANSOMWARE

Issues of greatest opportunity or concern in the next 6 months



Notwithstanding the overriding focus on people, the opportunities and challenges presented by harnessing data and technology are also reflected in the survey results.

As outlined above:

- managing IT/cyber risks (inc. those from rapid digitisation) are a key short-term concern
- various closely inter-related innovation, technology and data-related issues are key medium-term opportunities or concerns
- technology transformation is a key opportunity to drive growth in the short to medium term.

With the ever-growing frequency and magnitude of ransomware attacks and cybersecurity breaches, we sought views on paying ransoms and measures to combat the problem. A majority (54.1%) of survey respondents indicated they do not support paying a ransom.

33.9% of survey respondents indicated support only if it is necessary to provide continuity of essential services, and 24.8% indicated their support if proprietary information (e.g., trade secrets, customer data or other commercially sensitive information) would be leaked.

Our survey respondents also expressed strong support for measures to combat ransomware, including mandatory ransomware incident reporting to intelligence services (68.8%) and making it illegal to ask for a ransom (59.6%). Only 30.3% of survey respondents supported an outright ban on making ransom payments. These results suggest a distinction between organisational choice and regulatory limitation. While a majority of survey respondents oppose paying a ransom, less than one third believe it should be banned. In other words – approximately 20% of survey respondents do not wish to see others' ability to pay a ransom restricted, even if they would not pay one themselves.

Would you pay a ransom?



54.1%

No support for paying a ransom



33.9%

If needed to provide continuity of essential services

When would you pay a ransom?



24.8%

Assuming proprietary information (e.g. trade secrets, customer data or other commercially sensitive information) would be leaked



23.9%

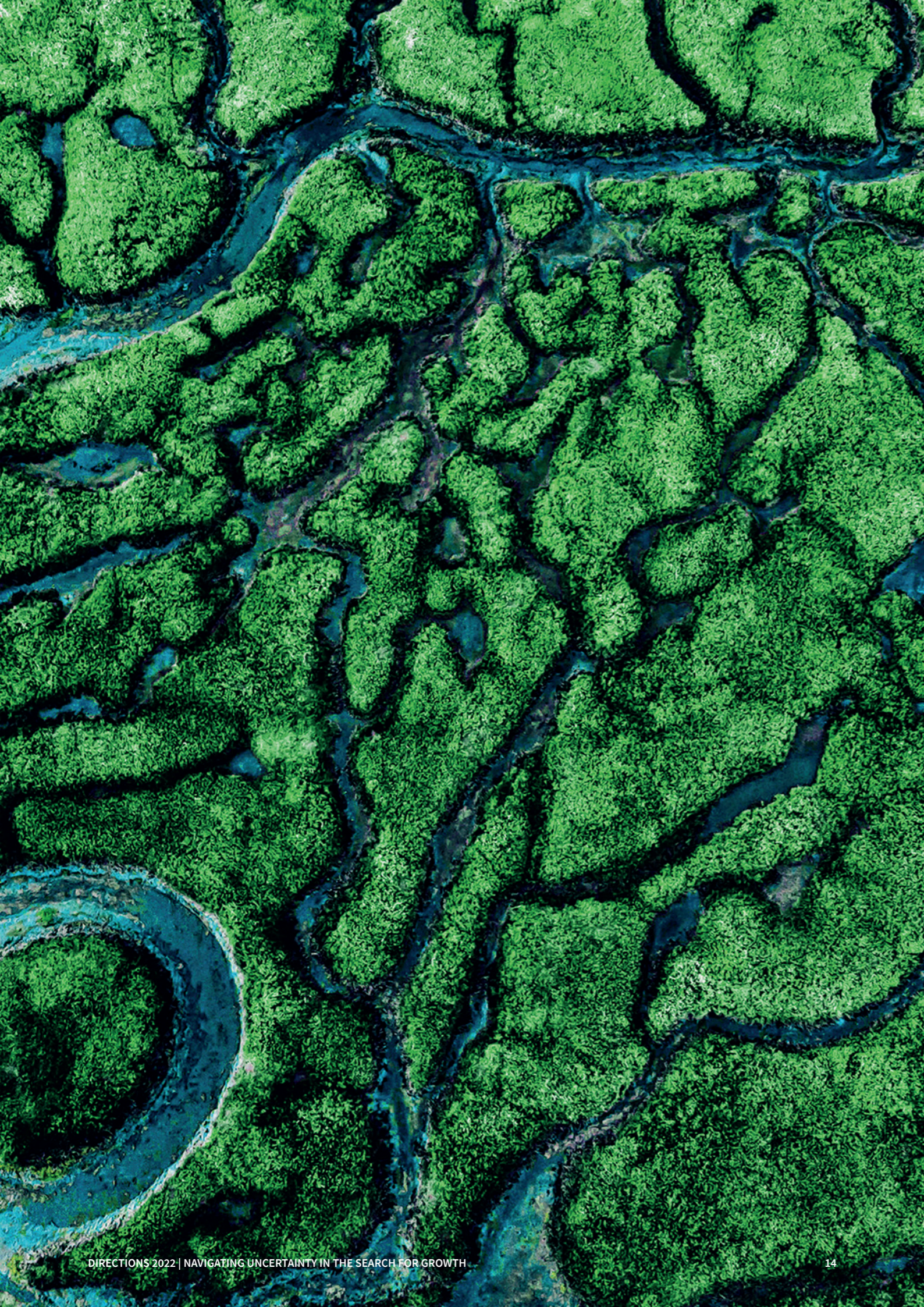
Assuming data would otherwise be lost forever



14.7%

Assuming business disruption for more than a week





ESG IS NOW BAU

The rise of ESG

ESG-related issues are now increasingly recognised and articulated as being an essential area of focus by Australian businesses, their boards and senior leaders.

Responses to our Directions survey suggest that the current top ESG-related priority for Australian business is assembling a diverse and inclusive workforce. This illustrates that senior business leaders are seeking to create a culture that will attract, retain and inspire people with a mixture of skills, experiences and perspectives.

“ESG, at its core, is a means by which companies can be evaluated with respect to a broad range of socially desirable ends.”¹
Bergman, Deckelbaum and Karp

ESG’s increasing prominence aligns with the rise of ‘stakeholder capitalism’ – a term first used more than 50 years ago to describe ‘a form of capitalism in which companies do not only optimise short-term profits for shareholders, but seek long term value creation, by taking into account the needs of all their stakeholders, and society at large’.² This conception of a company as being embedded within, and surrounded by, a range of stakeholders to which they were linked, competes with the notion of ‘shareholder primacy’, which holds that ‘the social responsibility of a company is to make profits’.³

The renewed and more deliberate focus on stakeholders and increasing attention on the impacts of companies and businesses has been triggered by a combination of corporate, market and regulatory failures, and economic, environmental, social justice and public health crises (most recently, the COVID pandemic).

Driving this focus is the recognition that these events now have the potential to trigger significant and far-reaching consequences for people and their communities, businesses and institutions, governments and the environment. Previously, such failures and crises may have been more ‘localised’ - attributable to specific organisations and individuals (a ‘few bad apples’ perhaps) and with relatively manageable impacts on markets and the broader economy. But this is no longer the case, due to:

- the inter-connectedness of people, including through the internet and travel
- the scale and footprint of organisations across the world and their dependence on global supply chains, trade and investment flows and markets.

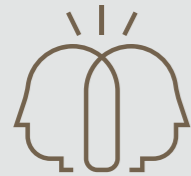
Larry Fink’s letter

In his most recent “*Letter to CEO’s*”, Larry Fink, the founder of BlackRock commented: “*In today’s globally interconnected world, a company must create value for and be valued by its full range of stakeholders in order to deliver long-term value for its shareholders... At the foundation of capitalism is the process of constant reinvention – how companies must continually evolve as the world around them changes or risk being replaced by new competitors. The pandemic has turbocharged an evolution in the operating environment for virtually every company.*”⁴

1 Mark S. Bergman, Ariel J. Deckelbaum and Brad S. Karp, “Introduction to ESG”, Harvard Law School Forum on Corporate Governance (1 August 2020), <<https://corpgov.law.harvard.edu/2020/08/01/introduction-to-esg/#:~:text=ESG%2C%20at%20its%20core%20is,of%20particular%20investments%20and%20companies>>
2 Klaus Schwab with Peter Vanham, “Stakeholder Capitalism: A Global Economy that Works for Progress, People and Planet”, <https://www.weforum.org/agenda/2021/01/klaus-schwab-on-what-is-stakeholder-capitalism-history-relevance/>
3 Milton Friedman, “A Friedman doctrine – The Social Responsibility of Business is to Increase its Profits”, The New York Times (13 September 1970), <<https://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of-business-is-to.html#:~:text=A%20Friedman%20doctrine%E2%80%9D%20The%20Social,Profits%20%2D%20The%20New%20York%20Times%20>>
4 Larry Fink, “Larry Fink’s 2022 Letter to CEOs: The Power of Capitalism”, Blackrock, <<https://www.blackrock.com/dk/formidler/2022-larry-fink-ceo-letter>>

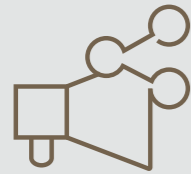


THE IMPACT IS SHOWING UP IN FOUR MAJOR TRENDS



1. Boards and senior leaders are increasingly recognising that their duties to act with care and diligence, and in the best interests of their organisation(s), require them to:

- design and implement governance arrangements to maintain and enhance their organisation's 'social licence to operate' (beyond 'mere' compliance with legal obligations)
- otherwise have regard to longer term performance and the quality of their relationships with key stakeholders (such as employees, customers, regulators and governments) in assessing how best to create and maximise value for shareholders.



2. Organisations are seeking to build and enhance their brand and reputation, and differentiate themselves from their competitors, by reference to an articulated purpose and corporate 'values' and by promoting themselves as 'doing the right thing' (including through the publication of sustainability reports, publicly communicating ESG commitments and providing information to ESG ratings agencies).



3. Shareholders (particularly industry superannuation funds and 'ethical investors'), proxy advisers and other activist stakeholders are increasingly adopting a more overt role of 'stewardship' by expressing their own values. They're demanding that boards and senior leaders account for the organisation's strategy and performance in connection with to ESG-related issues.



4. Key stakeholders, such as customers and employees, are engaging with organisations in relation to their approach to ESG-related issues, and in many instances making purchasing and employment-related decisions informed by the organisation's stated commitments and track record on those issues.

Current ESG priorities



MORE THAN JUST THE E – DON'T FORGET ABOUT THE S AND THE G!

While climate and environmental-related considerations have featured most prominently in ESG-related commentary in recent years, it is important to recognise that ESG captures a broad range of environmental, social and governance concerns. There is no 'fixed list' of issues and many of the concepts overlap. Many commentators prefer the term 'sustainability', to reflect the need for a long-term view of an organisation's 'value', and also to avoid needing to define what each of the 'E', 'S' and 'G' cover. What is important is that organisations know what the key non-financial value drivers are for them, having regard to their industry, and also their purpose, values and strategy.

Consistent with the overall focus on people-related issues (the 'S' in ESG), the top ranking key ESG priority identified by survey respondents was creating and maintaining a diverse and inclusive workforce (e.g., gender, ethnicity, age, sexual orientation) (55.4%), followed by:

- building/improving sustainability capability (53.6%)
- making and satisfying public commitments to address greenhouse gas emissions (e.g., net zero/carbon neutral/carbon negative) (43.8%).

While at first glance, the second and third ranking priorities may appear to be more 'E' related, they both have a clear 'S' and 'G' dimension, insofar as they require skilled personnel and governance oversight to monitor operational implementation and performance.

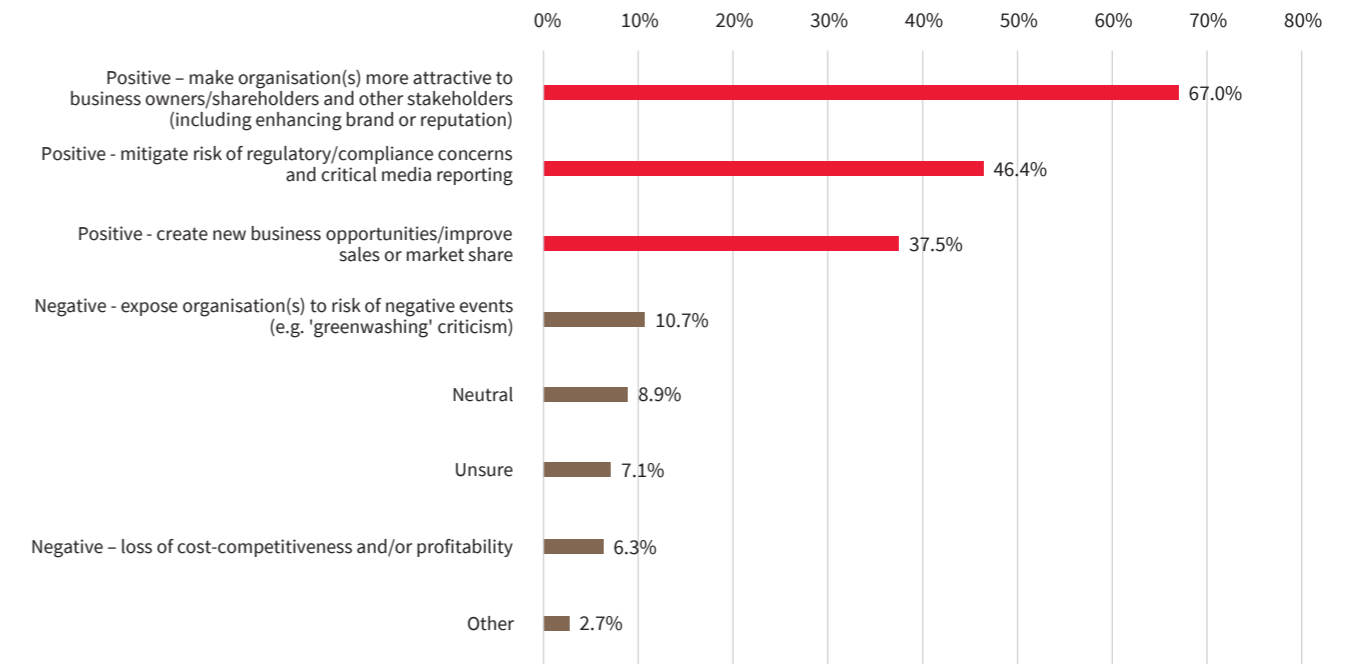
Emerging from the COVID shutdown environment, we see Australian boards and senior leaders actively seeking to (re)position their organisation(s) within their communities and with broader stakeholders. 39.3% of survey respondents said actively participating and investing in local communities in which businesses/operations are located (including through donations/volunteering) is a priority. 36.6% of survey respondents identified engaging with stakeholders (e.g., investors, proxy advisers, ESG ratings agencies) on the organisation's ESG-related initiatives and progress as a priority.

We consider that this aligns with the increasing recognition that broad collaboration between businesses, industries and governments will be required to 'fix the problems'.

Positive impacts expected to exceed implementation challenges

Survey respondents overwhelmingly considered that the medium to longer term impact(s) of the actions being taken by their organisation(s) to make progress towards their key ESG priorities would be positive. 67% consider that it would make their organisation(s) more attractive to business owners/shareholders and other stakeholders (including enhancing brand and reputation). 37.5% anticipate that their ESG actions would create new business opportunities/improve sales or market share.

Anticipated impact of taking ESG action



Key influencers of ESG activity

Asked to select their top three, survey respondents identified board/senior leadership as having the greatest influence on what their organisations are doing in relation to ESG matters, followed by business owners/shareholders, and customers.

51.9% of survey respondents identified stakeholder management issues (e.g., balancing competing interests and objectives) as the biggest ESG challenge. In yet another reminder of the consistent and wide-ranging concern regarding human capital, the area of second-greatest concern among respondents (43.5%) is a lack of specialised personnel/knowledge to implement actions required to progress towards their key ESG priorities.

Who pays?

Survey respondents recognised the difficulties in allocating the financial cost of actions to satisfy climate commitments, with 52.7% indicating that it should be a combination of stakeholders, and 37.3% indicating that it should be business owners/shareholders, who bear the cost.



John Elkington on the Future of ESG:

“ESG is the future [but] it won't necessarily be called that. I think we're moving towards some sort of peak moment in all of this where, because we're a herd animal after having this feeding frenzy, people back off for a while and then come back, recharged.”

“It's about building the new economy in a way that is genuinely fit for purpose, and that is not just about simply addressing climate change, although that will become absolutely crucial over time. It's doing it in an inclusive and honest way. That's why I say responsibility as an agenda is not going away, but it's certainly going to mutate and evolve very rapidly in the coming months and years.”⁵

Our key takeaway from the responses to our 2022 *Directions* survey is that we are in a new age of collectivism and engagement .

There is a clear recognition among senior business leaders and other stakeholders that it will be critically important that businesses, together with government and other institutions, work together to face into the broad range of issues falling under the ESG umbrella in order to navigate the range of complex challenges affecting their organisations, the communities in which they operate and the planet.

This focus cannot be 'set and forget' or delegated to a team or business unit to administer – it will need to be sophisticated, holistic and measurable. No longer a matter of mere 'morality', specific legal, governance and compliance requirements will continue to evolve, and stakeholders will demand greater transparency and accountability in relation to achievement of objectives and targets. But instead of being seen as 'red tape' or a compliance burden, our survey results indicate an over whelming optimism that taking ESG-related actions will generate positive outcomes for business, as well as for the wider community.

⁵ John Elkington in Lucy Dean, “Disgrace: Tesla's dumping from ESG benchmark highlights ratings problem”, The Australian Financial Review (15 June 2022), <<https://www.afr.com/wealth/investing/cannon-brookes-rates-alongside-musk-gore-says-esg-leader-20220614-p5atn4>>





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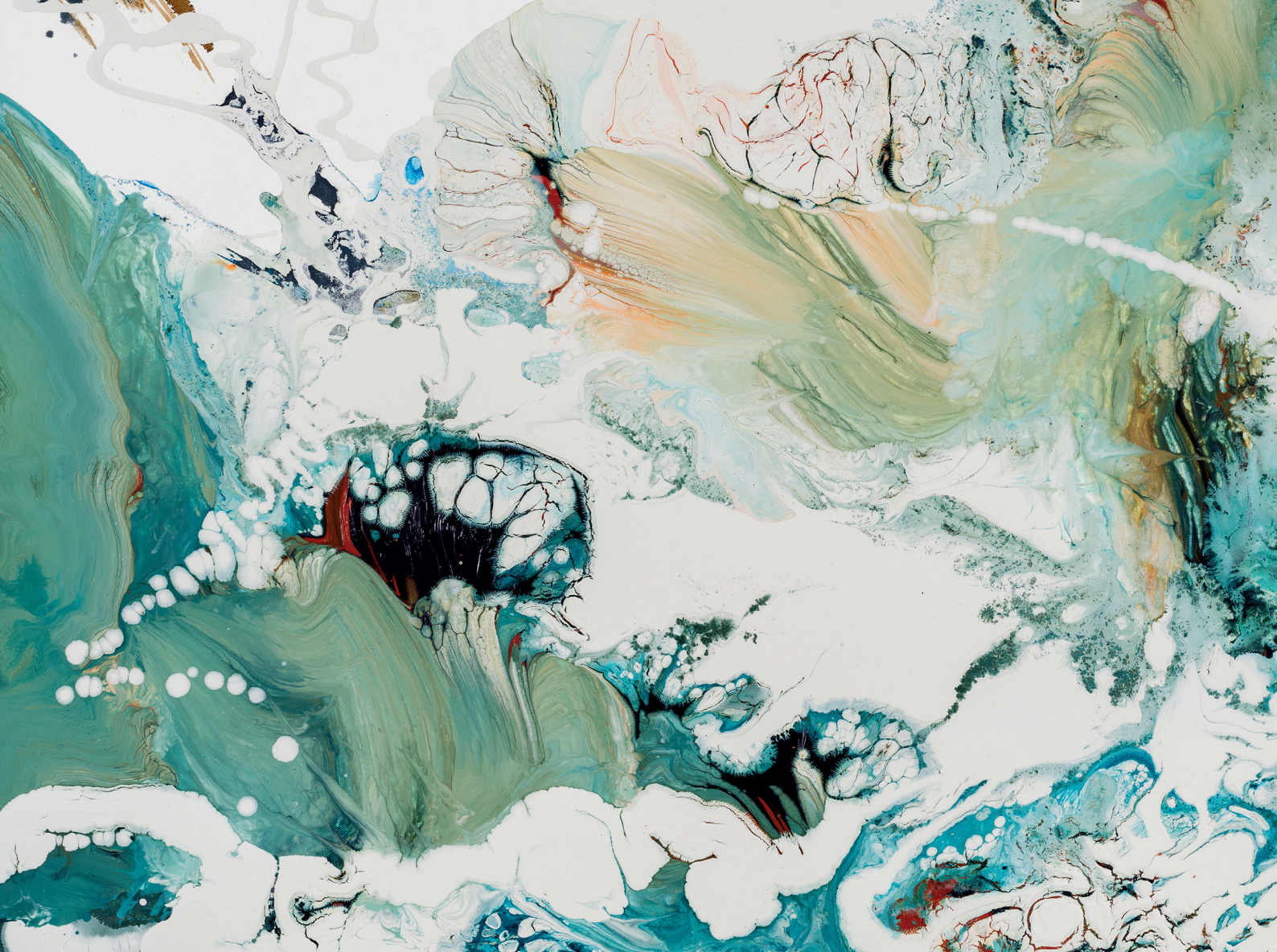
About the Survey: King & Wood Mallesons' 2022 *Directions* survey was conducted during April 2022. The results discussed in this report are drawn from the response of 118 director and senior executive/ executive clients.

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