

# Active Value

New Research Empowering  
Sustained Superannuation Prosperity



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Australian superannuation sector leaders have self-identified as:

- Retirement-timeframe, long-term and universal investors
- An interested party in the economic quality-of-life of client/members, their families and communities
- Having a fiduciary responsibility for active ownership, incumbent on their economic scale



A research breakthrough:  
New knowledge illuminates the path  
to responsible action

to price the future,  
and to grow the pie

#### Why Do We Need To Act?

- **Sustainability threats have advanced from being on the long-term horizon to tangible immediacy**
- **Australian superannuation is exposed to existential risk from a compounded triple-whammy of at-scale systemic issues**

.....unless it chooses deliberate leadership action.....

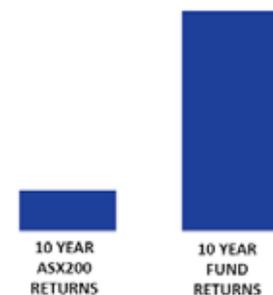
# Critical Issues

## ASX200 Returns are Below Investment Grade

The first systemic market issue is the boat-anchor effect of the Australian economy in general, including, but not limited to sustained low performance across the ASX200.

And yet, Australian Superannuation investors must invest in these underperforming companies, or jeopardise social licence, and the community and employment prospects of clients/members and their families. Poor economic performance and ASX returns are undermining fund performance and client/member well-being – but funds have no choice but to remain invested.

**Imperative:** lift ASX200 performance to set Australia's future economic health



## Offshore Investment Erodes Social License

The second issue is the unsustainable growth in funds going offshore, initially to spread the risk, but increasingly simply in pursuit of better returns.

The industry's social licence to operate is bound to the understanding that Australians' personal assets are being invested in Australia's future. We may already have passed the threshold of public tolerance for investing in foreign assets – but we are trending ever higher.

Australian companies have a poor track record operating overseas. Investors see no evidence of capability and mark-down further attempts. Jointly building this capacity is vital if Australian economic growth is to outpace our meagre demographic trends.

**Imperative:** Australian companies must develop capacity for success in international growth markets



In a healthy scenario, investors would seek to defray their immense exposure to offshore governance and sovereignty risk, by investing through, rather than around well-managed Australian global firms. But first, the agency cost of international operations must be made viable.



GROWTH IN ILLIQUID ASSETS

## A Looming Bubble in Illiquid Assets?

The third issue is the meteoric rise in off-market, or illiquid asset investment that has been the funds manager 'go-to' over recent years. It is clear that circumventing the performance constraints and perverse incentives of the regulated market does not come with an automatic grant of good governance.

In fact, the research shows that there is widespread lack of awareness of what high quality governance practices that impact performance even look like. And, there is even less knowledge on how to negotiate them, or how a board or trustee can assure they are maintaining best-practice, sustained-performance oriented governance within their portfolio. Research evidence shows material performance differential between comparative off-market investments arising as a direct result of the quality of governance arrangements – but extremely limited adoption of better-practice.

**Imperative:** enhanced governance practices are essential to avert risk



## Low Trust Generates Volatile Reactions

This triple-whammy systemic risk is compounded by a mercurial social and political context. We are seeing increased sovereign risk, public bickering and record lows in public faith in institutions. We see sovereign action against assets and asset holders rising from low-growth budget pressures and compromised license to operate.

The bar on securing public trust is moving. Trump is what happens when institutional government erodes its social license to operate. The public, particularly youth, are hungry for meaningful engagement, but are cynically quick to dismiss marketing or unearned demands for respect. Trust comes from shared lived experience. So, don't claim it, prove it.

**Imperative:** leadership... use it or lose it

Large-scale investors, as trustees of public assets, must engage as stewards of the social as well as the financial future of society – providing leadership on public accountability, transparency and the role of our public enterprises in the future of society.

# Breakthrough Research

## Summary

2017 Doctoral research at La Trobe University, Melbourne, Australia, involving directors at nine of the ASX10 (seven at Chair) amongst 60 expert interviews, has delivered a breakthrough in the long sought-after link between governance practice and organisational performance. Governance of Value Creation: An integrated multi-disciplinary governance model for sustained value creation in large scale organisations.

Governance of Value Creation is a future-oriented equivalent to Financial Governance. It enables accounting-style understanding of the (risk and uncertainty mitigated) future value of all of the work of an organisation, a collaborative network, or, a market sector.

It enables leaders to assure the 'Future Fiduciary' question 'Are we optimally invested in our own future'. And, it enables consistently enhanced decision-making throughout an organisation in continuous support and optimisation of better future outcomes. The practice enables communication and communities of collaboration on multi-bottom-line (societal, environmental, and other outcomes as well as financial measures) across multiple future timelines.

The Governance of Value Creation:

- Enables leaders to run more effective organisations focusing on productivity as the achievement of more valuable outcomes (not just cutting cost).
- Creates organisations that can value, and reliably achieve value from ideas and the full potential of staff and community.
- Enables investors to value organisations on auditable evidence of delivering the best future prospects (costing future risk).
- Enables governments to engage in social-value outcome stewardship of collaborative action occurring across collaborative networks and markets.

And, it enables citizens to understand, gain trust and participate in, what their public and industrial institutions are doing and actually achieving towards making a better world.



## Research Context

The link between Corporate Governance and firm performance, or more broadly between Environmental, Social and Governance measures as an indicator of sustained future performance has been “the unicorn” of business management research for decades.

*“We know that there must be some relationship. All corporations, stakeholders and regulators will benefit from knowing what it is”.*

*However, “What is truly astonishing, given the enormous amount of work that has been done on corporate governance, is how little has actually been learned about the value of Corporate Governance and what is actually involved in effective governance.”*

**Leblanc and Gillies (2003)**

The most recent of many Meta-studies, a review of 305 papers from the last 5 years, by University of Sydney Business School, was sponsored and published by Australian Institute of Company Directors (AICD) as “Emerging themes of corporate governance and firm performance” Ford and Rooney (2017).

**It concludes by confirming prior findings that the “Results are inconclusive”.**

## A New Research Approach

2017 Doctoral research by Danny Davis, at La Trobe University, Melbourne, Australia, has taken a new approach using qualitative research grounded theory in interviews with 60 leadership professionals, including Directors at nine of the ASX10 (seven at Chair), ASX200 Directors, Long-term Investors, Departmental Secretaries, Senior Leadership Team Executives, University Chancellors and Subject Matter Specialists. It has developed a new theoretical model, Governance of Value Creation, as the missing link between governance and actual performance. It provides direct practical guidance on what leaders of large organisations can do to phase-shift their capacity for sustained value-creation

And, it has developed an assessment model, in the phases of Innovation Maturity. This measures effective implementation of Governance of Value Creation practices within a large-scale organisation, and hence, their sustained value-creation capacity.

# Research Findings

## **Governance of Value Creation**

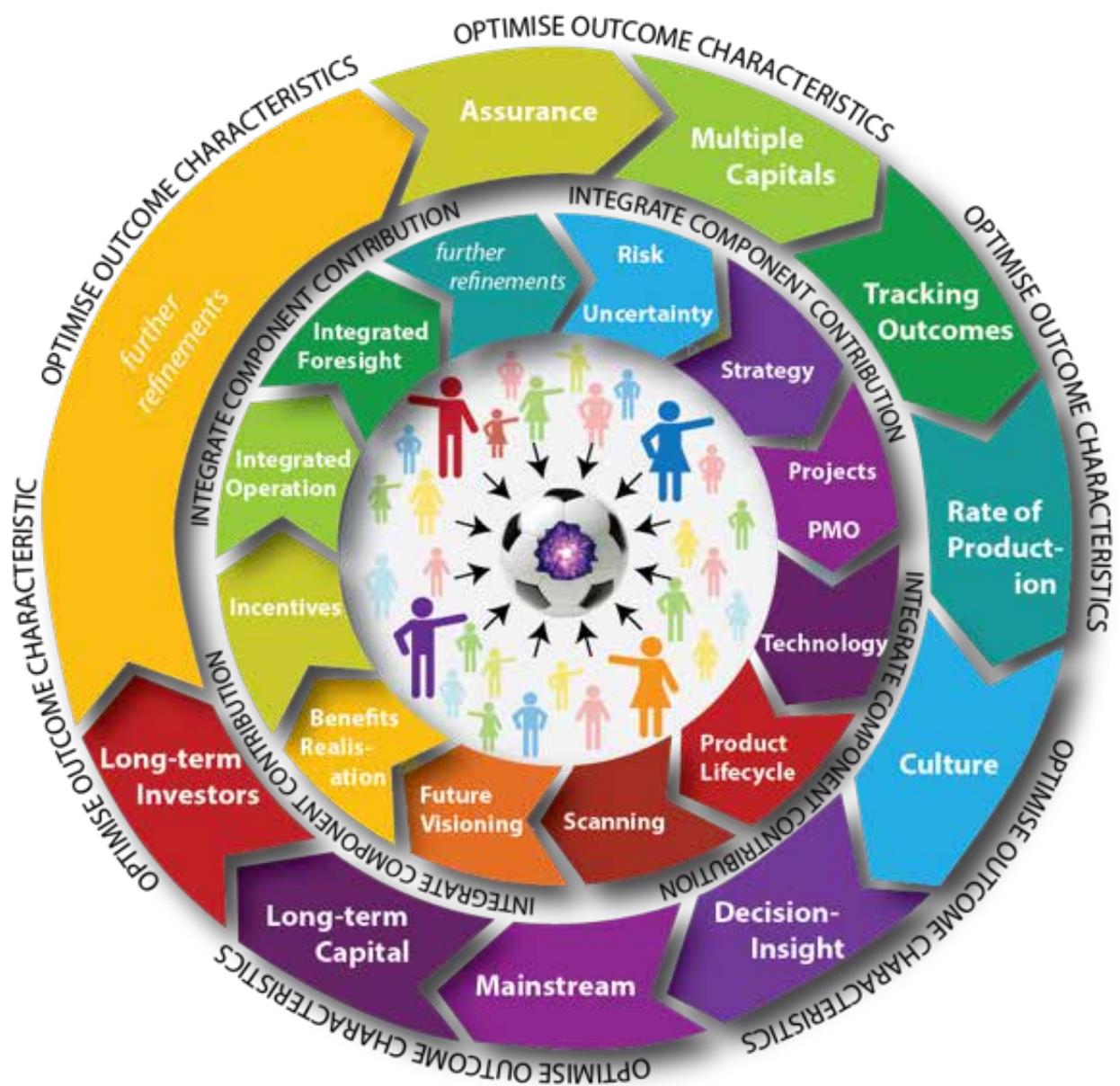
Governance of Value Creation is a future-oriented equivalent to Financial Governance. It enables accounting-style understanding of the (risk and uncertainty mitigated) future value of all of the work of an organisation, a collaborative network, or a market sector.

It enables leaders to ASSURE the core 'Future Fiduciary' question 'Are we optimally invested in our own future?'.

And, it enables consistently enhanced decision-making throughout an organisation in continuous support and optimisation of better future outcomes. The practice enables communication and communities of collaboration on multi-bottom-line (societal, environmental, and other outcomes as well as financial measures) across multiple future timelines.

Governance of Value Creation can be considered as an extension to Integrated Reporting's notion of Integrated Thinking... as a multi-discipline integrated model aligning the contribution of key component disciplines into the effective achievement of optimised outcome characteristics.

And, it enables cross-silo collaboration on sustained multi-bottom-line future-oriented value creation, and the creation of Integrated-foresight for better quality forward looking decision-making. It enables the optimised allocation of capital and tracking of progress at Senior Leadership Team and Board.



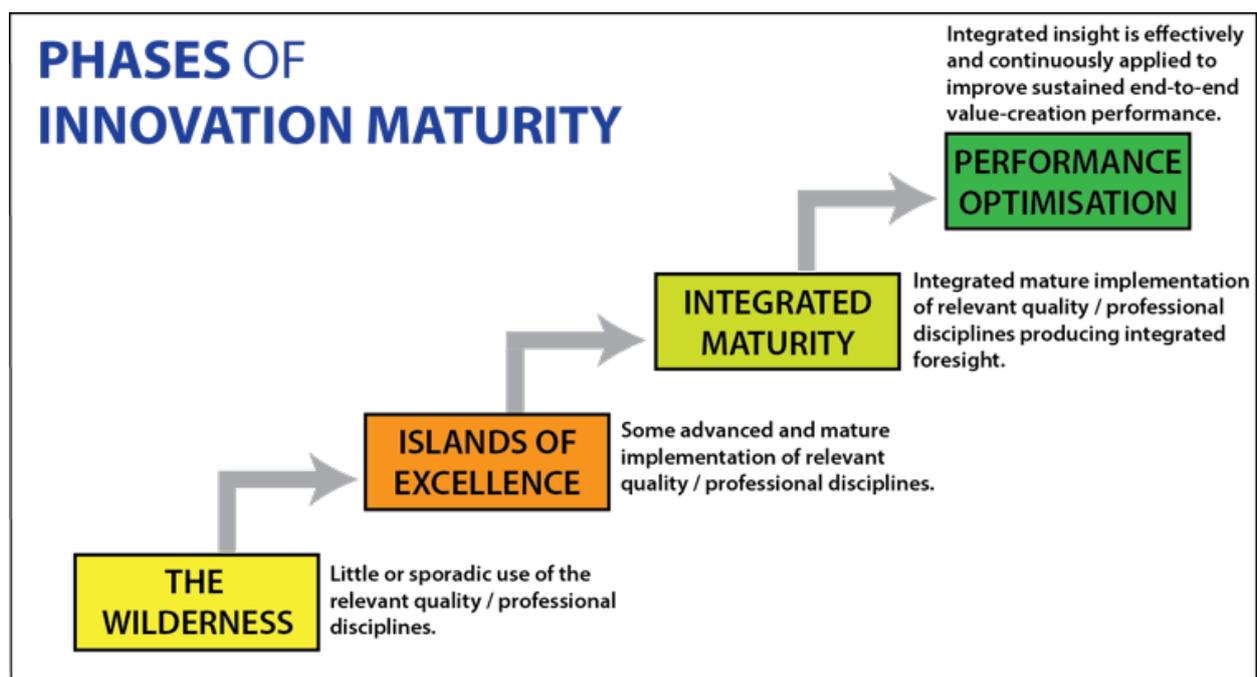
# Research Findings

## Measurement of Innovation Maturity

The Innovation Maturity model provides an assessment of the extent to which there has been effective implementation of Governance of Value Creation practices within a large-scale organisation.

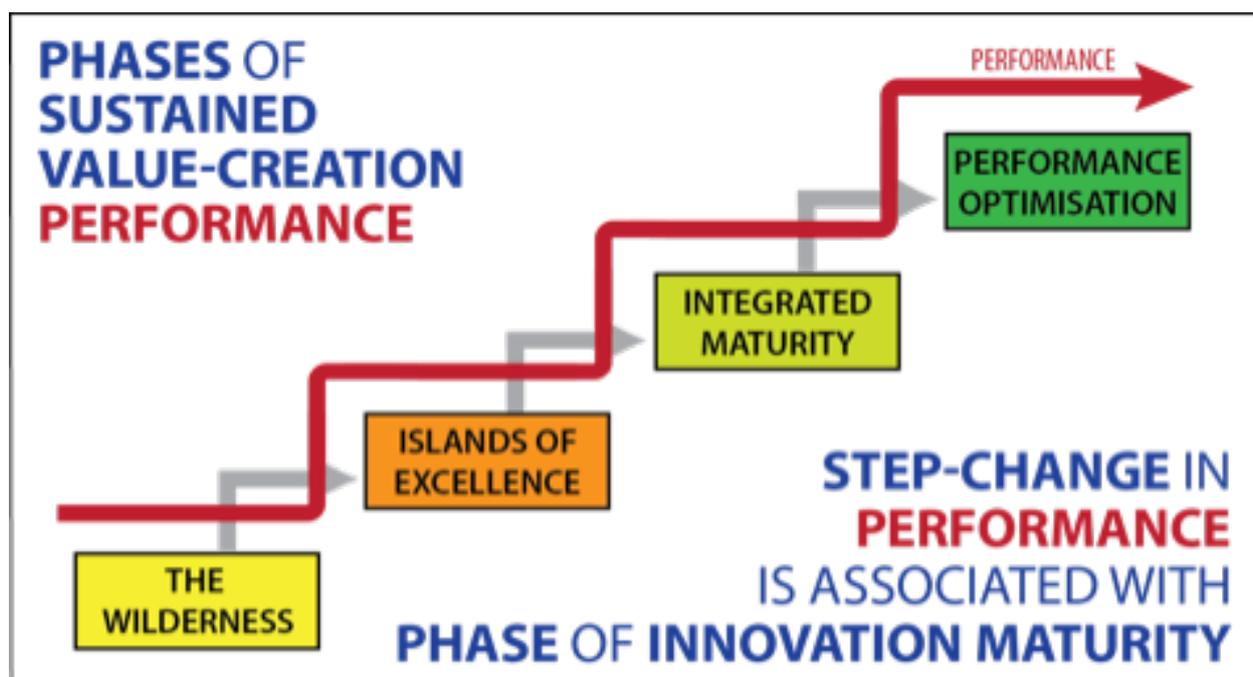
**Assessment of Innovation Maturity enables us to measure an organisation's capacity for sustained value-creation.**

The assessment process measures the maturity of practice and integration of the component disciplines within the Governance of Value Creation model. Simplistically it is the equivalent of an auditor's "financial practices maturity audit" undertaken annually and made visible to investors and stakeholders in the annual report.



In practice, Innovation Maturity is aligned to the professional discipline of Capability Maturity Modelling Integration (CMMI). It is measured using Governance of Value Creation to define the reference model concept within ISO/IEC15504 IT Process Assessment along its capability and process dimensions. It is the first application of these process maturity standards to governance process.

The theoretical basis of CMMI and ISO/IEC15504 lead to a prediction that higher phases of Innovation Maturity are associated with a step-change higher level of sustained value-creation performance.

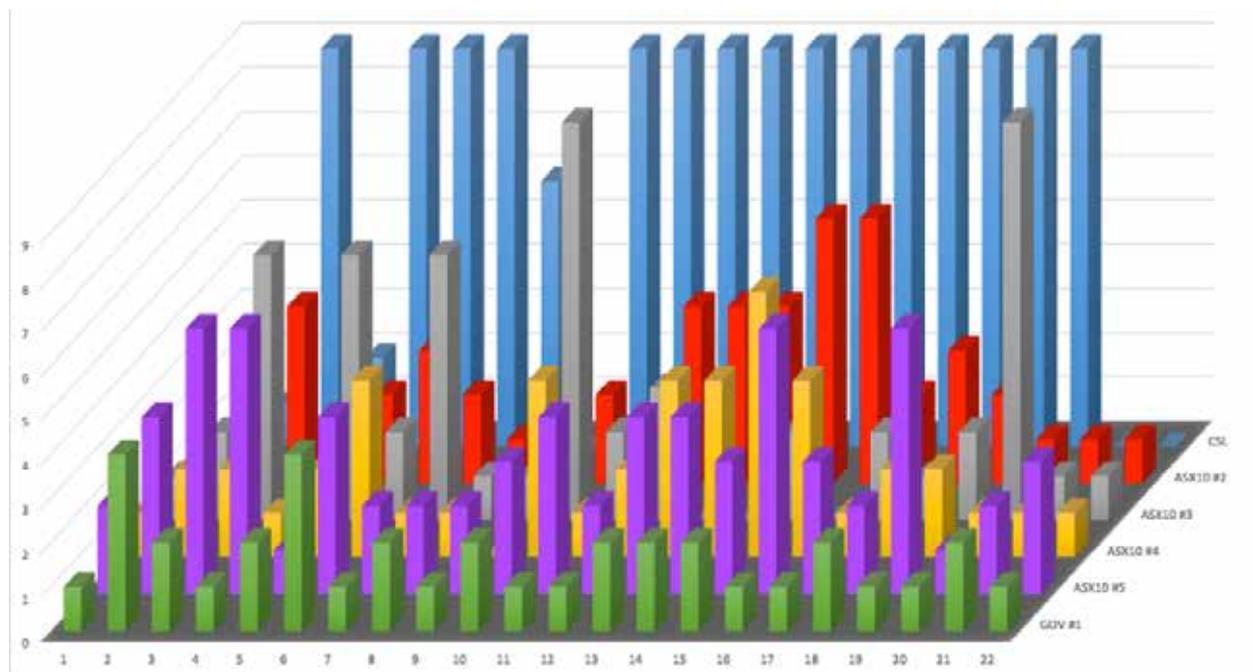


# Research Findings

## Assessment of five of the ASX10

The research interviews gathered in this research were analysed as the basis for assessing the Innovation Maturity levels of five ASX10 organisations, plus one government jurisdiction.

This graph shows the Innovation Maturity rating across each of the disciplines identified in the Governance of Value Creation model (X axis).



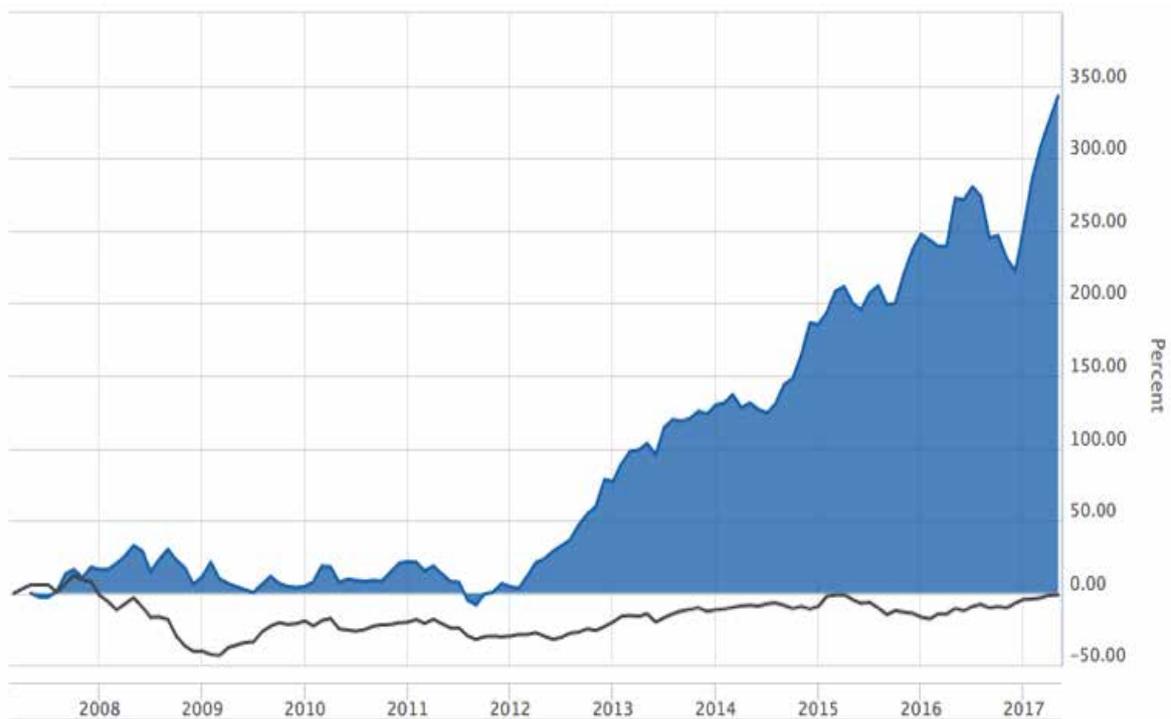
The set of measures in Green are assessment for a government jurisdiction. Purple, Yellow, Grey and Red are assessments of ASX10 companies. Each of these organisations are assessed in the phase of 'Islands of Excellence'. The Blue measures are for CSL (also in the ASX10). They are assessed to be in the phase of 'Integrated Maturity'.

**CSL is clearly the outstanding performer in the Innovation Maturity rating assessment.**

**So... does it make a difference?**

## ASX Performance

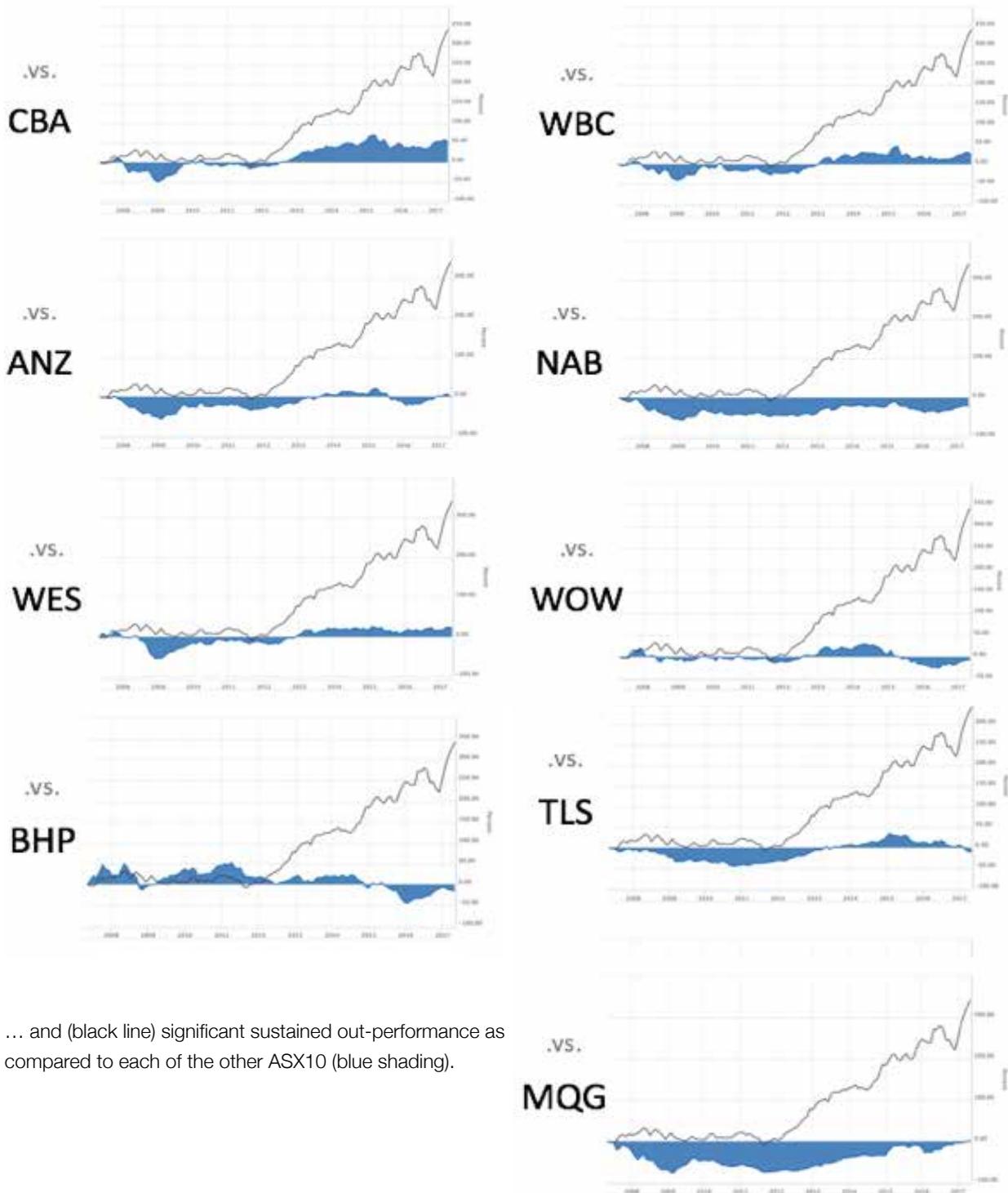
10 year share price is taken as a proxy for sustained value creation performance. This, and subsequent, charts are were produced using the ASX website charting tools on a common-base comparison of share price over 10 years.



CSL (blue shading) shows significant sustained out-performance as compared to the ASX200 index (black line)...

# Research Findings

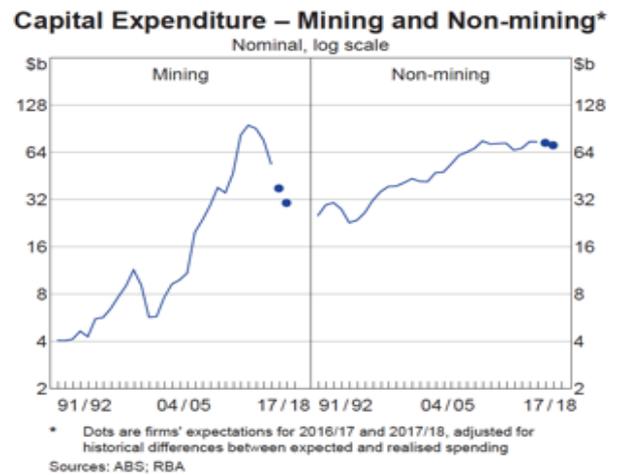
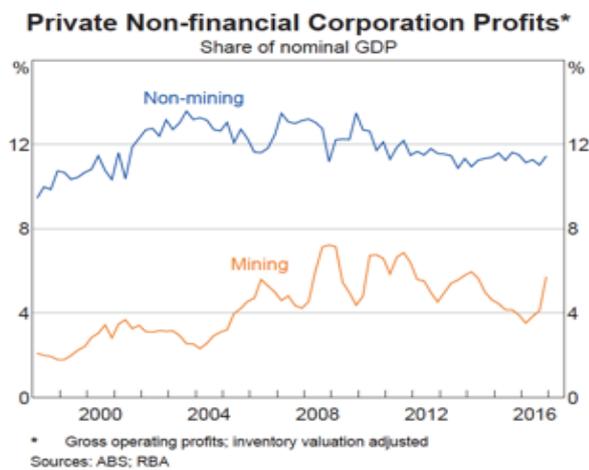
## Comparative Performance of five of the ASX10



# Implication

## Context and Action

In a decade of unprecedented global threat and opportunity Australia's corporate (non-mining) profitability and capital investment have shown flat-line growth.



The mining sector provides proof that with evidence of the right conditions, significant investment can be mobilised.

**There is no shortage of capital, but it is knowledge that drives sustained investment. Not animal instinct, and not government incentives.**

Sadly however, the 'smart money' is right to be holding back from Australian enterprises. The 2016 INSEAD Global Innovation Index rates Australia's effective innovation performance at number #73, just behind Pakistan & Zambia. We spend in the top 12. We just aren't good at achieving outcomes.

**The AIPS aims to 'move the needle' on effective innovation performance in the 65% of GDP made up of large corporates, government jurisdictions and large-scale investors**

Economy-wide change will be achieved by coaching 'elite practitioners' on the high-performance use of advanced disciplines – to help them achieve the potential 'step-change' in performance. Smaller organisations, particularly in the services sector (refer to the boom in mining services sector) and the 'ideas economy', will follow.

**Applied knowledge empowers existing leaders to drive more effective innovation investments**

# Deliver Benefit Through Action

## Price The Future

### ***Future-risk looms as the largest unmitigated investment risk***

Based on new breakthrough research, the structured, assurable, standards basis of Governance of Value Creation, and its Innovation Maturity Measurement practice provides a basis for the development of investment grade assessment and mitigations. It will enable better stock selection, and better identification of risk in your portfolio.

### ***Valuation***

Governance of Value Creation provides an assurable method of rating the capacity of an organisations to achieve their potential opportunities. It is not a measure of their exposure to growth markets, or a subjective historical opinion on the quality of their leadership. It is a measure of the maturity of the quality practices, and business portfolio future-value-accounting that allow an organisation to assure achievement of forecast outcomes through effective practice.

### ***Investment Signal***

There is value even in the low-hurdle of identifying the bottom 25% of performers who need your active ownership "attention". Much more is possible. It provides a comparative rating of the level of risk associated with an organisation's future assertions... are they reporting tangible achievement of value-creation progress and prospects, or are they blowing smoke?

**Goal:** to value companies who are the most effective investors in value creation and sustained competitiveness.

### ***Illiquidity Risk***

This rating practice provides an early warning of the extent of the future-risk you are holding. This is of particular value where off-market investment, or your saturation of ownership, means you are no longer able to trade away from strategic misadventure.

**Goal:** to value organisations who can ASSURE that they are OPTIMALLY invested in their own future.

### ***Long-Term Systemic Shift***

Early focus will be on collaborative development of a 'Future Rating Agency' to assess by interview and analysis. In the longer term we target the self-reporting of future projections and their associated risk and uncertainty confidence levels. Here Directors vouch for the quality of standardised practice appropriately supported by external audit (eg: ASIC controlled Financial reporting, or the JORC code for Resource and Reserves Reporting).

**Goal:** to accurately price future-risk and value (conservatism), and, to change behaviours in the market (activism).

## Grow The Pie

### **Motivation**

The value-creation behaviours of organisations across the economy are influenced by Investors' valuation practices. The use of Governance of Value Creation, and its Innovation Maturity Measurement to value organisations will provide an incentive for all organisations to improve their effectiveness, and in doing so, increase the pool of investible future-oriented growth stocks. Assurable evidence based standards enable investors to operate as "Fiduciary Activists" in alignment with core principles.

**Goal:** A rising tide to float all boats

### **Risk Reward**

Research has uncovered conservatism, disincentives, perverse incentives and rewards for outright value-destruction plaguing market-exposed corporations. The economic reward for unlocking this behaviour is enormous. The mantra that reward requires accepting higher levels of risk is FALSE. The research documents the widespread use of corporate-risk and decision-making practices that are consistently promoting higher-risk, lower-return options.

Investors have the potential to change behaviours. The continued development of accounting standards, and the JORC code in the resources sector are key examples. Ultimately it is investors who drive corporate aspiration – and thereby the systemic capacity for governance, leadership, global growth and business innovation.

**Goal:** To provide a rational, measurable, multi-bottom-line evidence basis to counter-balance short-termism, misplaced treatment of risk, volatility-complacency, and agency risk of inaction.

### **Productivity and Pace**

Governance of Value Creation refocuses productivity as the achievement of more valuable outcomes, not just the removal of cost. It is the productivity of effective strategic action, and a zero waste interpretation of learning and experimentation. The evidence-based-confidence that is produced builds systemic willingness to invest in opportunity that is currently going to waste. Research has quantified the pent-up investable opportunity, identified but dormant within Australia's corporate leaders at over \$100Bn annually.

**Goal:** Investing in Economic Growth.

### **Expand Asset Classes**

The Governance of Value Creation practice may be further enhanced to price the risks constraining investor participation in a range of new asset classes including public infrastructure, provision of public services, and support for unlisted small and mid-tier growth companies.

# The Australian Institute of Performance Sciences

The Australian Institute of Performance Sciences (AIPS) seeks to realise the economic and social benefits (the impact potential) of the Governance of Value Creation breakthrough for the sustained prosperity and economic wellbeing of all Australians.



The AIPS can be thought of somewhere between the collaborative development of Accounting Standards and the Australian Institute of Sport. It facilitates the ongoing collaborative development of leading-edge practices... and delivers coaching for high-performance use by elite practitioners.

The AIPS is an independent, for-industry-by-industry organisation, funded by industry subscription across the top 500 participants in the Australian economy. It is independent, not-for-profit, led by an independent expert board. It promotes enhanced collaborative innovation practice for evidence based decision-making across all sectors of the economy. It is not a lobbyist for special interests.

The AIPS aims to 'move the needle' on effective innovation performance in the 'top 500', the 65% of GDP made up of large corporates, government jurisdictions and large-scale investors

Economy-wide change will be achieved by collaborative development of leading-edge practice and coaching 'elite practitioners' on their high-performance use. It will focus on enabling them to achieve the potential 'step-change' in performance identified in the research. Smaller organisations, particularly in the services sector and the 'ideas economy', will follow.

By increasing corporate capabilities, and the evidence to support it, to 'investible quality', the AIPS expects to stimulate \$100bn in additional annual corporate investment focused on innovation, productivity and export growth.

The AIPS is a cross-industry collaborative initiative. It requires no corporate welfare, no blank-cheque programs, no new policy, and no legislative change.

New knowledge and collaborative action across Active Investors and Operating Companies will influence economy-wide highly-effective Value Creation.

The AIPS will drive the knowledge to make large-scale organisations more effective at sustained value creation, and enable them to produce assurable evidence to justify further investment.

Additionally, the AIPS will:

- Facilitate governance standards for illiquid asset performance – enabling trustees to assure standards across the portfolio
- Develop consumer views of social, environmental and financial futures arising from the efforts of companies and investment portfolios
- 'float all boats' in your portfolio
- Develop an investible rating practice allowing you to identify future-risk within your portfolio
- Enable new investment classes through enhanced value-creation progress reporting
- Enable accounting quality reporting of future-value projections
- Drive public sector effectiveness
- Increase industry and public participation in the community sector
- Operate a 'trusted third space' innovation lab running evidence-based collaboration between government, industry and community (increased pace of innovation across civil society)
- Fuel the effective uptake of technology and innovation across the Australian economy
- Enhance Australia's corporate innovation, and international operation capabilities
- Transform the ideas economy from a push-model to a pull-model through the setting, and delegation of corporate value-creation targets

In complexity, leadership must become both art and science.



**Governance of Value Creation and the Australian Institute of Performance Sciences are presented as an alternative approach to economic development, enterprise productivity, public sector reform and the competitive transformation of the Australian economy.**

**COLLABORATIVE PARTICIPATION FROM ASX200, INVESTORS AND GOVERNMENT WILL HELP BUILD SUSTAINED SUCCESS IN THE AUSTRALIAN ECONOMY**