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Insight Newsletter

Preparing for Accelerated growth

Welcome to the second edition

In this issue:

Welcome to the second addition of the *Insight Newsletter!* The first edition was well received based on comments from those the team and I have spoken to. They have also given us feedback that we have taken onboard in pulling together this second addition.

In short, the team was asked to bring more articles on risk, but to also maintain a balance with general interest articles.

I have taken the liberty of including an article that tells you more about the services that PwC Zambia can offer through the Risk and Assurance Solutions department.

We all know that Zambia is currently going through a lot of change. There are debates raging on whether these are good, bad, neutral, required, rushed, etc. I will not get into such a debate, however, I have included an article that asks if you are ready for the impact of these changes.

We have also included and article dealing with two areas of risk that no Director (executive or non-executive) can ignore - reputational risk and procurement risk.

Those two areas touch on each and every organisation. For example in PwC, we guard our reputation very jealously as do all organisations out there.

Lastly, we have included an article of general interest around the decentralisation of the water sector, running a good comparison with what is happening in Zambia against the region.

The team and I continue to work hard to deliver a quality newsletter. I would like to thank all the contributors to this newsletter. Without them there would be no newsletter.

I would also like to thank those who provided me with feedback on the first addition as your comments can only make this product better.

If you are interested in giving us additional feedback, please do not hesitate to contact us on **insight.zambia@zm.pwc.com**

Kimani Kariuki

The Insight Newsletter, while continuing to deliver articles that are of interest to you, the senior manager, has also delved a little further in the realm of risk and risk assurance services

Reputation: Deal Maker or Breaker?

A Closer Look at Reputation Risk

It is often said that while a good name is built over time, it does not take a lot to destroy it. In today's world, corporate and individual customers purchase goods and services; from financial services to toothpaste brands, based to a large extent on the 'good word' of existing customers.

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Producers of imitation products thrive on the good reputation of original brands. The quest for product and service differentiation has highlighted that intangible assets like reputation provide a potential competitive advantage to an organisation.

Reputation risk is regarded as the greatest threat to a company's market value, according to a study by PwC and the Economist Intelligence Unit. Like many of the intangible assets whose value has risen in recent years, reputation has been overlooked by organisations because it is so difficult to measure accurately.

It is only when a reputation incident severely damages the credibility of an organisation or one of its brands, or its standing in the eyes of its key stakeholders, that the potentially catastrophic consequences of not managing the crisis properly become apparent.

Many organisations make the mistake of assuming that all that is needed is media training and crisis planning. However, a reputation crisis exposes to public and media scrutiny not only the organisation's competence at crisis handling, but the values, standards and shortcomings that could have existed beforehand.

Understanding Reputation Risk

Reputation risk is the risk that potential negative publicity regarding an organisation's business practices could cause a decline in the customer base, costly litigation, or revenue reductions. It is the current and prospective impact on earnings and capital arising from negative public opinion.

This affects the company's ability to establish new relationships or services or continue servicing existing relationships. Reputation risk exposure is present throughout the organisation and includes the responsibility to exercise caution in dealing with its stakeholders.

Assessing Reputation risk is a subjective assessment that could depend on a number of different factors. Reputation is and could be perceived as an intangible asset, synonymous with goodwill, but it is more difficult to measure and quantify. Consistently strong earnings, a competent board of directors and senior management, loyal and committed employees, and a strong customer base are just a few examples of positive factors that contribute to a company's good reputation.

The rewards can be great for a company that has an excellent reputation. A good reputation strengthens a company's market position and increases shareholder value. It can even help attract top talent and assist in employee retention. In short, reputation is a prized asset, but it is one of the most difficult to protect.

The Price of a Tainted Reputation

Just as reputation can be built and preserved over time, it can also be destroyed quickly. Severe erosion of shareholder value is common during Reputation crises.

In its battle with the US government in the aftermath of the 2008–09 financial crisis, the investment bank Goldman Sachs saw a 13% drop in its share price. This was on the back of a charge by the US Securities and Exchange Commission for defrauding investors by misstating and omitting key facts about a financial product tied to subprime mortgages as the US housing market was beginning to falter. During the BP oil spill disaster in the Gulf of Mexico, BP's stock was almost cut in half, the equivalent of about US$90 billion in shareholder value, more than the market value of Procter & Gamble.

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Managing Reputation Risk

In some cases the drop in stock value is temporary, in other cases permanent. Much depends on how the companies handle the aftermath of crises and commit to resolving the underlying business issue rather than engaging in shallow PR exercises.

Other factors such as bad customer service or costly lawsuits and litigation could all have a significantly negative impact an organization's reputation. So, how can a company prevent its reputation from being damaged or tainted?

Preserving a strong reputation revolves around effectively communicating and building solid relationships. Communication between a company and its stakeholders can be the foundation for a strong reputation. Timely and accurate financial reports, compliance with laws and regulations, and excellent customer service are important aspects of reinforcing a company's credibility and obtaining the trust of its stakeholders.

Reputation risk is managed through strong corporate governance; an institution's board of directors and senior management should actively spearhead Reputation risk awareness by demanding accurate and timely management information, which they then use to communicate with stakeholders.

The reputation risk management strategy should have two simple objectives – to prevent the causes that could damage the organisation's reputation, and to minimise the impact if, a reputation crisis should occur. The following are some of the key elements that should be incorporated in an effective reputation risk management strategy:

- Maintaining timely and efficient communications among shareholders, customers, boards of directors, and employees
- Establishing strong reputation risk management policies and procedures throughout the organisation, including an effective anti-fraud program;

- Reinforcing a risk management culture by creating awareness at all staff levels through reputation management training and education;
- Instilling ethics throughout the organisation by enforcing a code of conduct for the board, management, and staff;
- Developing a comprehensive system of internal controls and practices, including those related to computer systems and transactional websites;
- Complying with current laws and regulations and enforcing existing policies and procedures;
- Responding promptly and accurately to company regulators, oversight professionals (such as internal and external auditors), and law enforcement; and
- Establishing a crisis management team.

An organisation's reputation remains its greatest asset and risk; if you have no reputation, you have no business. Boards of directors and senior management are responsible for measuring and monitoring Reputation risk and therefore must remain vigilant and active in providing the safeguards to prevent loss of reputation.

PwC Zambia, supported by the wider PwC network has a vast pool of resources that can assist you and your organisation manage reputational risk.

Under the Sustainability arm of the Risk and Assurance Solutions services, we are distinctly aware that running a sustainable business and more importantly, reporting to stakeholders that you have a sustainable business, is more than media reporting.

Our experts will work hand in hand with you to identify gaps and their potential effect on the business. Please contact ***Kimani Kariuki*** via email: ***insight.zambia@zm.pwc.com*** for more information.

Change is here to stay in Zambia – but are companies prepared?

The Zambian economy continues to undergo a lot of change in the operating environment. CEO's and Directors need to be very conscious of the impact these changes would have on the organisation.

Senior management should not just focus on trying to predict the changes coming and their impact, but also on preparing a resilient organisation that is flexible enough to convert 'change' into 'opportunity'.

Over the past 18 months, there have been a significant number of changes to the overall business environment in Zambia.

In 2012, we saw the Bank of Zambia raise the minimum capital requirement of Banks, we saw the kwacha-risation of the economy through SI33, we were introduced to new minimum wages, and we now have a rebased currency that is stronger that the South African Rand.

There were also a number of subtle changes with big impact, such as the banning of tujiri jiri. In 2012, we also saw the successful Sovereign Bond issue that was over-subscribed and put Zambia squarely on the map of potential global investors.

2013 has not been any more stable. In May, the Government removed subsidies on maize and fuel that were costing the economy up to 2% of GDP. To put that in perspective, the public service wage bill stands at about 8% of GDP and GDP for 2012 was estimated at $23.68 billion. (Alan Whitworth, 2002-2011, *Creating and Wasting Fiscal Space: Zambian Fiscal Performance*)

We also saw the introduction of legislation that is meant to assist the Bank of Zambia monitor the movement of foreign currency in and out of the country. We are also waiting for a new Companies Act, and a Banking and Financial Services Act, amongst others.

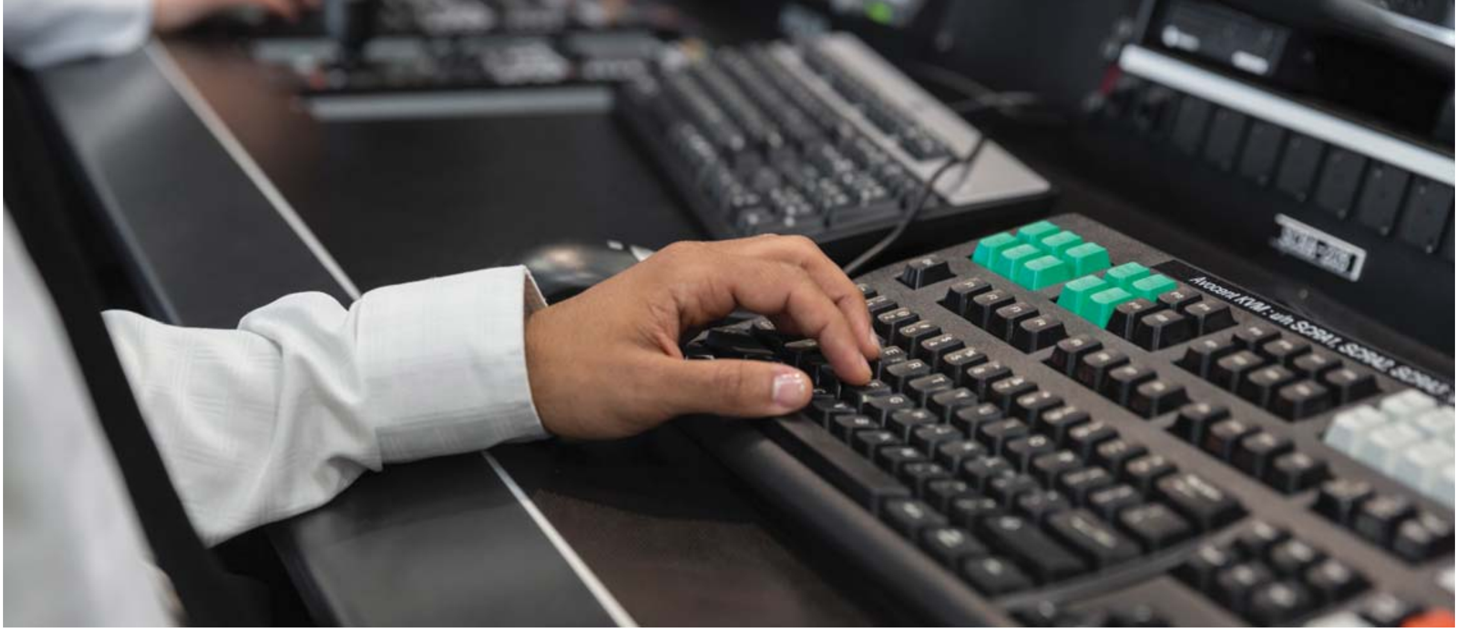
We can get into a debate about whether these changes are good or not for the economy. However, one theme that is common in discussions amongst senior company officials is whether their companies are prepared for the impact of these changes.

Sweeping changes require businesses to act swiftly and take immediate action. If we talk of changes in minimum capital, banks have to put in place measures to grow their asset base to be commensurate with the funds invested in them by their shareholders. Growing an asset base is not just about lending more; it requires Infrastructure and Human Resources (numbers with relevant skills).

With the successful Sovereign Bond, plus plans by other public entities to raise funding using a similar route, Zambia becomes more attractive to investors, bringing unprecedented competition for local business. This interest also brings the potential for merger or acquisition activity that has long been tame in local market.

In determining how prepared the organisation is, CEOs and Board of Directors can request specific services either from their internal or external experts such as Risk and Corporate Governance or Internal audit. These services would include:

Process Assurance – This is where each organisation looks at existing processes and determines whether they are appropriate for their current and



future levels of business. There are growing complexities and increased regulatory pressures in Zambia, which have been compounded by market stressors such as cyber security threats, rapid technological advancements, and operational efficiency imperatives. All these combine to force organisations to seek more assurance, value and reporting over a widening spectrum of activities.

Process assurance covers various elements such as IT performance improvement, improved analytical reporting and business intelligence, back-office performance improvement, regulatory compliance and cost rationalisation and assistance in documenting or testing the internal control environment.

IT and Project Assurance - For most companies, investing in technology is a significant cost that is made with associated risks. In making technology investments, there are at least three key hurdles to overcome: making the right technology choices, acquiring adequate funding and realising the full value of the investment after implementation.

Similarly, in preparing for change, it is likely that a large number of projects (IT, market stimulus, production improvement, stock management) need to kick off simultaneously, raising the risk that uncoordinated projects could easily become expensive and may not meet the entities objectives and goals.

Corporate Governance, Risk and Compliance - One indisputable consequence of the changes being demanded by the economy coupled with the global corporate disasters is a sharp increase in the attention paid to risk and risk management by key stakeholders. Companies need to identify and manage significant risks including strategic risks, operational risks, financial risks, compliance risks and/or reporting risks.

Because of this need, robust risk management processes have become a critically important tool to assist companies in this regard and to gain a competitive advantage over their peers. Some of the areas where companies are looking to achieve this competitive edge are through Enterprise Risk Management, better business continuity management and planning and robust compliance and regulatory risk management.

Internal Audit - Internal audit works to bring together all of these elements. We must bear in mind that in the modern world, internal audit functions can either consist purely of a team employed by the organisation; a team that is a mix of employees and external experts; or a team consisting of purely external consultants. None is preferable to the other, but the choice depends on the business model of the company concerned.

Companies continue to prepare themselves for the changes that are there and continue to come. This article is not a paper on all the areas that CEO's should be concerned about, but it does give some indicators of how CEO's can assess the level of preparedness of their organisation.

Management need to take time to ensure they are prepared for the impact of all the changes in the operating environment. It is becoming more critical for senior management to sit back and, not try to predict the future, but create an organisation that is flexible, ready to take advantage of positive change, and resilient to adverse movements in the market.

At PwC Zambia, we work with many organisations to enhance value by translating strategy into action and focusing on results. Our hub-and-spoke model ensures that we bring the right resources to bear every time, with all of our clients. Get in touch at ***insight.zambia@zm.pwc.com*** for more information.

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Procurement risk management

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Procurement represents one of the largest functions within any organisation. An weakness in this function will cost a business money, time, profitability and reputation.

We are increasingly being exposed to details around what goes behind the scenes in procurement deals, particularly of large tenders in public institutions.

Unfortunately, in most cases, the tales are told after the fact and in most cases it is only the 'shady' deals that seem to attract the most attention. This probably goes hand in hand with a more enlightened population that is demanding more transparency and accountability; any sniff of fraudulent or errant activity in procurement, will set interested parties like taxpayers or concerned citizens off.

From purchasing of commodities like oil, medical supplies, helicopters, ships, gold, land, to services including currency printing, currency, medical service providers, electronic voter registration, clearing and forwarding, and even ISO certification…the list is endless; question marks cropping up being the common theme.

If you are the head of an organisation or in charge eg chairing a Board, don't be trying to find out the detail when the scandals breaks out or when you are called before the Board/Public accounts committee or to the parent Ministry. It doesn't hurt to know what it happening in your organization. In fact, it is imperative.

Are you confident about those in your organization tasked with procuring large items are not creating a problem for you in the future? Are you able to explain sufficiently what was considered? Are there skeletons in your procurement cupboard that if leaked what cause you and your organisation severe reputational damage?

Or more importantly, are you comfortable that all yoru procurement is above board? Is there any possibility of a bidder lodging an appeal and demanding explanations? Could any of the assumptions made by the tender committee or evaluators lead to a cancellation or prove costly in the long run? Are all the vested interests of all the key stakeholders catered for and balanced? This may include, parent ministries, donors, PPOA.

Whether it is through error or fraudulent activity, these deals can cost the organizations a great deal, in both monetary and intangible costs.

Obviously the reputational risks associated with this can be quite catastrophic to an organisation, as these often have a direct correlation and impact on the share price or the perception in terms of credibility of an organisation.

Intangible costs come in a several forms. Apart from the time wastage (and the extra wage bill associated with that time) there is the opportunity loss of what the employees, and other personnel involved could have been doing with their time instead.

While I wouldn't wish to hazard a guess, in my view there are also many more tenders that are awarded after a robust procurement process and no scandal follows. Any review or audit thereafter would provide assurance of a robust process.

And the goods or services purchased are indeed beneficial to the organisation. However, perhaps because they don't necessarily attract media attention, we don't get to hear a lot about them. As a leader, I know where I would prefer to be.

So why are some procurement successful? What are the key ingredients of a well executed procurement?

The first thing is the quality of the people involved, starting with their integrity and objectivity. This sounds pretty obvious but as we know human beings have different levels to which they begin to get compromised. As the old adage says, everyone has a price.

Given that lying or sinning is as much a part of our make up as is breathing, it shouldn't be entirely surprising that you run the risk of some of your teams being compromised, should the opportunity and motive present itself in the process.

To counter this, you will need to ensure that the organisation has a robust procurement structure and appropriate checks and balances built into it. The Public Procurement Act goes a long way in trying to mandate some of these.

However, working in collusion with other parties, stakeholders and fellow employees involved in the process some of these checks and balances can be circumvented.

However, not all people are brave enough to succumb to some form of temptation. But do they possess the necessary skills, tools and competencies to conduct the purchasing orchestra successfully or steer the procurement ship to harbor safely?

More so, once the ship docks, are you people up to the task of offloading, securing and utilising the cargo to the optimum level?

80% of IT projects fail in implementation, because, amongst other things, procurement did not evaluate the abilities of the users and how this matched the system.

It is imperative that you either provide the teams, management or even the Board with the necessary skills to define the requirements sufficiently so that potential bidders are scoping and pricing it appropriately.

Thereafter, they must be able to receive bids and assess them robustly, against pre agreed evaluation criteria. The rigor applied to this process, the documentation to support any decisions, the basis of any assumptions they make, the moderation of scores, and the completeness of this is such a fundamental part of any procurement that I would recommend having this to be checked once, twice and even thrice before being confirmed.

Why? Because it is often very voluminous, and as they say, the devil is in the detail. If your internal audit department is up to the task they too can provide one line of defense, as can an independent part of management separate from the team directly involved. But are they close to those tasked with the procuring? Do they too have the prerequisite skills to perform a rigorous review? Do they understand what qualities are appropriate?

Do you check out the CVs of the people do reference checks, interview the members of your team to confirm their appreciation and understanding and confirm that they have handled similar exercises if you are relying on their experience.

They say 80% of (IT) projects fail on implementation, even when the correct system is acquired so don't stop at the evaluation or procuring team; assess the adequacy of the skills of those tasked with utilising the goods or services being procured.

Finally, timing. It's no use checking the stable after the horse has bolted. It is imperative to ensure that this is done as the process is being undertaken so that the benefits of a quality check are built into the remainder of the process.

Start as early as possible (even before selecting the team). You could also have periodic checks at specific stages or milestones; and then an overall summary. Timing also touches on the evidence that you need to retain to offer any explanations in future should the need arise.

After a specific stage is completed, it is often difficult if not impossible, to recreate the supporting evidence. Let the evidence support the story and hold with the passage of time. Scandals normally come at the end of the process so worth retaining it.

Dynamics of decentralisation in the water sector

Across the world every 21 seconds, a child dies from a water-related illness. Women spend 200 million hours a day collecting water. In Africa, 345 million people have no access to safe water. These statistics are alarming - without water, life would not exist. It is a prerequisite for all human and economic development.

http://water.org/water-crisis/water-facts/water/

Despite the very real danger of future global water shortages, for the vast majority of the nearly one billion people without safe drinking water, today's water crisis is not an issue of scarcity, but of access.

Most Southern African countries have amended their water laws and policies during the last 15 years or so, and restructured their institutional and governance frameworks accordingly.

The integrated water resource management (IWRM) approach inspired new Southern African water policies and one of the key principles was participation which referred to the idea of decentralisation of water policy implementation.

While much effort and goodwill was put into decentralisation reforms in many basins in the region, results are not uniformly realized. For instance, in South Africa twelve years after the launch of the National Water Act only two catchment management agencies out of the 19 originally foreseen are operational, while many water user associations (WUAs) still struggle to find their place and role in the complex and somehow confused context of water management.

In other Southern African countries, the process of decentralization in the water management institutions is even less advanced.

In view of the foregoing, how successful is the decentralisation process of the water sector in Zambia? What lessons can be learnt from other countries and consider implementing in Zambia?

In Zambia, statistics indicate that urban and rural access coverage for improved water supply and sanitation has increased overall since 1990, but is still unlikely to meet its Millennium Development Goals targets.

A Case of Zambia

In Zambia, attempts to reform the water sector commenced as early as 1976, however a number of challenges hindered the process. One key issue was that proposals did not fit in the decentralisation policy of the time.

With a change in Government in 1991 and the introduction of the public service reform, a new attempt was made to solve problems linked to Water Supply and Sanitation. The introduction of new economic policies to liberalise markets influenced the direction of the reform.

The first step in the implementation of the water sector reforms was the adoption of the National Water Policy of 1994. The National Water Policy provides the overall framework for the water sector. It covers water resources management, urban and rural water supply and sanitation, water quality and water tariffs.

In Zambia, statistics indicate that urban and rural access coverage for improved water supply and sanitation has increased overall since 1990, but is still unlikely to meet its Millenium Development Goals targets.

Whereas the Government has developed progressive policies and strategies for meeting the MDG goals, robust commitments to sector policies, increased financing for water and sanitation infrastructure, and better coordination amongst stakeholders are critical to maintaining current coverage rates.

Other challenges include capacity constraints, unplanned settlements, etc. While Zambia has made important advances in regulatory and institutional reforms, the pace of decentralisation continues to be extremely slow.

Recently, the Government of the Republic of Zambia approved the revised National Decentralisation Policy which will empower provinces and districts to manage their own affairs for effective socio-economic development. The revised policy promotes citizen's participation in democratic governance and development at the local level.

Lessons on Southern Africa

Research has revealed that the main difficulties scholars and practitioners identify in Southern Africa water decentralisation processes is lack of knowledge and information among the relevant stakeholders - including water institutions' staff - and the lack of negotiation and decision-making tools which need urgent attention.

The existence of tools and processes for participatory decision-making at the local and intermediate levels are also seen as important factors for successful water governance decentralisation. Other challenges include the following:

- Lack of dedicated resources to effectively carry out mandate in specific areas;
- Inadequate financial resources;
- Lack of transparency and accountability;
- Power conflict between central government and local authorities; and
- Lack of technical competencies.

The above challenges are no exception to Zambia. It is important that appropriate interventions are put in place to improve service delivery as well as meet the Millennium Development Goals.

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