KPMG

On the 2019 board agenda

Board Leadership Center

Board agendas should continue to evolve in 2019. The game-changing implications of technology/digital innovation, scrutiny of corporate culture, growing demands to address environmental and social issues, and investor expectations for greater board engagement, diversity, and long-term value creation should all drive a sharper focus on positioning the company for the future. Combined with concerns about mounting trade tensions, resurging debt, high valuations, and political swings in the U.S., UK, and elsewhere, the year ahead will require a careful balance of near-term focus, agility, and long-term thinking.

Drawing on insights from our work and interactions with directors and business leaders over the past 12 months, we've highlighted seven items for boards to consider as they focus their 2019 agendas on the critical challenges at hand and on the road ahead:

- Take a hard look at the board's composition: Is the talent in the boardroom diverse and aligned with the company's strategy and future needs?
- Recognize that connecting digital disruption with risk management and strategy is more important—and more challenging—than ever.
- Help focus the company on long-term value creation and understand the views of all key stakeholders.
- Make CEO succession and talent development throughout the organization a priority.
- Assess, monitor, and reinforce culture as a strategic asset and critical risk.
- Continue to refine boardroom discussions about cybersecurity and data privacy as *risk management* issues.
- Reassess the company's crisis prevention and readiness.

Take a hard look at the board's composition: Is the talent in the boardroom diverse and aligned with the company's strategy and future needs?

Institutional investors are increasingly focused on board composition, expressing concern about lack of diversity, low director turnover, and whether the board has the right skill sets to guide the company and its strategy in the future. While determining the company's current and future needs is the starting point for assessing and enhancing the board's composition, there is a broad range of board composition issues that require board focus and leadership—including succession planning, age and term limits, diversity, individual director evaluations, removal of underperforming directors, and board refreshment, as well as disclosures regarding these issues.

As Vanguard Chair William McNabb wrote in a letter to public company directors last year, the board "is one of a company's most critical strategic assets," and Vanguard looks for "a high-functioning, well-composed, independent, diverse, and experienced board with effective ongoing evaluation practices." The New York City Comptroller and the New York City Pension Funds, as part of a boardroom accountability project, sent letters to more than 150 companies in 2018 requesting disclosure of the skills, gender, race, and (optionally) sexual orientation of directors in a board matrix in the proxy. As of June 2018, 49 of the companies had elected new diverse directors, and another 24 publicly committed to include women and people of color in their candidate pool for every board search. Some large institutional investors, including BlackRock and State Street, have announced that they will vote against or withhold votes from directors—primarily nominating and governance committees—due to lack of board gender diversity. California's recently passed law requiring publicly traded companies based there to have at least one woman on their board by the end of 2019 clearly punctuates the calls for progress on diversity.

Board composition and diversity should be a key area of board focus in 2019 and a topic for communication with the company's institutional investors, including through enhanced disclosure in the company's proxy.

Recognize that connecting digital disruption with risk management and strategy is more important—and more challenging—than ever.

Advances in digital technologies such as cloud computing, robotic process automation, machine learning, artificial intelligence (AI), and blockchain—and the *speed* of these advances—are disrupting business models and transforming how companies do business. As discussed in the 2018 NACD Blue Commission Report, *Adaptive Governance: Board Oversight of Disruptive Risks,* traditional enterprise risk management processes may not be designed to address the disruptive risks posed by these digital advances or to assess the continuing validity of key assumptions on which the company's strategy and business model are based. Help management reassess the company's processes for identifying the risks and opportunities posed by digital advances and for assessing their impact on the company's strategy. Does management have an effective process to monitor technology changes in the external environment? Does the process provide an early warning that adjustments to the strategy might be necessary?

Also, understanding how the company collects, protects, analyzes, and uses data has become table stakes for broader, potentially game-changing questions: What are the goals of the company's digital strategy and how can the use of big data and advanced analytics help drive the business? Does the company have the right tools, technology, resources, and talent to develop a quality big data program? How do we determine what information drives value for the organization—e.g., insights into customers, employees, suppliers, and business processes—and how do we manage the data in a responsible, ethical manner?

Help the company test its strategic assumptions and keep sight of how the big picture is changing by connecting dots, thinking differently, and staying agile and alert to what's happening in the world. In short, digital disruption, strategy, and risk should be hardwired together in boardroom discussions.

Help focus the company on long-term value creation and understand the views of all key stakeholders.

Major investors (Blackrock, Vanguard, State Street, and others) continue to emphasize their expectations for companies to focus on long-term value creation and the factors driving it: strategy and risk, talent, R&D investment, culture and incentives, and environmental, social, and governance (ESG) issues—particularly climate change and diversity. At the same time, these investors stress the importance of the sustainability of the company's business model.

In his 2018 letter to CEOs, BlackRock's Larry Fink expanded on this theme, emphasizing *purpose* and a *stakeholder-focused model of governance*: "Without a sense of purpose, no company, either public or private, can achieve its full potential. It will ultimately lose the license to operate from key stakeholders. It will succumb to short-term pressures to distribute earnings and, in the process, sacrifice investments in employee development, innovation, and capital expenditures that are necessary for long-term growth. It will remain exposed to activist campaigns that articulate a clearer goal, even if the goal serves only the shortest and narrowest of objectives. And ultimately, the company will provide subpar returns to the investors who depend on it to finance their retirement, home purchases, or higher education."

Calling Fink's letter "both inspiring and blunt," William W. George, Senior Fellow, Harvard Business School, suggested that, "There should be no debate between the stakeholder value model and the advocates of creating shareholder value. Shareholder value is the *result* of having a clear mission and set of values that motivate employees to serve customers. Companies that start with the mantra of 'maximizing shareholder value' ultimately destroy the very shareholder value that they are trying to create because they refuse to make the long-term investments required to create sustainable shareholder value." Martin Lipton of Wachtell Lipton said that Fink's letter "sets out the type of engagement between corporations and their shareholders that BlackRock expects in order to secure its support against activist pressure… [and] needs to be carefully considered in developing investor relations engagement practices…"

The shareholder/stakeholder debate may seem philosophical, but we believe it is a discussion every board should have, as it raises practical questions about the company's strategy and how that strategy should be communicated to investors and other stakeholders.

Make CEO succession and talent development throughout the organization a priority.

Few board responsibilities are more important than hiring and firing the CEO—a reality that continues to hit the headlines, particularly if the board is caught flat-footed. Given the complex and disruptive business and risk environment today, it is essential that the company has the right CEO in place to drive strategy, navigate risk, and create long-term value for the enterprise. The board should ensure that the company is prepared for a CEO change—both planned and unplanned. CEO succession planning is a dynamic and ongoing process, and boards should always be thinking about developing potential candidates. Succession planning should start the day a new CEO is named. How robust are the board's succession planning processes and activities? Are succession plans in place for other key executives? Do we engage in due diligence about the "how" as well as the "what" of a candidate's job history when recruiting a new CEO or other key executive?

Closely linked to the importance of having the right CEO is having the talent required—from the top of the organization down through the ranks—to execute the company's strategy and keep it on track. Institutional investors are becoming more vocal about the importance of human capital and talent development programs and their link to strategy. We expect companies will face an increasingly difficult challenge in finding, developing, and retaining talent at all levels of the organization. Does management have a talent plan that aligns with its strategy and forecast needs for the short and long term? Which talent categories are in short supply and how will the company successfully compete for this talent? More broadly, as millennials join the workforce in large numbers and talent pools become globally diverse, is the company positioned to attract, develop, and retain top talent at all levels?

Assess, monitor, and reinforce culture as a strategic asset and critical risk.

Corporate culture is front and center for companies, share-holders, regulators, employees, and customers—as it should be for every board. Headlines of sexual harassment, price gouging, shady sales practices, and other wrongdoing—with corporate culture as the culprit—have put boards squarely in the spotlight: Where was the board? And what is it doing to fix the culture?

Given the critical role that corporate culture plays in driving a company's performance and reputation—for better or for worse—we see boards taking a more proactive approach to understanding, shaping, and assessing corporate culture. Among the messages we hear: Have a laser focus on the tone set by senior management and zero tolerance for conduct that is inconsistent with the company's values and ethical standards, including any "code of silence" around such conduct. Be sensitive to early warning signs and verify that the company has robust whistle-blower and other reporting mechanisms in place and that employees are not afraid to use them.

Understand the company's actual culture (the unwritten rules versus those posted on the breakroom wall); use all the tools available—surveys, internal audit, hotlines, social media, walking the halls, and visiting facilities—to monitor the culture and see it in action. Recognize that the tone at the top is easier to gauge than the mood in the middle and the buzz at the bottom. How does the board gain visibility into the middle and bottom levels of the organization? Do employees have the confidence to escalate bad behavior and trust their concerns will be taken seriously? Make sure that incentive structures align with strategy and encourage the right behaviors, and take a hard look at the board's own culture for signs of groupthink or discussions that lack independence or contrarian voices. Focus not only on results, but also on the behaviors driving them.

Continue to refine boardroom discussions about cybersecurity and data privacy as *risk management* issues.

Cyber threats continue to grow more sophisticated and aggressive, with implications for nearly every facet of business. Hacks at major companies punctuate the new reality that any organization on the grid is vulnerable. Boardroom discussions should be moving beyond prevention to *detection, containment, and response*—and to addressing cybersecurity as an enterprise-wide business issue that affects strategy, compliance, product development, M&A, expansion into new geographies, and relationships with vendors, suppliers, and customers. A robust and frank boardroom dialogue is vital to helping the company learn to live with cyber risk and making cybersecurity a core competency across the business.

How frequently is the maturity of the company's cybersecurity risk management framework evaluated? How is the company keeping up with regulatory changes and new legal requirements? Is the company staying abreast of industry practices and connecting with law enforcement? Does the company have an incident readiness and response plan that has been reviewed and tested? Is the board getting the information it needs (cyber dashboard) to oversee cybersecurity efforts?

What risks do the use of big data pose, and who is responsible for making decisions about the collection and use of data? Europe's recently enacted General Data Protection Regulation and other data privacy rules such as California's Consumer Privacy Act should prompt rigorous assessments of companies' data practices. Indeed, with data privacy linked so tightly to trust and reputation, a running reality check is essential: "Just because we can doesn't mean we should."

Reassess the company's crisis prevention and readiness.

Crisis prevention and readiness have taken on increased importance and urgency for boards and management, as the list of crises that companies have found themselves facing in recent years continues to grow. Crisis prevention goes hand in hand with sound risk management—identifying and anticipating risks and putting in place a system of controls to help prevent crises from happening and mitigate their impact when they do occur. We're clearly seeing an increased focus by boards on cultural risks as well as key operational risks across the extended global organization—e.g., supply chain and outsourcing risks, information technology and data security risks, etc. Does the board understand the company's critical operational risks? What's changed in the operating environment? Has the company experienced any control failures? Is management sensitive to early warning signs regarding safety, product quality, and compliance?

Help ensure that management is weighing a broad spectrum of what-if scenarios—from supply chains and the financial health of vendors to geopolitical risks, natural disasters, terrorist acts, and cyber threats. Is the company's crisis response plan robust and ready to go? Is the plan actively tested or war-gamed and updated as needed? Does it take into account the loss of critical infrastructure—e.g., telecommunications networks, financial systems, transportation, and energy supplies? Does it include communications protocols to keep the board apprised of events and the company's response? Of course, even the best-prepared companies will experience a crisis, but companies that respond quickly and effectively tend to weather crises better.

About KPMG Board Leadership Center

The KPMG Board Leadership Center champions outstanding governance to help drive long-term corporate value and enhance investor confidence. Through an array of programs and perspectives—including KPMG's Audit Committee Institute, the WomenCorporateDirectors Foundation, and more—the Center engages with directors and business leaders to help articulate their challenges and promote continuous improvement of public- and private-company governance. Drawing on insights from KPMG professionals and governance experts worldwide, the Center delivers practical thought leadership—on risk and strategy, talent and technology, globalization and compliance, financial reporting and audit quality, and more—all through a board lens. Learn more at kpmg.com/us/blc.

Contact us

kpmg.com/us/blc
T: 1-800-808-5764
E: us-kpmgmktblc@kpmg.com

Some or all of the services described herein may not be permissible for KPMG audit clients and their affiliates or related entities.

kpmg.com/socialmedia