On the 2017 private company board agenda

Board Leadership Center

In 2017, corporate performance will still require the essentials—managing key risks, innovating and capitalizing on new opportunities, and executing on strategy. But the *context* is changing quickly—and perhaps profoundly—as advances in technology, business model disruption, expectations of investors and other stakeholders, and global volatility and political shifts challenge companies and their boards to rethink strategy development and execution and what it means to be a corporate leader. Drawing on insights from our recent survey work and interactions with directors and business leaders over the past 12 months, we have highlighted six items that private company boards should keep in mind as they help guide the company forward in the year ahead.

Take a hard look at the board's composition: Is the talent in the boardroom aligned with the company's strategy and future needs? Given the demands of today's business and risk environment, aligning boardroom talent with company strategy—for both the short term and the long term as the strategy evolves—should be a priority. Not surprisingly, 43 percent of respondents in our recent survey, *Building a Great Board,* cited "resistance to change" and "status quo thinking" as hampering their board-building efforts. Consider key recommendations of the NACD Blue Ribbon Commission Report, *Building the Strategic Asset Board,* and the KPMG/WCD Thought Leadership Commission report, *Seeing Far and Seeing Wide: Moving Toward a Visionary Board*. As noted in these reports, directors should focus squarely on board composition/diversity and succession planning, robust evaluations, director recruitment and onboarding, board leadership, stakeholder communications, and continuing director education—all tailored to the company and industry. In short, "periodic board refreshment" should give way to robust, continual improvement and *active* board succession planning.

Pay attention to potential risks posed by tone at the top, culture, and incentives. While a robust risk management process is essential to prevent and mitigate risk events, it is not enough. As we have seen in recent years, many of the crises that have posed the most damage to companies, particularly those that have significantly derailed start-up companies and turnarounds, have been caused by a breakdown in the organization's tone at the top, culture, and incentives. As a result, boards need to pay particular attention to these capital "R" risks, which may pose the greatest risk of all to the company. In today's business environment, it is more important than ever that the board be acutely sensitive to the tone from (and example set by) leadership, and they need to reinforce the culture of the organization, i.e., what the company does, how it does it, and the culture of compliance, including a commitment to management of the company's key risks.

Be vigilant about potential conflicts of interest.

According to a recent Forbes Insights/KPMG private company governance survey, 28 percent of directors said that conflicts of interest, including related-party transactions, represent one of the greatest challenges to the effectiveness of a private company board. This is a particular challenge for directors of private equity or venture capital portfolio companies who are also representatives of their specific investment fund. While the interests of the portfolio company and the fund are in most cases aligned, conflicts arise—e.g., in the form of management fees, debt and equity financing terms for the portfolio company, timing of "exit" strategies, etc. More and more regulators around the globe—including the SEC—are focusing on the relationship and potential conflicts of interest between venture capital or private equity funds and their portfolio companies. Be vigilant to identify early on any potential conflicts between the interests of the portfolio company and the investment fund, and work with legal counsel to develop an appropriate course of action to surface and resolve these conflicts.

Help ensure that M&A and new financing deliver the value that they should.

Both equity and debt capital markets are undergoing a transition, adjusting to slower growth, significant currency fluctuations, shifting interest rates, and a more difficult political and geopolitical environment. Given the incentives to strike a deal while some start-up company valuations are still elevated or debt capital remains cheap, some boards might be pressured to approve a transaction on the basis of an "expedited" due diligence process. In this environment, private company boards face an even greater challenge in helping to ensure a deal delivers the value that it should—and minimize the risk of failure. Among the key areas of board focus: Test alignment of the deal with the company's strategy, and challenge the value creation potential of the deal. Consider the range of financing options (whether as buyer or seller)? Closely monitor key aspects of the due diligence process before approving the deal. And examine the postmerger or postfinancing plan in detail, and track performance against the plan.

Monitor implementation plans and activities for major accounting changes on the horizon—particularly the new revenue recognition and lease accounting standards.

The scope and complexity of implementation efforts and the impact on the business, systems, controls, and resource requirements, should be a key area of focus. The new revenue standard (effective January 1, 2018 for calendar-year-end public companies and January 1, 2019 for private companies) provides a single revenue recognition model across industries, companies, and geographical boundaries. While the impact will vary across industries, many companies—particularly those with large, complex contracts—will experience a significant accounting change when implementing the new standard. The new standard will require companies to apply new judgments and estimates, so the audit committee (if applicable) will want to inquire about the judgment and estimate process and how judgments and estimates are reached. Under the new lease standard (effective January 1, 2019 for calendar-year-end public companies and January 1, 2020 for private companies) lessees will recognize most leases, including operating leases, on the balance sheet. This represents a wholesale change to lease accounting, and many companies will face significant implementation challenges during the transition. *Implementation of these two new standards is not just an accounting exercise*; the board and audit committee will want to receive periodic updates on the status of implementation activities across the company (including possible trouble spots), the adequacy of resources devoted to the effort, and the plan to communicate with stakeholders. Additionally, many private companies—particularly those anticipating a transaction involving public financing or an already public company—may want to consider implementing the updated standards on the public company schedule.

Refine and widen boardroom discussions about cyber risk and security.

Despite the intensifying focus on cybersecurity, the cyber-risk landscape remains fluid and opaque, even as expectations rise for more engaged oversight. As the cyber landscape evolves, board oversight—and the nature of the conversation—must continue to evolve. Discussions are shifting from prevention to an emphasis on detection and containment and are increasingly focused on the company's "adjacencies," which can serve as entry points for hackers. The Internet of Things and the digital records that surround people, organizations, processes, and products ("code halos") call for deeper—if not wholly different—conversations. The board should help elevate the company's cyber-risk mind-set to an enterprise level, encompassing key business leaders, and help ensure that cyber risk is managed as a business or enterprise risk—not simply an IT risk. Do discussions about M&A; product development; expansion into new geographies; and relationships with suppliers, customers, partners, advisers, and other third parties factor in cyber risk? Help ensure that awareness of—and accountability for—cybersecurity permeates the organization, with a security mind-set, proper training, and preparation for incident response. Is cybersecurity risk given regular and adequate time on the board's agenda? Where are the company's biggest vulnerabilities and how is it protecting its most critical data sets? Does the company benchmark against others in its industry? Does the company have a cybersecurity scorecard and a robust cyber-incident response plan? Do directors work under the assumption that any e-mail could become public at any time?

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Private Company Boards

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