KPMG

On the 2018 board agenda

Board Leadership Center

Board agendas should continue to evolve in 2018—the game-changing implications of technology/digital innovation, scrutiny of corporate culture and leadership, growing demands for companies to address environmental and social issues, and investor expectations for greater board engagement and diversity and long-term corporate performance will all drive a sharper focus on positioning the company for the future. Combined with a slow-growth economy, uncertainty around tax, trade, and infrastructure policies, and geopolitical tensions at precarious levels, 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 six items for boards to consider as they focus on their 2018 agendas—on the critical challenges at-hand and on the road ahead.

Help the company keep its eye on the ball: long-term value creation.

One of the board's most important roles is to empower the CEO and management team to think and act long-term—investing in talent, driving innovation, and taking the long view on corporate performance. Of course, the short-term cannot be ignored—there is a genuine need for short-term stewardship but don't let it distract from focusing on the long term. The challenge for the board is to help the company align near-term activities and results with long-term value creation.[1]

Indeed, major investors (such as BlackRock, Vanguard, State Street, and others) have made clear their expectations for companies to focus on long-term value creation and the factors driving it—strategy and risk, talent, investment in research and development, culture and incentives, and, more recently, environmental, social, and governance (ESG) issues, particularly climate change and diversity. On ESG issues—which are squarely in the sights not only of investors, but also of employees, customers, and communities—the board can help management widen its aperture to understand how the company's strategy and operations impact all of its key stakeholders and drive long-term performance. (See KPMGs "ESG, Strategy, and the Long-View."[2])

Among the key areas of board focus: Do we have a coherent long-term strategy? How closely do our short-term actions and targets connect with that strategy? Can the management team and members of the board articulate that connection? Do current and potential shareholders have a clear understanding of the connection to help them make informed investment decisions?[3]

[1] Report of the 2015 NACD Blue Ribbon Commission: The Board and Long-Term Value Creation.
[2] KPMG Board Leadership Center, *ESG, Strategy, and the Long-View: A Framework for Board Oversight*, 2017 available at kpmg.com/us/esgframework.
[3] Ibid.

Expect disruption to continue full-force with technology and "digital" at its core.

The raft of start-ups upending traditional business models should put disruption high on board agendas. Advances in digital technologies such as cloud computing, robotic process automation, machine learning, artificial intelligence (AI), and blockchain are transforming how companies do business. Moreover, the speed and impact of these technologies—automating, self-learning, reshaping business processes—have the hallmarks of another "new economy" (the Internet was the last one). Help the company test its strategic assumptions and keep sight of how the big picture is changing. What disruptive trends are directors seeing in other industries?

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 drive the business? Do we 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, business processes, and emerging risks?

Be particularly sensitive to risks posed by the tone at the top and culture throughout the organization.

As recent headlines have demonstrated, many of the crises that have caused the greatest damage to corporate reputations were driven by the conduct of and tone set by leadership, as well as the risks associated with the culture throughout the organization. The right tone at the top and culture are essential to any effective risk management program. Have a laser-like 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.

Corporate culture—what the company does and how it does it—permeates virtually every aspect of an organization, is critical to the execution of strategy, and needs to be front and center in the boardroom.

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 it 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.

Learn to live with cyber risk and refine boardroom discussions about cyber risk and security.

Not only is the cyber threat not going away, it is growing more sophisticated and aggressive, with implications for nearly every facet of the business. Hacks at prominent organizations punctuate the new reality that any system "on the grid" is vulnerable. Boardroom discussions should be moving from prevention to *detection, containment, and response* and to addressing cyber risk as an enterprise-wide business issue that can potentially impact 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 making cybersecurity a core competency across the business.

How often is the maturity of the company's cybersecurity risk management framework evaluated? How does the company keep up with regulatory changes and new legal requirements? Does the company stay abreast of industry practices and connect with law enforcement? Does the company have an incident readiness and response plan that has been reviewed and tested? Who leads the plan? Does the board get the information/reports it needs (cyber dashboard) to oversee cybersecurity efforts? Is there a C-suite executive who can effectively communicate with the board on cyber issues in the context of the business and in language the board understands?

Promote effective shareholder engagement, including engagement with activists.

Shareholder engagement continues to be a priority for companies as institutional investors increasingly hold boards accountable for company performance and demand greater transparency, including direct engagement with independent directors. Institutional investors expect to engage with portfolio companies—especially when there are governance concerns or when additional information is needed to make a more fully informed voting decision. Boards should request periodic updates from management about the company's engagement practices: Do we know and engage with our most significant shareholders and understand their priorities? Do we have the right people on the engagement team? What is the board's policy on meeting with investors? Which of the independent directors should be involved? And perhaps most importantly, does the company provide investors with a clear, current picture of its performance, challenges, and long-term vision?

As reflected in 2017 proxy trends, strategy, executive compensation, management performance, environmental and social initiatives, and board composition and performance will remain on investors' radar during the 2018 proxy season. Expect investors to focus on how companies are adapting their strategies in light of the uncertainties and dynamics shaping the business and risk environment in 2018—e.g., slow growth; questions around tax, trade, and infrastructure policy; the impact of technology on labor/wages; and extreme weather events. In his annual letter to CEOs,[4] BlackRock's Laurence Fink called it "imperative that companies understand these changes and adapt their strategies as necessary … as part of a constant process of understanding the landscape in which you operate ... How have these changes impacted your strategy and how do you plan to pivot, if necessary, in light of the new world in which you are operating?"

Having an "activist mind-set" will continue to be important for companies and boards in the year ahead. As we've seen, no company—no matter how large—is immune from shareholder activism.

Focus on building a board that is fit for purpose looking forward, recognizing that diversity and healthy turnover are key.

Being fully engaged in the business requires the board to plan for its own evolution by recruiting the mix of skills, perspectives, and backgrounds that align with the company's future needs. That said, it is clear that the world is changing faster than boards. Director turnover remains low (0.7 new directors per board annually); average director age has risen slightly in the last decade to 63; and progress on board diversity remains slow, with women in just 21 percent of board seats today and minorities in 15 percent among the top 200 largest companies.[5] That tenure-limiting mechanisms—term limits and mandatory age limits—have had limited impact is not surprising. Only 4 percent of boards have term limits for independent directors, and although 73 percent of boards have a mandatory retirement age (typically age 72+),[6] many have raised it and some expressly permit exceptions to the policy.[7]

The surge in proxy access proposals in recent years highlights investor frustration over the pace of change in boardrooms and points to the central challenge of board composition: a changing business and risk landscape (marked by competitive threats and business model disruption, technology innovations and digital changes, the Millennial effect, and global volatility) requires a proactive approach to board-building. Is there a plan to help ensure that the board serves as a strategic asset to the company? Take a hard look at the board's composition and how it assesses its effectiveness and positions the company for the future—i.e., board evaluations, skills/diversity matrix, succession planning, board and committee leadership, and ongoing director education. Consider a mix of director tenures (<5, 5–10, >10 years of service) to provide a blend of institutional memory and fresh perspectives.[8] Keep the critical value of this effort front and center: Diverse thinking drives better governance—and better business decisions.

Also see KPMG's *On the 2018 Audit Committee Agenda* at kpmg.com/blc.

[4] BlackRock's 2017 Annual Letter to CEOs
[5] Spencer Stuart Board Index
[6] Spencer Stuart Board Index
[7] Shearman & Sterling 2017 Corporate Governance and Executive Compensation survey.
[8] Report of the 2016 NACD Blue Ribbon Commission: Building the Strategic-Asset Board.

About the 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, all through a board lens. Learn more at kpmg.com/blc.

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