Audit Committee News
Edition 59 / Q4 2017 / Corporate Governance

Corporate leadership reaches an inflection point

Dennis Whalen talks to Tim Nixon of Thomson Reuters about the changing role of the corporation in society

Tim Nixon, managing editor of *Thomson Reuters Sustainability*, sat down with Dennis Whalen, Leader of the KPMG Board Leadership Center, to understand more about why corporate governance is reaching an inflection point, with a new emphasis on transparency, long-term value, and key non-financial factors. This interview is reprinted with permission from *Thomson Reuters Sustainability*.

Sustainability: As the leader of the KPMG Board Leadership Center (BLC) and someone who boards turn to for insight about where governance is headed, what's top of mind for you today?

Dennis Whalen: The BLC was created to focus squarely on issues and practices that drive leadership in the boardroom. Leadership has always been essential, but it's clear that corporate governance has reached an inflection point in terms of heightened investor expectations for boards to be more deeply engaged, bring strategic insight and value to the table, really challenge management's strategy and assumptions, and keep everyone's eye on the ball. And it's about understanding how a company's long-term performance hinges on the shared success of all of the company's key stakeholders – its investors, employees, customers, supply chain, and communities. One of the critical leadership issues facing Corporate America today is avoiding the quarterly earnings mentality and focusing on long-term value creation and drivers of that long-term value. This is an issue that's front and center for most investors, and it's right in the board's sweet spot.

Sustainability: What's the board's role in managing the tension between pressures for quarterly earnings and expectations for a long-term perspective and performance?

Whalen: It's really a matter of aligning the two. The short-term can't be ignored – near-term objectives and results are necessary. But boards are recognizing that an all-consuming focus on quarterly earnings and "total shareholder return" can undermine the company's long-term performance if not the sustainability of the business model. The board's role, then, is to help push that time-horizon further out, and alleviate pressures on management for short-term results by setting the right tone, focusing on the durability of the business model, and ensuring that the company is communicating its long-term focus to investors.

But doing that requires understanding the drivers of long-term value for the enterprise. Beyond rear-view financial and operational performance numbers, what metrics are the best indicators that the company is creating long-term value? And is the company communicating the drivers of long-term value to investors?

Sustainability: What does a healthy mix of near-term and long-term performance metrics look like?

Whalen: The mix will vary by company and industry, but the traditional measures of financial health – cash flow, growth in revenues and profits, and return on invested capital – are important, though these are historical measurements that don't necessarily tell us about future performance and the potential for future growth and returns. So more companies and directors are putting greater emphasis on key non-financial measures or drivers of the long-term health and performance of their organizations, like innovation, customer satisfaction, talent and innovation, reliability and durability of the supply chain, brand and reputation, and increasingly, how the company addresses social and environmental issues.

Sustainability: Say more about "environmental, social, and governance" (ESG) as a metric, and connecting ESG to corporate performance.

Whalen: By any name – ESG, corporate social responsibility, sustainability, corporate citizenship – how a company manages environmental and social issues and connects these activities to financial and operational performance are increasingly signals to investors of how well the company is run and its long-term financial sustainability. It's about seeing – and tightening – the connection between social capital and long-term performance.

The notion that doing good and creating value are not mutually exclusive is not new, but how these issues are framed and discussed has a major impact on understanding their importance to the business. And language matters. A boardroom discussion about the connection between environmental stability and the company's financial stability is likely to be more meaningful than a discussion about "global warming."

Sustainability: What are you hearing from investors, as the users of this information?

Whalen: Investors expect companies to provide a clear, consistent story about their strategic priorities and long-term goals. So the company needs to bring its investors along this journey, communicating how the company is addressing environmental and social issues, why, and how it benefits the long-term interests of the company and its stakeholders. Talk about the company's progress and results – even if the goals are ambitious and haven't been reached yet – and how it all links to the strategy. In a recent survey we conducted with the Wall Street Journal, more than 70 percent of the readers who responded said communicating the company's long-term vision and value was equally or more important than communicating

quarterly earnings. Similarly, CECP's Strategic Investor Initiative, with $15 trillion in AUM on its advisory board, is launching a forum where CEOs can present long-term plans to long-term investors, and demonstrate the greater sustained earnings power proven to come from longer-term thinking. Investors want to know where the company is headed, how it plans to get there, and how it's doing against that plan.

Sustainability: What are some practical steps boards can take to help management sharpen their focus on these issues?

Whalen: In a paper we just developed with Harvard Business Review's Analytic Services, we point to five ways the board can help the company stay focused on the big picture: Helping to set – or reset – the context for the company's discussion of environmental and social issues; understanding whether management has identified key environmental and social risks and opportunities across the enterprise; embedding environmental and social initiatives into the company's strategy; insisting that management clearly communicate the company's environmental and social efforts to investors; and helping to set the tone and culture around environmental and social activities – giving management permission to think and act long-term. The full paper is called Doing Good While Doing What's Good for Business. It's a great boardroom resource for leading the way forward on this.

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Social responsibility and strategy meet in the boardroom

The context for corporate performance is changing rapidly: Consideration of the corporation's role in society is moving from the periphery to the center of corporate thinking as investors, customers, employees, and other stakeholders are challenging companies to understand the total impact of the company's strategy and actions. A tighter connection between "social capital" and bottom-line performance is being forged.

Call it corporate social responsibility (CSR), sustainability, corporate citizenship, or environmental, social and governance (ESG), how a company manages environmental and social issues – and connects these activities to financial and operational performance – are increasingly signals to investors of how well the company is run and its long-term financial sustainability.

In this environment, it is critical that boards understand how the company is managing the risks and opportunities related to environmental and social issues, and embedding its initiatives into the corporation's strategy and culture. How these issues are framed and discussed has a big impact on understanding why they matter to the business and how to address them. It requires a deep understanding of the business and the issues affecting the company's long-term success.

Today, companies – and boardroom discussions – are moving at different speeds on addressing environmental and social issues, but wherever the company is on this journey, the board can help lead the organization forward by focusing on the big picture:

- Help set (or reset) the context for the company's discussion of environmental and social issues.
- Energize management's assessment of risks and opportunities.
- Embed environmental and social initiatives into the strategy and look at these issues in terms of long-term value creation.
- Tell investors and stakeholders about the company's environmental and social efforts.
- Help set the tone at the top and culture around environmental and social initiatives.

For more information, read Corporations and Society: Doing Social Good While Doing What's Good for Business, a KPMG-sponsored Harvard Business Review Analytic Services Report.