On the 2020 board agenda

Board Leadership Center

Prioritizing board agendas will be particularly challenging in 2020 as the game-changing implications of technological and digital innovation, growing demands to address environmental and social issues, scrutiny of corporate culture, and investor expectations for greater board engagement, diversity, and long-term performance all drive a sharper focus on positioning the company for the future. Combined with concerns about the economy—mounting trade tensions, resurging debt, a looming market correction—and political gridlock in the U.S., U.K., 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, we highlight eight items for boards to consider as they focus their 2020 agendas on the critical challenges at hand and on the road ahead:

- Link boardroom discussions on strategy, risk, and global disruption.
- Understand how the company aligns profit and purpose.
- Build the talent in the boardroom around the company's strategy and future needs.
- Help set the tone and closely monitor the culture throughout the organization.
- Approach cybersecurity and data privacy holistically—as data governance.
- Make CEO succession and talent development a priority.
- Have a crisis response plan in place and practice it.
- Be proactive in engaging with shareholders, including activists.

Link boardroom discussions on strategy, risk, and global disruption.

Trade wars, Brexit, rising populism, cyberattacks on critical infrastructure, and the threat of military conflict in geopolitical hotspots—combined with an absence of global leadership and the deterioration of international governance—will continue to drive global volatility and uncertainty. As Ian Bremmer, Eurasia Group's founder and president, has noted, this environment "will require more investment in scenario planning and stress testing. It also means drawing up contingency plans to shorten supply chains, cutting long-term fixed costs, and limiting business exposure to political relationships that have considerable potential to go south."

Companies also need to address the potential disruption to business models posed by *accelerating* advances in digital technologies such as robotic process automation, machine learning, artificial intelligence, and blockchain. Are the company's risk management processes adequate to address the speed and disruptive impact of these advances, and to assess the continuing validity of the key assumptions that form the basis of the company's strategy and business model? Tomorrow's competitors are likely to be different than yesterday's.

Help management reassess the company's processes for identifying the risks and opportunities posed by disruption—geopolitical, technological and digital, social, and environmental—and their impact on the company's long-term strategy. Is there an effective process to monitor changes in the external environment and provide early warning that adjustments to strategy might be necessary? Help the company test its strategic assumptions and keep sight of how the big picture is changing: connecting dots, thinking differently, and staying agile and alert to what's happening in the world. In short, disruption, strategy, and risk should be hardwired together in ongoing boardroom discussions.

Understand how the company aligns profit and purpose.

Corporate growth and shareholder return still require the essentials—managing key risks, innovating, capitalizing on new opportunities, and executing on strategy—but the context for corporate performance is changing quickly, and perhaps profoundly. Mounting societal issues—including jobs and wages, income inequality, climate and environmental issues, health and safety, and calls for greater diversity and inclusion, coupled with limited government solutions—continue to heighten expectations for corporations to help address the gaps and rethink their responsibility to society.

Major institutional investors have long emphasized their expectations for companies to explain how they are addressing environmental, social, and governance (ESG) issues in the context of long-term value creation. Employee and consumer activism regarding ESG issues is in its early stages but is growing, driven largely by millennials. We continue to see a number of shareholder proposals on ESG issues—particularly on the "E" and the "S" issues. More recently, echoing BlackRock CEO Laurence Fink's focus on "linking purpose and profits," the Business Roundtable (BRT) issued its Statement on the Purpose of a Corporation, in which the signatory CEOs committed "to lead their companies to benefit all stakeholders—customers, employees, suppliers, communities, and shareholders."

Reactions from the business and investor communities to the BRT statement have varied widely. Some see it as an important commitment to stakeholders by corporate America. Others, such as the Council of Institutional Investors, expressed concern that the statement undercuts notions of managerial accountability to shareholders, and that boards and managers need to stay focused on long-term shareholder value. Still others see the statement as business as usual.

Whether or not a company supports the BRT Statement, it will likely face increasing pressure from stakeholders to develop its own statement of purpose (if it hasn't already) articulating the company's commitment to stakeholders and how it will factor stakeholder considerations into efforts to create long-term value. Investors, customers, employees, and other stakeholders are challenging companies to understand that there is an inextricable link between purpose and profit. The board has a key role to play in shaping the debate and setting the tone and expectations for linking purpose and profit. As stakeholder expectations for transparency and disclosure regarding these issues continue to mount, the board should be intentional about how it engages with management on these issues. (For more on communicating ESG-related activities to shareholders, see *On the 2020 audit committee agenda*.)

Build the talent in the boardroom around the company's strategy and future needs.

Given the demands of today's business and risk environment, boards are increasingly focused on aligning board composition with the company's strategy, both today and longer term. Talent and diversity in the boardroom are also front and center for investors, regulators, and other stakeholders. That said, it's clear that the world is changing markedly faster than boards.

According to Spencer Stuart's 2019 U.S. Board Index of S&P 500 companies, board turnover remains low (0.88 new directors per board annually). Average director tenure (8 years) has changed little, while average director age has *risen* slightly in the last decade (to 62.7). Progress on board diversity is constant but there is still a long way to go—26 percent of S&P 500 directors are women, and 19 percent of the directors in the top 200 of these companies are African American, Latino, or Asian. Tenure-limiting mechanisms—term limits and mandatory age limits—have had limited impact, and that is not surprising: only 5 percent of boards have term limits for independent directors, and the most common mandatory retirement age is 75, with many boards expressly permitting exceptions to the policy.[1]

The increased level of investor engagement on this topic highlights investor frustration over the slow pace of change in boardrooms, and points to the central challenge with board composition: a changing business and risk landscape. Addressing competitive threats and business model disruption, technology innovations and digital changes, cyber risk, and global volatility requires a proactive approach to board building and board diversity—of skills, experience, gender, and race/ethnicity. As part of its Boardroom Accountability Project 3.0, in October, the Office of the New York City Comptroller sent letters to 56 S&P 500 companies requesting that they "adopt a diversity search policy *requiring* that the initial lists of candidates from which new management-supported director nominees and chief executive officers (CEOs) are chosen include qualified female **and** racially/ethnically diverse candidates" (sometimes referred to as the "Rooney Rule").

It's clear that board composition and diversity should be a key area of board focus in 2020, as a topic for communications with the company's institutional investors, enhanced disclosure in the company's proxy, and positioning the board strategically for the future.

Help set the tone and closely monitor the culture throughout the organization.

Does the company make it safe for people to do the right thing? Headlines of sexual harassment, price gouging, aggressive sales practices, and other wrongdoing continue to put corporate culture front and center for companies, shareholders, regulators, employees, and customers. Boards themselves are also making headlines—particularly in cases of self-inflicted corporate crises—with investors, regulators, and others asking, "Where was the board?"

[1] *2019 U.S. Spencer Stuart Board Index.*

Given the critical role that corporate culture plays in driving a company's performance and reputation—for better or, as evidenced by #MeToo, for worse—we see boards taking a more proactive approach to *understanding, shaping, and assessing* corporate culture. 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? 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 on the behaviors driving results.

Approach cybersecurity and data privacy holistically—as data governance.

In our conversations with directors, it is clear that many companies need a more rigorous, holistic approach to data governance—the processes and protocols in place around the integrity, protection, availability, and use of data.

Boards have made strides in monitoring management's cybersecurity effectiveness—for example, with greater IT expertise on the board and relevant committees, company-specific dashboard reporting to show critical risks, and more robust conversations with management focusing on critical cybersecurity risks, operational resilience, and the strategies and capabilities that management has deployed to minimize the duration and impact of a serious cyber breach. Despite these efforts, given the growing sophistication of cyberattackers, cybersecurity will continue to be a key challenge.

Data governance overlaps with cybersecurity, but it's broader. For example, data governance includes compliance with industry-specific privacy laws and regulations, as well as new privacy laws and regulations that govern how personal data—from customers, employees, or vendors—is processed, stored, collected, and used. Examples include the EU General Data Protection Regulation that went into effect in May 2018 and the California Consumer Privacy Act to take effect in January 2020. Data governance also includes the company's policies and protocols regarding data ethics—in particular, managing the tension between how the company may use consumer data in a legally permissible way with consumer expectations as to how their data will be used. Managing this tension poses significant reputation and trust risks for companies and represents a critical challenge for leadership.

To help develop a more rigorous approach around oversight of data governance:

— Insist on a robust data governance framework that makes clear how and what data is being collected, stored, managed, and used, and who makes decisions regarding these issues.

— Clarify which business leaders are responsible for data governance across the enterprise—including the roles of the chief information officer, chief information security officer, and chief compliance officer.

— Reassess how the board—through its committee structure—assigns and coordinates oversight responsibility for both the company's cybersecurity and data governance frameworks, including privacy, ethics, and hygiene.

Make CEO succession and talent development 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, it is essential that the company have 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—planned and unplanned. CEO succession planning is a dynamic and ongoing process. Boards must always be thinking about developing potential candidates, and planning for succession 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?

Clearly 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 that is required at all levels of the organization. Does management's talent plan align 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 and younger employees 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? Compensation committees should continue to sharpen their focus on talent development, and consider including succession planning and talent development as a performance metric tied to pay plans.

Have a crisis response plan in place and practice it.

It's a sobering data point: Between 2010 and 2017, headlines with the word "crisis" and the name of one of the top 100 companies as listed by Forbes appeared 80 percent more often than in the previous decade.[2]

Even the best-prepared companies will experience a crisis, and companies that respond quickly and effectively tend to weather crises better. Crisis readiness goes hand-in-hand with good risk management—identifying and anticipating risks and putting in place a system of controls to help prevent crises or mitigate their impact. We're clearly seeing an increased board focus 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? Does it cover different scenarios? 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—and to address the company's stakeholders?

Be proactive in engaging with shareholders, including 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 be able to engage with portfolio companies—especially when there are governance concerns or when engagement 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 largest shareholders and understand their priorities? Do we have the right people on the engagement team? What is the board's position on meeting with investors? Which independent directors should be involved? And perhaps most importantly, is the company providing investors with a clear, current picture of its performance, challenges, and long-term vision?

As reflected in 2019 proxy trends, strategy, executive compensation, management performance, ESG initiatives, and board composition and performance will remain squarely on investors' radar during the 2020 proxy season. We can also expect investors to focus on how companies are adapting their strategies to address the economic and geopolitical uncertainties and dynamics shaping the business and risk environment in 2020.

[2] Sanjay Kalavar and Mihir Mysore, "Are you prepared for a corporate crisis?" *McKinsey Quarterly* (April 2017).

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, 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