On the 2023 board agenda

Board Leadership Centre Saudi Arabia

The business environment has changed dramatically over the few years, emerging from two years of pandemic-driven challenges, greater global geopolitical instability, surging inflation, cybersecurity risk (including ransomware attacks), regulatory and enforcement risk, continuous war for talent, and the prospect of a global recession now added to the mix of macroeconomic risks. Amid this growing external instability, Saudi Arabia's domestic economy showed resilience, with high international oil prices supporting an economic recovery across both the oil and non-oil sectors. The boards in Saudi Arabia have positive growth expectations – they are ready and prepared to weather current geopolitical and economic challenges. The boards can expect their oversight and corporate governance processes to be put to the test in 2023 by an array of above mentioned challenges.

The increasing complexity and fusion of risks unfolding simultaneously, and the increased interconnectedness of these risks up the ante for boards to have holistic risk management and oversight processes.

In this volatile operating environment, demands from employees, regulators, investors, and other stakeholders for greater disclosure and transparency – particularly around cybersecurity, climate, and other environmental, social, and governance (ESG) risks – will continue to intensify.

Drawing on insights from our latest survey work and interactions with directors and business leaders, we highlight eight issues to keep in mind as boards consider and carry out their 2023 agendas:

- Maintain focus on how management is addressing geopolitical and economic risk
- Reassess the board's committee structure and risk oversight responsibilities
- Monitor management's progress in building and maintaining supply chain resilience
- Keep ESG, including climate risk and DEI, embedded in risk and strategy discussions and monitor regulatory developments
- Approach cybersecurity, data privacy, and artificial intelligence (AI) holistically as data governance
- Make talent, HCM, and CEO succession a priority
- Think strategically about talent, expertise, and diversity in the boardroom
- Engage proactively with shareholders and other stakeholders

Maintain focus on how management is addressing geopolitical and economic risk

This environment will call for continual updating of the company's risk profile and more scenario planning, stress testing strategic assumptions, and analyzing downside scenarios. Leaders will need to assess the speed at which risks are evolving, their interconnectedness, the potential for multiple crises at the same time, and whether there is flexibility in the company's strategy to pivot. The boards should:

- Oversee management's reassessment of the company's processes for identifying and managing existing and emerging risks and their impact on the company's strategy and operations. Challenge the management to ensure that the company is prepared to weather an economic downturn.
- Help management 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. Disruption, strategy, and risk should be hardwired together in boardroom discussions.
- Challenge and question management's crisis response plans to ensure if they are robust, actively tested or war-gamed, and updated as needed. Ask about communications protocols to keep the board apprised of events and the company's response, as well as to determine when/if to disclose matters internally and/or externally?
- Make business continuity and resilience part of the regular board discussion.

Reassess the board's committee structure and risk oversight responsibilities

The increasing complexity and fusion of risks unfolding simultaneously requires a more holistic approach to risk management and oversight. At the same time, investors, regulators, ESG rating firms, and other stakeholders are globally demanding higher-quality disclosures – particularly on climate, cybersecurity, and other ESG risks – and about how boards and their committees oversee the management of these risks; going forward, Saudi Arabia will be no different.

Given this challenging risk environment, many boards are reassessing the risks assigned to each standing committee. In the process, they are considering whether to reduce the major risk categories assigned to the audit committee beyond its core oversight responsibilities (financial reporting and related internal controls, and oversight of internal and external auditors) by transferring certain risks to other committees or potentially creating a new committee.

The challenge for boards is to clearly define the risk oversight responsibilities of each standing committee, identify any overlap, and implement a committee structure and governance processes that facilitate information sharing and coordination among committees. While board committee structure and oversight responsibilities will vary by company and industry, we recommend four areas of focus:

- Recognize that rarely does a risk fit neatly in a single, siloed risk category. While many companies historically managed risk in siloes, that approach is no longer viable and poses its own risks.
- Does the audit committee have the time and members with the experience and skill sets necessary to oversee areas of risk (beyond the committee's core responsibility) that the audit committee has been assigned – such as cybersecurity, data privacy, supply chain, geopolitical, climate, and other ESG-related risks – as well as the adequacy of management's overall ERM system and processes?
- Does another board committee(s) have the time, composition, and skill set to oversee a particular category of risk? Is there a need for an additional committee, such as a technology, sustainability, or risk committee? Is there a need for new directors with skill sets or experience to help the board oversee specific risks?
- Identify risks for which multiple committees have oversight responsibilities, and clearly delineate the responsibilities of each committee. To oversee risk effectively when two or three committees are involved, boards need to think differently about how to coordinate committee activities. Also see our On the 2023 audit committee agenda.
- The full board and each standing committee should play a key role in helping to ensure that (from top to bottom) management's strategy, goals, objectives, and incentives are properly aligned, performance is rigorously monitored, and that the culture the company has is the one it desires

Monitor management's progress in building and maintaining supply chain resilience

Companies continue to navigate unprecedented supply chain stresses and strains with the ultimate goal of assuring supply – and survival. Amid ongoing supply chain turmoil, many companies are implementing efforts to address vulnerabilities and improve resilience and sustainability.

Boards should help ensure that management's initiatives to rethink, rework, or restore critical supply chains are carried out effectively, such as:

- Are the supply chain risk and vulnerability assessments updated on regular basis? Is the management deploying technology to improve supply chain visibility and risk management?
- Is the management developing plans to address future supply chain disruptions, including diversifying the supplier base and re-examining supply chain structure and footprint and considering to develop more local and regional supply chains?
- Are supply chain initiatives being driven by an overarching vision and strategy? Who is leading the effort, connecting critical dots, and providing accountability?
- At the same time, boards need to sharpen their focus on the company's efforts to manage a broad range of ESG risks in its supply chain. Such risks – particularly climate change and other environmental risks, and important "S" risks such as human rights, forced labor, child labor, worker health and safety, as well as diversity, equity, and inclusion (DEI) in the supply chain – pose significant regulatory and compliance risks as well as critical reputation risks for the company.

Keep ESG, including climate risk and diversity, equity and inclusion (DEI), embedded in risk and strategy discussions and monitor regulatory developments

How companies address climate change, DEI, and other ESG issues is viewed by investors, research and ratings firms, employees, customers, regulators and other stakeholders as fundamental to the business and critical to long-term value creation. It is now expected from the businesses that they would do more to solve societal problems. The stakeholders continue to view ESG issues as fundamental to long-term value creation.

The ESG issues of importance will vary by company and industry. Demands for higher-quality climate and other ESG disclosures should be prompting boards and management teams to reassess and adjust their governance and oversight structure relating to climate and other ESG risks – and to monitor regulatory developments in these areas. We suggest the board to consider:

- How is the board helping to ensure that these issues are priorities for the company, and that the company is following through on its commitments?
- How is the company embedding these issues into core business activities (strategy, operations, risk management, incentives, and corporate culture) to drive long-term performance?
- Is there a clear commitment and strong leadership from the top, and enterprise-wide buy-in? Are there clear goals and metrics?

- Is management sensitive to the risks posed by greenwashing.

Approach cybersecurity, data privacy, and artificial intelligence (AI) holistically as data governance

Cybersecurity risk continues to intensify. The acceleration of AI and digital strategies, the increasing sophistication of hacking and ransomware attacks, the greater geo-political instability, and ill-defined lines of responsibility – among users, companies, vendors, and government agencies – have elevated cybersecurity risk and its place on board and committee agendas.

Boards have made strides in monitoring management's cybersecurity effectiveness. For example, some have greater IT expertise on the board and relevant committees (although that expertise is in short supply). Other efforts include company-specific dashboard reporting to show critical risks and vulnerabilities; assessing cybersecurity talent; weighing vulnerabilities and emerging threats; war-gaming breach and response scenarios; and discussions with management on the findings of ongoing third-party risk assessments of the company's cybersecurity program. Despite these efforts, the growing sophistication of cyber attacks point to the continued cybersecurity challenge ahead. Accordingly, the boards should continue to monitor regulatory developments in respect of Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure, as well as management's preparations to comply.

While data governance overlaps with cybersecurity, it's broader and includes compliance with industry-specific privacy laws and regulations, as well as privacy laws and regulations that govern how personal data – from customers, employees, or vendors – is processed, stored, collected, and used.

To oversee cybersecurity and data governance more holistically, we suggest that the board:

- Insist on a robust data governance framework that makes clear what data is being collected, how it is 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 the company's cybersecurity and data governance frameworks, including privacy, ethics, and hygiene.
- Boards should also understand the process for how AI is developed and deployed. What are the most critical AI systems and processes the company has deployed? To what extent is bias – conscious or unconscious – built into the strategy, development, algorithms, deployment, and outcomes of AI-enabled processes? What regulatory compliance and reputational risks are posed by the company's use of AI, particularly given the global regulatory focus on the need for corporate governance processes to address AI-related risks, such as bias and privacy? How is management mitigating these risks?

Many directors may be uncomfortable with responsibility for overseeing AI risk because of their lack of expertise in this area. But, boards need to find a way to exercise their supervision obligations, even in areas that are technical, if those areas present enterprise risk, which is already true for AI at some companies.

Make talent, human capital management (HCM), and CEO succession a priority

Most companies have long said that their employees are their most valuable asset. COVID-19; the difficulty of finding, developing, and retaining talent in the current environment; and an increasingly knowledge-based economy have highlighted the importance of talent and HCM – and generated the phenomenon of employee empowerment – causing many companies and boards to rethink the employee value proposition.

While the most dramatic change in the employee value proposition took place during the pandemic, employee empowerment hasn't abated, and employees are demanding fair pay and benefits; work-life balance, including flexibility; interesting work, and an opportunity to advance.

They also want to work for a company whose values – including commitment to DEI and a range of ESG issues – align with their own.

In 2023, we expect continued scrutiny of how companies are adjusting their talent development strategies to meet the challenge of finding, developing, and retaining talent amid a labor-constrained market. Accordingly, we suggest that the boards consider the following:

- Obtain good understanding of the company's talent strategy and its alignment with the company's broader strategy and forecast needs for the short and long term?
- What are the challenges in keeping key roles filled with engaged employees?
- Which talent categories are in short supply and how will the company successfully compete for this talent? Does the talent strategy reflect a commitment to DEI at all levels?
- Is the company positioned to attract, develop, and retain top talent at all levels, including millennials and younger employees with a consideration for diversity?
- Discuss with management the company's HCM disclosures in the Annual Report – including management's processes for developing related metrics and controls ensuring data quality – to help ensure that the disclosures demonstrate the company's commitment to critical HCM issues.

Pivotal to all of this is having the right CEO in place to drive culture and strategy, navigate risk, and create long-term value for the enterprise. CEO succession planning is a dynamic, ongoing process, and the board should always be focused on developing a pipeline of C-suite and potential CEO candidates. Succession planning should start the day a new CEO is named. The board should consider the following:

- Is the company prepared for a CEO change – whether planned or unplanned, on an emergency interim basis or permanent.
- How robust are the board's succession planning processes and activities?
- Has the succession plan been updated to reflect the CEO skills and experience necessary to execute against the company's long-term strategy?
- Are succession plans in place for other key executives? How does the board get to know the high-potential leaders two or three levels below the C-suite?

Think strategically about talent, expertise, and diversity in the boardroom

Boards, investors, regulators, and other stakeholders are increasingly focused on the alignment of board composition – particularly director expertise and diversity – with the company's strategy.

Indeed, the increased level of investor engagement on this issue points to the central challenge with board composition: Having directors with experience in key functional areas critical to the business while also having deep industry experience and an understanding of the company's strategy and the risks to the strategy. It is important to recognize that many boards will not have "experts" in all the functional areas such as cybersecurity, climate, HCM, etc., and may need to engage outside experts.

Developing and maintaining a high-performing board that adds value requires a proactive approach to board-building and diversity – of skills, experience, thinking, gender, ethnicity and social background. While determining the company's current and future needs is the starting point for board composition, there is a broad range of board composition issues that require board focus and leadership – including succession planning for directors as well as board leaders (the chair and committee chairs), director recruitment, director tenure, diversity, board and individual director evaluations, and removal of underperforming directors. Boards need to "tell their story" about the composition, skill sets, leadership, and functioning of the board and its committees. Also see our On the 2023 audit committee agenda.

Board composition, diversity, and renewal should remain a key area of board focus in 2023, as a topic for communications with the company's institutional investors and other stakeholders, enhanced disclosure in the Annual Report, and most fundamentally, positioning the board strategically for the future.

Engage proactively with shareholders and other stakeholders

Given the intense investor and stakeholder focus on executive pay and director performance, as well as climate risk, ESG, and DEI, particularly in the context of long-term value creation, engagement with shareholders and stakeholders must remain a priority.

Institutional investors and stakeholders are increasingly holding boards accountable for company performance and are continuing to demand greater transparency, including direct engagement with independent directors on big-picture issues like strategy, ESG, and compensation. Indeed, transparency, authenticity, and trust are not only important to investors, but increasingly to employees, customers, suppliers, and communities – all of whom are holding companies and boards to account.

The board should request periodic updates from management about the company's engagement activities:

- Does the company know, engage with, and understand the priorities of its largest shareholders and key stakeholders?
- Are the right people engaging with these shareholders and stakeholders – and how is the investor relations (IR) role changing?
- What is the board's position on meeting with investors and stakeholders? Which independent directors should be involved?

In short: Is the company providing investors and stakeholders with a clear picture of its performance, challenges, and long-term vision – free of greenwashing? Investors, other stakeholders, and regulators are increasingly calling out companies and boards on ESG-related claims and commitments that fall short.

Strategy, executive compensation, management performance, climate risk, other ESG initiatives, DEI, HCM, and board composition and performance will remain squarely on investors' radar during the 2023 general assembly meetings' season. We can also expect investors and stakeholders 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 2023.

Contact us

KPMG Board Leadership Centre

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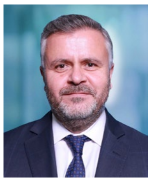

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