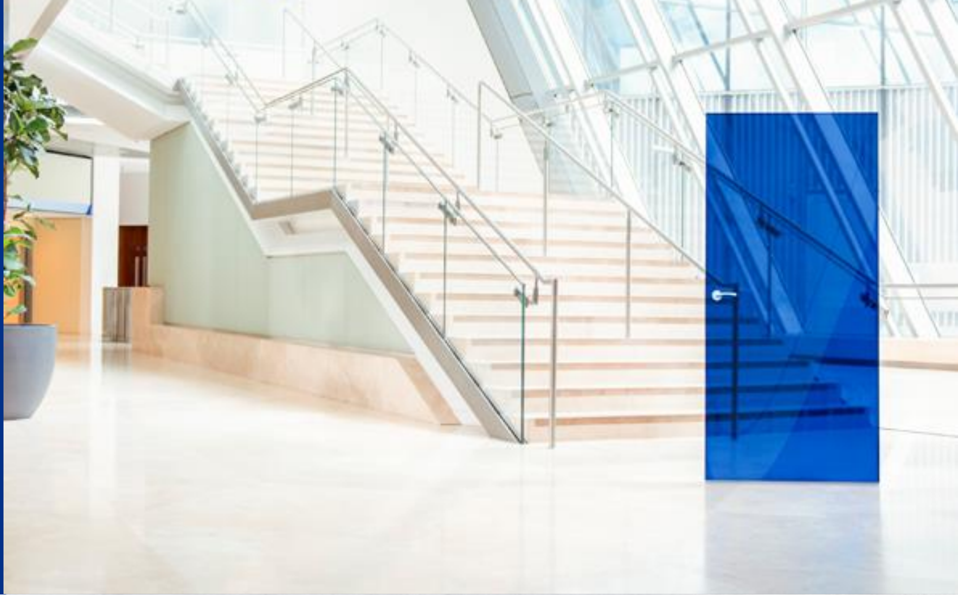
# On the 2021 board agenda

**KPMG Board Leadership Centre**



COVID-19, recession and an undercurrent of social injustice all paint a picture of a daunting and opaque business and risk environment for the year ahead. Global volatility – driven by trade and geopolitical tensions, resurging debt, technology and business model disruption, elevated cyber risk and regulatory scrutiny – will add to the challenge. The pressure on employees, management, boards, and governance will be significant.

Along with the business, boards will continue to operate against a backdrop of tremendous uncertainty, an uneven economic recovery, and heightened expectations of all stakeholders – investors, employees, customers, suppliers, and communities. Indeed, many boards will see 2020/21 as an inflection point for corporate governance, with demands for greater attention to corporate purpose and stakeholder views, corporate culture and incentives, diversity and inclusion, the richness of boardroom dialogue and debate, and the company's (and board's) readiness for the risks and opportunities ahead – some of which may be backed up by investor votes against directors.

Drawing on insights from our latest survey work and interactions with directors and business leaders, we highlight ten issues for boards to keep in mind as they consider and carry out their 2021 agendas.

**Maintain focus on management's response to COVID-19, while keeping sight of the bigger picture**

COVID-19 will continue to redefine business as usual for nearly all companies – and their boards – regardless of industry, size, or geography. All leaders will face significant disruption and uncertainty – grappling with how to reopen, the implications of managing remote workforces, accelerating digital transformation, building more resilient supply chains, and strengthening connections with customers in the months to come. At the same time, some companies are finding new opportunities for growth in this uncertain environment.

Navigating the uncertainty will require a sharp focus on people, liquidity, operational risks, and contingencies while keeping sight of the bigger picture: strategy, risk, and resilience.

With information about COVID-19 and the economy changing frequently, companies should expect to recalibrate their responses – and potentially reframe their thinking about how the COVID-19 crisis is impacting the business. As consumer demand and jobs growth return and the new reality takes shape, it will be critical to stay nimble and have a strategy for operating effectively, staying competitive, and eventually thriving.

Perhaps most important will be the continued attention to human resource issues, particularly reopening plans, employee safety, engagement, and morale, as well as normalising work-from-home arrangements – while focusing on diversity and equity in the workplace. Companies may need to rethink how work is carried out and reassess the operational and policy implications of working remotely. Is management considering more flexible work-from-home policies longer-term, and the implications for workflow, efficiency, performance, talent development, and culture?

Leadership and communication regarding the company's reopening plans and strategy will be critical to retaining the trust and confidence of employees, customers, and investors. Understanding and compassion have become more important than ever: As many have emphasised, the company's stakeholders will remember how they were treated during COVID-19.

**Make human capital management and CEO succession a priority**

COVID-19 and social unrest since the summer have amplified the critical importance of human capital management (HCM) to a company's performance and reputation.

Even before the pandemic, institutional investors were asking for better disclosure of how the board oversees human capital and talent development programs and their link to strategy. For example, the Human Capital Management Coalition, a group of institutional investors representing $6 trillion in assets, has been engaging with boards regarding their oversight of HCM and calling for better disclosure.

Some investors are expecting more robust disclosure on diversity. For example, in August 2020, State Street Global Advisors informed board chairs that starting in 2021, SSGA will ask companies in its investment portfolio "to articulate their risks, goals and strategy as related to racial and ethnic diversity, and to make relevant disclosure available to shareholders." The letter emphasised, "we are prepared to use our proxy voting authority to hold companies accountable for meeting our expectations."

To gain better oversight of HCM, many boards are charging the remuneration committee (or another board committee) with oversight of talent development and related HCM issues and changing the name of the committee and its charter to reflect these additional responsibilities. Boards will want to discuss with management the company's human capital resources disclosures in the annual report and accounts, including management's processes for developing any related metrics, and help ensure that the disclosures demonstrate the company's commitment to these critical human capital issues. Those discussions should help deepen the board's understanding of the company's HCM strategies and better integrate HCM into the board's agenda and priorities.

Does management's talent plan align with its strategy and forecast needs for the short and long term? Has management considered whether reskilling of certain categories of employees makes sense? 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?

For its part in HCM, the board should help ensure that the company is well prepared for a CEO change. Are succession plans (including emergency succession plans) for the CEO and other C-suite roles formalised and reviewed at least annually (if not more often), and which board committee is responsible? In considering potential CEO successors, the board should ensure that if the business and strategy have changed as a result of the impact of COVID-19, the desired profile of a new CEO has been updated accordingly. The numerous crises of 2020 may require other changes in the succession pipeline, with some skills becoming more important, and some executives having stepped up with steady leadership in the face of tremendous uncertainty. How does the board get to know senior executives in the leadership pipeline – particularly given the limitations of a remote work environment?

**Insist on real changes to combat racism and inequality in business**

The disproportionate impact of COVID-19 on certain communities and the social unrest following the death of George Floyd are driving a critical dialogue about systemic racism and inequality across the business world. Are companies doing enough – using their financial resources, advocating for public policies, engaging in public/private partnerships, and leading by example ("walking the walk") – to make real and enduring changes to combat systemic bias and racism?

Headlines such as "CEOs talk social justice, and how they can do better", "The UK can no longer close its eyes to racial inequality" and "John Parker decries slow progress on ethnic minority board representation" point to the soul-searching that many companies are, and should be, doing as communities, employees, customers, and investors call on companies to drive lasting change

Sir John Parker, a former chair of five FTSE100 companies, recently said "Don't tell me the talent is not there, you just have to look at our new Chancellor, and there are many more people in the ethnically diverse communities in the UK and overseas." He continued, "When we are all holed up in our homes, we are going to have more time to think, more time to reflect. I want to see a just society – where regardless of colour people can actually develop their talents."

Business leaders and advocates point to a number of steps that can drive diversity and systemic change, including clearly committing to building the company's pipeline of diverse employees at all levels and among its board members; defining diversity and setting aggressive goals at all levels; measuring progress and holding the CEO and leadership team accountable; insisting on robust tracking of diversity metrics; when choosing vendors/consultants/business alliances, considering their track record on diversity; telling the company's diversity story in detail; redoubling employee training to combat racial bias; reassessing the company's public advocacy spending and activities; and understanding and mitigating the risk of racial bias in the company's data. How the company addresses these issues may affect its reputation, ability to attract and retain talent, and the views of customers.

**Re-evaluate the company's focus on ESG and corporate purpose**

Corporate growth and shareholder return still require the essentials – managing key risks, innovating, capitalising on new opportunities, and executing on strategy – but the context for corporate performance is changing quickly and COVID-19 is accelerating that change.

The ongoing challenges of stagnant wages, income inequality, climate and environmental issues, health and safety, and diversity and inclusion – with limited government solutions – continue to spotlight business' role: What is the company's responsibility to society and the stakeholders it relies on for growth?

Employee and consumer activism regarding environmental, social, and governance (ESG) issues continues to grow, with millennials leading the way. Shareholders continue to submit more proposals on ESG issues – particularly the "E" and the "S" issues related to COVID-19.

There are increasing stakeholder demands for clearer disclosure of how the company is addressing ESG risks and opportunities – particularly climate change and diversity. Which ESG issues are of strategic significance i.e., key to the company's long-term performance and value creation? How is the company embedding ESG into its core business activities (strategy, operations, risk management, incentives, and corporate culture)? Is there a clear commitment and strong leadership from the top as well as enterprise-wide buy-in? For more on communicating ESG-related activities to shareholders, see On the 2021 audit committee agenda.

**Reassess whether crisis readiness and resilience plans are effectively linked to the company's key risks**

COVID-19 is a stark reminder of the need to have robust enterprise risk management (ERM) processes that are closely linked to crisis preparedness and resilience. Are the company's risk governance processes keeping pace with its changing risk profile? Does the board understand who owns key risks at the management level, and would an empowered chief risk officer help create a more unified approach to risk? The events and crises of 2020 suggest a number of fundamental questions for boards and management teams as they reassess the company's risks and readiness, including:

- Do we have a complete inventory of the company's critical risks? COVID-19 has surfaced a range of heightened risks to manage, from employee and customer health and safety and managing remote workforces to the acceleration of digital transformation, changing customer demands, and vulnerable supply chains. Extreme weather events – droughts, wildfires, hurricanes, flooding, rising sea levels – illustrate the risks that climate change poses to companies, supply chains, and customers. COVID-19 and social unrest have cast a bright light on a host of ESG risks that should be front and centre for business leaders – including employee well-being, pay equity, racial and gender diversity, and human rights, and how companies are meeting their commitments to stakeholders. Management will need to regularly reassess the risk landscape in light of the dynamic operating environment.
- Are crisis readiness plans closely linked to risk management, and are we prepared for a worst-case scenario? Even the best ERM isn't going to prevent every crisis. Companies need crisis response plans with a focus on agility, resilience and values – maintaining operations and company reputation in the face of disaster and learning from past crises. Identifying likely crisis scenarios and practicing responses using tabletop exercises is critical. Prepare for the worst-case scenarios (e.g., extended periods of supply chain disruption, substantial sustained reduction in sales and revenue, and the loss of key personnel) and consider having the board participate in these exercises.
- Does the board's committee structure bring the right focus and attention to the company's critical risks and its crisis readiness and resilience? Are the risk oversight responsibilities of each committee clear? Does that allocation of responsibilities still make sense – particularly in light of the changing risk environment? While boards may be reluctant to establish an additional committee, considering whether a finance, technology, risk, sustainability, or other committee would improve the board's effectiveness can be a healthy part of the risk oversight discussion. Also consider whether risks should be reallocated among committees, and whether committees have directors with the necessary skills to oversee the risks their committees have been assigned.

**Approach cybersecurity and data privacy holistically as data governance.**

The accelerated shift to digital that many companies are experiencing underscores a trend we highlighted last year: the importance of taking a 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 of key risks, and more robust conversations with management focusing on operational resilience and the strategies and capabilities that management has deployed to minimise the duration and impact of a serious cyber breach. Despite these efforts, given the growing sophistication of cyber attackers, the shifts to remote work and online customer engagement, cybersecurity will continue to be a key challenge.

The broader challenge is data governance, encompassing 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.

It also includes the company's policies and protocols regarding data ethics – in particular, managing the tension between how the company may use customer data in a legally permissible way with customer expectations. 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.

**Help set the tone and monitor the culture throughout the organisation.**

COVID-19 has increased the risk of ethics and compliance failures, particularly given heightened fraud risk due to employee financial hardship and the pressure on management to meet financial targets. Closely monitor the tone at the top and culture throughout the organisation with a sharp focus on behaviours (not just results) and yellow flags. Is senior management sensitive to the human resource issues stemming from COVID-19, particularly the pressures on employees (in the office and at home), employee health and safety, productivity, engagement and morale, and normalising work-from-home arrangements? Does the company make it safe for people to do the right thing? Headlines of lax data privacy protections, aggressive sales practices, and other lapses continue to put corporate culture front and centre 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?"

Given the critical role that corporate culture plays in driving a company's performance and reputation, we see boards taking a more proactive approach to understanding, shaping, and assessing corporate culture. 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.

Verify that the company has robust whistle-blower and other reporting mechanisms in place and that employees are using them without fear of retaliation.

Understand the company's actual culture (how things get done versus the values statement in the employee handbook); use all the tools available – surveys, internal audit, hotlines, social media, walking the floor, and visiting facilities – to monitor the culture and see it in action. Recognise 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 organisation? Make sure that incentive structures align with strategy and encourage the right behaviours, and take a hard look at the board's own culture for signs of groupthink or discussions that lack independence or contrarian voices. Culture and strategy are inextricably linked. If the company's strategy has changed as a result of COVID-19 and related impacts, carefully consider what changes to the culture may be necessary to support the new strategy.

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

Boards are increasingly focused on aligning board composition with the company's strategy, today and for the longer term. Talent and diversity in the boardroom are also top of mind for investors, regulators, and other stakeholders. That said, it's clear that the world is changing markedly faster than boards.

Although fewer directors were appointed to the boards of the UK's top 150 companies in 2019/20 than in 2018/19 (203 c.f. 238 last year), according to According to Spencer Stuart's 2020 UK Board Index of the largest 150 companies in the FTSE, there have been some improvements in gender diversity. For the second year in a row, the majority of newly appointed directors are women (51 percent) and women now make up 34 percent of all directors and 46 percent of non-executives. However, the picture is less rosy at the executive level. Just 13 percent of executive directors are women and progress on executive committees is glacially slow with an increase of just four percentage points over the last four years. Only 8.3 percent are identified as black, Asian or minority ethnic (BAME).

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 and digital innovation, cyber risk, and global volatility requires a proactive approach to board-building and board diversity – of skills, experience, gender, race/ethnicity, and sexual orientation and cognitive thinking.

Board composition and diversity should remain a key area of board focus in 2021 – as a topic for communications with the company's institutional investors, enhanced disclosure in the company's annual report and AGM notices, and to help position the board strategically for the future. Indeed, votes against directors by an increasing number of institutional investors for a lack of diversity should serve to sharpen every board's focus on diversity and inclusion as a business imperative.

**Be proactive in engaging with shareholders and 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.

In light of COVID-19, transparency, authenticity, and trust (or lack thereof) are increasingly important themes for engagement with shareholders. Boards and management must be thinking about engaging not only with shareholders but with their own employees, customers, suppliers, and community stakeholders. Boards should request periodic updates from management about the company's engagement practices: Do we know and engage with our largest shareholders and key stakeholders and understand their priorities?

Do we have the right people on the engagement team? What is the board's position on meeting with investors and stakeholders? Which independent directors should be involved? And perhaps most importantly, is the company providing investors and stakeholders with a clear, current picture of its performance, challenges, and long-term vision?

Strategy, executive compensation, management performance, ESG initiatives, human capital management, and board composition and performance will remain squarely on investors' radar during the 2021 proxy season. We also expect investors and stakeholders to focus on how companies are adapting their strategies to address the continuing impact of COVID-19 and the economic and geopolitical uncertainties and dynamics shaping the business and risk environment in 2021.

**Factor emerging and disruptive technologies into the boards thinking around strategy and risk**

As digital technologies such as cloud computing, AI and blockchain continue to advance – both in capability and in application – their impact on risk assessment – both in terms of disruption as well as protection solutions – becomes as increasingly important as it is challenging.

Boards are increasingly aware that most companies' risk management processes are not fully robust – being unable to identify emerging and disruptive risks. Now more than ever is the time to firmly pose questions around this, and just as importantly to follow up robustly on the proposed actions. 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 are the basis for the company's strategy and business model? Tomorrow's competitors are likely to be different than yesterday's.

Where disruptive technology is identified as a risk management opportunity does the business have the right skills to deliver on it? Understanding the risks and opportunities posed by technologies is a long way from being able to actively manage or leverage them which requires skills rarely found in current management but typically prolific within the millennial population.

## The KPMG Board Leadership Centre

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