Building back better
A board's eye view

KPMG Board Leadership Centre

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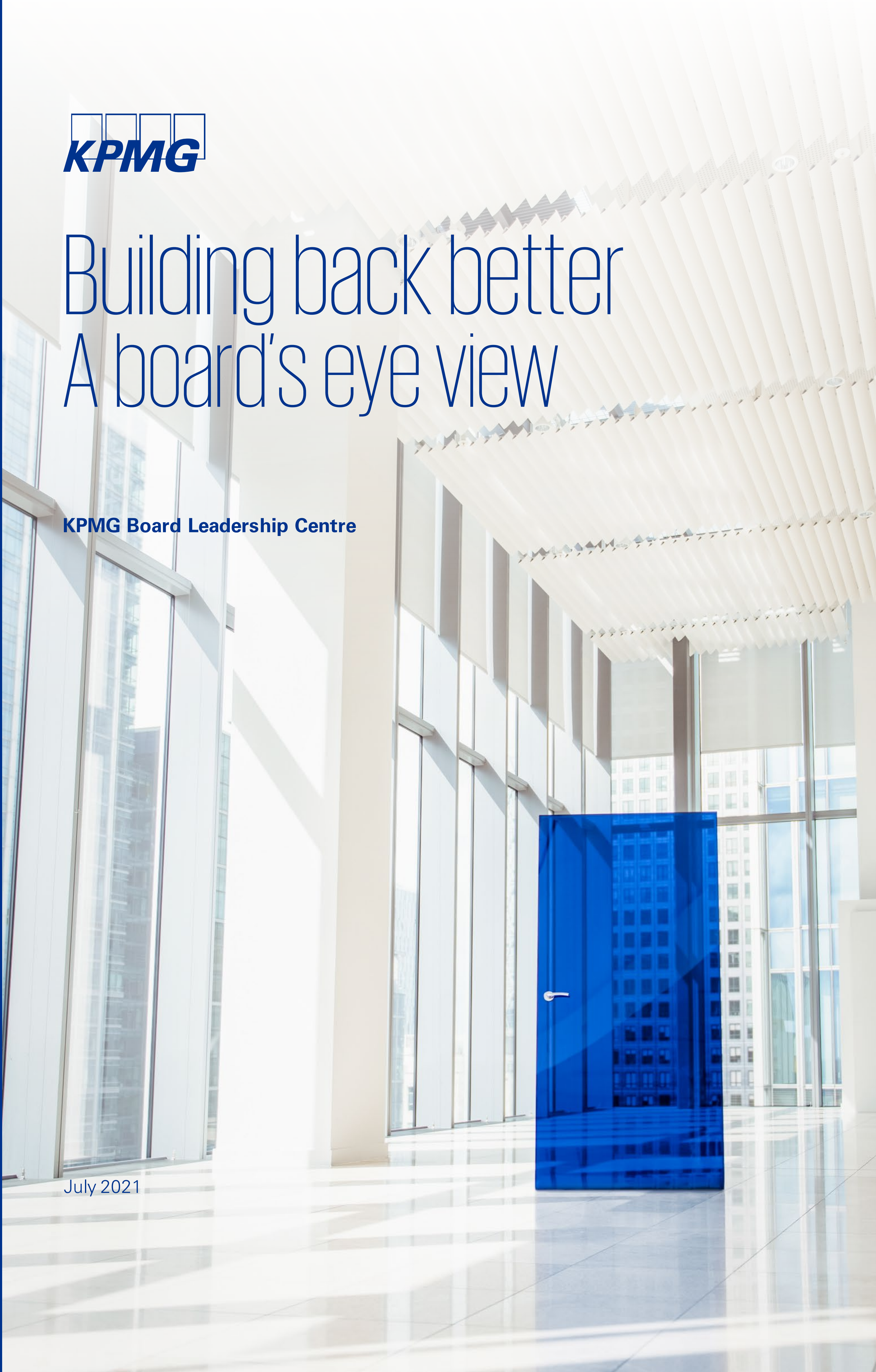

Building back better

Over the past year and a half, we have all faced extraordinary challenges whether in business or in our communities or in our professional and personal lives. Someway, somehow, everyone has been impacted by the COVID19 pandemic. But the vast impact of the pandemic also stretches way beyond the immediate health crisis. It has brought into sharp focus many pre-existing issues such as economic inequality, social injustice and the climate crisis to name but a few.

All of these issues are big, important – even existential – challenges, that none of us can solve alone. They require multilateral, multinational collaboration and cooperation to help fix. Different perspectives aligning and coming to agreement. Different parties from all corners of society working together.

And stakeholders want business to lead on them. We are being tested in ways that we haven't in the past. From withstanding the difficulties of an economy under strain to developing a recovery strategy. From figuring out the best way to support our people to the broader communities we serve in a time of need. We've all had to adapt to doing things differently and 'building back better'.

To help us explore this, KPMG's Board Leadership Centre (BLC) embraced new ways of connecting with the global director community by bringing together board members from 26 different countries to hear some renowned business leaders debate corporate purpose and the role of business in furthering social progress, ESG, and leadership. you can read more about the discussion on the following pages or listen to the webinars here and here.

I thank our keynote presenter, Paul Polman – former CEO of Unilever Plc and now Co-founder and Co-Chair of IMAGINE – and all the panellists listed below for their huge contribution to the debate:

- João Brega
- Kiran Mazumdar-Shaw
- Blythe McGarvie
- Simone Menne
- Dr Nora L Scheinkestel

I would also like to thank all the people who work in (or with) our Board Leadership Centres for putting these global webinars together, and in particular we remember Wim Vandecruys (1982 – 2021) – a driving force behind our Global BLC activities – who sadly passed away earlier this year.

Timothy Copnell
Board Leadership Centre, UK

Environmental, Social and Governance issues

ESG is something that we at KPMG have truly started to lead on, having launched *KPMG: Our Impact Plan* at the start of the year, where we put all our ESG commitments across our global network under one umbrella. In it we also started to report against the ESG-focused metrics we helped develop in partnership with the World Economic Forum and its International Business Council. But, looking more broadly, how should business work with governments to solve some of today's existential crises such as climate change and social inequality?

Climate change

Paul painted a graphic picture around climate change. There has been a 68% decline in natural habitats and species, and rainforest has been cut in half. Last year, World Overshoot Day – the day the world has used all the resources it can replenish – came as early as 22 August. "Every day after that, we're stealing from future generations."

"You can't have healthy people on an unhealthy planet. And yet, we have just experienced our worst ever decade in terms of climate change. Enormous levels of over-consumption are pushing the planetary boundaries. We have seen three degrees of warming, increasingly extreme weather patterns, a 68% decline in the number of species, and rainforest cut by half."

"You can't have infinite growth on a finite planet. And anything you can't do infinitely is ultimately unsustainable. COVID has increased our awareness of the inter-connectedness of everything. We've reached a point where the cost of not acting exceeds the cost of acting. So, that actually becomes an opportunity. It's one we have to grasp."

Social inequality

A second pressing issue is inequality. Paul highlighted the dismal statistic that 4.2bn people live on less than $5 a day. COVID has hit the most vulnerable groups hardest, and an estimated 500m jobs have been lost around the world due to the pandemic.

"We have regressed 15-20 years against the sustainable development goals."

"Rebellion is growing in different ways as a result of the social inequality we are witnessing – on the streets and at the ballot box. We are also seeing the rise of nationalism, populism and xenophobia."

Ten business myths about climate change

1. **ESG Committing to a Science Based Target (SBT) means my business is insulated from Climate Risk**

   Whilst committing to an SBT is an indicator of responsible business, it does not protect a business from other impacts of climate change. These risks include both physical impacts (e.g. flooding, storms, drought and wildfire), and transition impacts (e.g. technology-driven market shifts, supply chain disruption and changes in resource costs).

2. **We have an A in our CDP, so we're on top of climate risk**

   The Carbon Disclosure Project (CDP) assesses disclosures on climate change and decarbonisation but does not assure the quality of the disclosure or underlying analysis.

   Plenty of companies who disclose to CDP, even those with 'A' scores, may not be appropriately assessing climate risks and opportunities internally or using the most robust analytical approaches. Stakeholder expectations are also shifting on how climate risk assessments are reflected in the assumptions underpinning company financial disclosures.

3. **Climate risk analysis doesn't provide a return on investment, therefore we are not interested in it**

   The purpose of climate risk scenario analysis is to assess an organisations' full exposure to the impacts of climate change, including both risks and opportunities over different timescales.

   Limiting climate change to 1.5 degrees will require deep economic transformation across sectors, whilst failing to limit climate change will result in significant damage from climate impacts globally. Given the scale of the changes expected, early and effective scenario analysis can deliver significant ROI through both revealing opportunities for value creation and mitigating the risk of value destruction.

4. **I'm not impacted by climate change because I'm not in the fossil fuel sector**

   Whilst some companies will be more exposed than others to climate change, climate risk is a systemic risk, meaning it can impact all sectors of the economy. These impacts arise because direct impacts, such as government policies or infrastructure damage, then have indirect consequences across the economy. Globalised operations and supply chains can increase exposure to these indirect, systemic impacts.

5. **Climate change is a long-term issue, we must focus on quarterly and annual priorities.**

   Climate change is happening here and now. Damage and disruption from hurricanes, wildfires and floods cost the world $210 billion in 2020 and these costs have risen every decade since 1970, according to Munich Re. These impacts are damaging infrastructure and assets and affecting insurance premiums today. Investor sentiment, a key driver for quarterly and annual earnings targets, is also increasingly shifting towards advocating for ambitious action on climate risk.

6. **Our company has never been impacted by climate change before, why should I worry about it now?**

   As global temperatures continue to rise year on year, so does the frequency and intensity of extreme climatic events. From shifts in precipitation patterns and rising storm surges to the expansion of arid and dry land, locations previously deemed as 'safe' are now considered to be at risk from the impacts of climate change. Furthermore, the implications of climate change stretch beyond your company's own operations, posing a threat to each of your suppliers.

7. **Stakeholders love our work on ESG, why do we need a climate risk framework too?**

   Climate risk is one element of ESG, but the two are not the same. ESG involves measurement and action on reducing your business impacts across a broad set of environmental, social and governance factors. On the other hand, climate risk relates specifically to managing the impact of climate change on your business. This distinction means that some companies can perform well on broader ESG benchmarks, but climate risk remains a weakness or a vulnerability to their business model or strategy. For this reason, some companies are seen as responsible businesses, but not resilient.

8. **We have insurance in place to protect us from climate change**

   Insurance policies play a key role in the traditional risk management process to protect businesses against physical damages from extreme weather events. However, with climate risks becoming more prominent, insurance companies are refraining from offering policies in at-risk locations, and where insurance is available, policy prices are rising to unaffordable rates.

   'Insurance leakage' is also a growing risk, where providers are reducing coverage and the scope of their policies in order to respond to the changing climate risk profile. Market leaders are recognising these new forms of insurance risk are amplifying over time and are reacting by integrating climate adaptation and resilience into their core strategy.

9. **Responding to climate change is too costly and we can't justify the expense**

   There is a common misconception that in order to respond to climate change a business must invest a significant amount of capital into new infrastructure and technologies. In many scenarios, by framing the issue of climate change strategically, it becomes apparent that reducing emissions, waste and resource use can come hand in hand with reducing your cost base.

   Responding to climate risks can also deliver significant avoided costs from reduced physical risk exposure, or increased revenues from capturing market share in growing markets for low carbon or environmental products and services.

10. **The sustainability function can manage climate risk and incorporate it into CSR reporting**

    Mitigating climate risks and capturing climate opportunities often requires strategic changes to an organisation. For these changes to be successful, action needs to be managed and driven from the top. This reflects the systemic nature of climate risk, which can impact all product lines, business segments and locations in ways that vary over time and between locations.

    Effectively tackling this new risk profile requires climate risk integration into enterprise risk frameworks, strategy development and financial planning processes, moving beyond what can be achieved by a sustainability function alone.

Hope for a better tomorrow?

Many of the pressing issues that COVID-19 has brought into such sharp focus have been brewing for a number of years. After the Global Financial Crisis, financial institutions were stabilised but we didn't right-size global economies. There was a perception that banks were too big to fail but people were too small to matter. The pandemic has led to a contraction of around 4% global GDP, with $28tn of output lost, and $16tn of stimulus packages needed in Europe and the US alone. It has put around 1 billion people back in extreme poverty and caused the loss of around 500 million jobs.

The result is a scale of change on a par with the Industrial Revolution combined with the speed of change of a technology revolution. Never have so many factors come together at the same time. The pandemic has made people feel vulnerable and afraid – and they're demanding more of governments and companies to help and support them.

What scope is there to be optimistic about the future? Arguably there are three key factors that might influence and accelerate change. Firstly, young people – the Millennial generation – are demanding change and have become incredibly influential. Secondly, the cost curve has changed and we have we have reached a point where the cost of inaction exceeds the cost of prevention. For example, it would cost $200-300bn to change our food systems – the cost of climate change to society is two or three times higher. The technology curve has helped too, such as green forms of energy that now beat fossil fuels in terms of pricing. And thirdly, the economic opportunities are coming into view – the best way to create economic returns is to actively embrace ESG. There is now so much awareness that people are beginning to make more conscious purchasing decisions. ESG investing, for example, is booming."

There is also hope for the future to be taken from the corporate response to the pandemic

"The speed with which companies adapted business models, the burst of creativity, innovation and also all the humour on display – these were really encouraging."

"It was inspiring to see how many leaders learned to empower and trust their teams: articulate the goals, designate the guardrails, equip people, and then get out of the way. It was pretty exciting and amazed us all. We need to keep this post-pandemic."

Businesses stepping up

Climate change and social inequality are areas where businesses have a particularly important role to play. The private sector represent 68% of the global economy, 80% of the financial flows and 90% of job creation. So it's in businesses' interests to step up. Responsible businesses realise that when society fails, they can't succeed either. They can't just be bystanders in the system that gives them their life.

"Boards need to put purpose at the core of their businesses, become more sustainable and compete on trust and responsibility."

"Shareholder primacy is increasingly being seen as a failed doctrine. It's a misconception that you can't be both profit and purpose driven. That couldn't be further from the truth. The pandemic has shown us that those businesses who responded well have more motivated and energised employees, more delighted customers and better relationships with suppliers and wider communities."

"Businesses need to pivot from being concerned with 'CSR' which is essentially about risk management and 'being less bad' to becoming an 'RSC' – a Responsible Social Corporation. An RSC realises it is responsible for the totality of its impacts, it takes a long-term focus, and it tries to optimise returns for all stakeholders, recognising that shareholder returns will naturally come as a result of what they do."

However, all of this requires businesses – and business leaders – to move out of their 'comfort zone'.

"It requires leadership and courage. It means you have to do more than pay lip service to ESG, but recognise how it actually links to value creation. It means you need to form relationships with a wide range of stakeholders including governments, regulators and NGOs and not just regard these as a 'nuisance'. It also means getting involved where you can in geopolitics and issues such as voting rights. Research has shown that 78% of people expect companies to have opinions on such matters and take an active role in maintaining decent values in society."

"Boards need to increase their competence in key areas such as ESG, climate change and digital. They also need to focus on talent development and succession planning. With average CEO tenures standing at less than 4.5 years, individuals are not in office long enough to take the right decisions and focus on long-term issues."

"It's a question of speed and scale. We are suffering from a lack of ambition. Many are simply playing not to lose. Our political systems remain largely focused on the short-term which results in gridlock. We need faster action with the private sector in the driving seat."

In some respects, responsible businesses may be more progressive than governments – but they need to recognise that getting political cooperation can de-risk the processes.

"Unfortunately, in many respects politicians are leaving us with a void and so businesses need to step up and fill it."

"Business needs governments. Strategic public-private partnerships can be highly effective. We can't overlook that. Everything is inter-dependent as COVID-19 has shown. We need global coordinated public-private approaches to vaccines for example. We simply must work together."

People and leadership

Society's expectations have changed and businesses are being asked to do more to take a stand on issues that they may not have been asked to a decade ago. This has ramifications for leadership and the boardroom, and some think a more empathetic style is needed.

Businesses can only be successful if they have the right people but, what people are looking for is changing.

"Now, people want to work for organisations that do more than just make money. That underlines the importance of values. And it also has implications at the top. We need broader social leaders, who have empathy and compassion and a high awareness of what's happening in the world. We need leaders who seek broader partnerships and have a multi-generational awareness."

Authentic and empathetic leadership

The importance of soft skills is much more apparent today than five or ten years ago. Think about the leaders of the past – very command and control. That doesn't go very far in this day and age with the expectations and impact that employees, shareholders, and other stakeholders have. "Great leaders today have empathy, good EQ, and are mindful of the broader dynamic they have to navigate."

"A lot of good responsibility-related work was being done before the pandemic. But it was going into glossy brochures or was part of 'brand positioning'. COVID has made us realise that this isn't about brochures – it's existential and very real. It was interesting that the latest Edelman Trust Barometer, which has been recording falls in levels of trust in institutions in recent years, found a small uptick in trust in companies. I think this underlines that employees need to feel sufficiently close to leadership to assess whether they're genuine. Employees – and customers and other stakeholders – expect leaders to not only run a business well but to take a stand on really important societal issues."

"Empathetic leadership is the hallmark of an organisation with a strong ESG approach. Leaders have to walk the talk and demonstrate a shared sense of purpose. We have to go beyond the usual performance metrics in the leadership of the future. It's also about the purpose of profit – there has to be a social benefit. If you can't deliver on that, you won't be able to run a sustainable business."

Board Composition: Ten questions for boards

As the board's role continues to evolve both in response to the pandemic and the strategic challenges that lie ahead in an increasingly regulatory and technologically enabled word, board composition – the 'right' number of board members with appropriately diverse skills and experience – is high on the agenda for boards, investors and other stakeholders.

Strategy has to be the number one reason for looking at board composition. The critical priority for boards today should be aligning boardroom talent with company strategy, both for the short and long-term. Whether it's addressing a gap around technology or finding people who have international experience, talent needs to be part of the strategy discussion. So, **Question#1** is around clarification of the company's purpose and direction, and **Question#2** is what skills gaps in relation to that strategy exist.

Question#3 is about diversity. Does the board have the right combination of skills, backgrounds, experiences, and perspectives to probe management's strategic assumptions and help the company navigate an increasingly volatile and fast paced world?

Closely linked with diversity is the breadth of the talent pool from which new board members are sought. **Question#4** is about whether sufficient attention has been given to recruiting directors with backgrounds in academia, government, civil society, as well as entrepreneurs and those from family businesses.

Question#5 is about challenging conventional wisdom. Is the 20th century paradigm of filling boards with directors with 'big company' experience still relevant in an age where an understanding of new technology and the agility to manage the consequential opportunities and risks are vital to success? Are today's boards lacking youth and IT literacy, and have the risks around wider business inexperience been overstated?

Taking individual responsibility

Business leaders need to take individual responsibility to understand and get to grips with the mega-issues facing organisations today.

"The Board Leadership Centre is a great tool to help boards gain the knowledge to build back better and board quality has never been so important. Yet an upgrade is needed in terms of many boards' competence around ESG, climate change, digitisation, cyber, diversity and inclusion. In fact, research has shown that only 17% of boards are ESG-competent, less than 10% are climate change-competent, and less than half have sufficient CEO succession plans in place. In my opinion, boards are not scoring highly. I'd give them a C minus. And I include myself in that!"

"I am trying to become ESG-competent myself by taking an in-depth course on the Circular Economy and Sustainability. I've already applied some of the learnings to the boards I sit on. And I'll be walking our CEO and Chairman through the insights too."

"Back in 2003, I remember there was a big push for board members who were finance-competent. Now, we need the same for those who are ESG-competent."

"Our inter-connectedness through technology has been very powerful. The pandemic accelerated a lot of what we used to consider in terms of five year strategic plans, such as digital transformation. That time has arrived already. Boards have had to learn to pivot rapidly and this holds us in good stead for the future. For myself, it's been fascinating to become a learner all over again at this stage of my career!"

"There is no delegation. You have to set the tone yourself and walk the walk. You can't just say, 'I don't know'. You've got to surround yourself with good people who can help show you where you are and where you want to be – and then you've got to drive the change."

The talent question

Leaders need to remember that their company is made of people, not hardware. It's essential to attract and retain the right people, and to do that you have to have clear values.

"Talent shortages hinge on how you define the talent pool and how much you're prepared to train people. Define your pool bigger!"

Getting the board composition right is underpinned by robust board evaluation and formal succession planning. Board evaluation is particularly useful in cases where there are unresolved difficulties around the boardroom table or if the company has changed significantly since the core members of the board were appointed. So, **Question#6** is, do we have a robust board evaluation process that focuses not only on what the board does, but how it does it and how it can improve?

Similarly, **Question#7** is about formal succession planning. Boards may be taking an increasingly rigorous approach to the succession of the executive leadership team, but for many companies more needs to be done in applying a similar approach to board composition.

Question#8 is about whether underperforming directors are being removed in an efficient and effective manner. There is no set formula for tackling boardroom change, but every board should have a system by which a director can voluntarily step off, or the board could say, respectfully, "We've really valued your service. It's just time for a change because it's good for the company."

Another pitfall to watch out for is appointing people 'known to the board' without considering whether their capabilities match the requirements or needs of the company. **Question#9** is about countering this risk. Are matrices identifying any missing knowledge, skills and expertise being applied without fear or favour when recruiting new board members?

Question#10, concerns leadership. Meaningful, constructive dialogue is essential for an effective board and this depends heavily on the board chair. Is the chair creating the conditions for board and individual director effectiveness; demonstrating the highest standards of integrity and probity, and setting clear expectations around the company's culture, values and behaviours, and the style and tone of board discussions.

The diversity aspect is also crucial here, both at a leadership level and all through an organisation.

"We need to change who's in charge if we want to change how we lead. There is too little diversity – too much conformity – in the boardroom. You get what you ask for. What would be really courageous would be if we saw some executives stepping aside to let others from more diverse backgrounds take their place. It actually doesn't take much to change it – just willpower, which is a renewable resource. The world is long on words and short on actions. We need to see more action!"

"The science is clear that diversity across all types, not just gender, improves sustainability and business success. But diversity is still much too low, there is still widespread unconscious bias. We still see very homogenous boards who frankly are defending their positions. There has to be more pressure to change this, with investors having an important role to play here too."

"We look at the progress we're making on diversity and Inclusion at every board meeting. It's the only way that things get done. As business people, we like data, we like to analyse it and see an improvement. It's exciting when you do. We take action too. In one case, we had a 75 year old executive who wanted to stay on for one more year. But we told him we felt it was time for him to step back – we found a 50 year old woman with a technology background, so that instantly improved our diversity!"

Protecting the wellbeing of staff

In recent months, employee health, safety, and wellbeing has taken on a new and expanded meaning and has become the focus of a wide range of stakeholders. Providing personal protective equipment for frontline workers, creating safe and productive work-from-home options when possible, implementing flexible working hours, providing health and wellbeing portals and advice, and providing additional time off to care for dependents are becoming more widespread practices.

"Sometimes, things just need to be mandated. I remember in 1974 the US government introduced a speed limit of 55mph. There was opposition but it actually saves lives and makes a big difference to emissions. In the same way, we've mandated across the companies I'm involved with that all staff should be vaccinated by 1 September. We're paying each staff member $300 to help with the costs involved in getting to a vaccination site and so on. We're putting our money where our mouth is. We simply have to ensure the safety of all our people – it's rule number one."

Board oversight of wellbeing

As they carry out their oversight of a broad array of human capital related issues in this new environment, boards can encourage management teams to:

— Prioritise and reassess the meaning of worker health, safety, and well-being.

— Re-evaluate diversity and inclusion initiatives at all levels.

— Take a fresh look at the company's talent development strategy.

More thoughts on the board's oversight of workforce wellbeing can be found in our publication here.

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The KPMG Board Leadership Centre

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