On the 2023 private company board agenda

KPMG Board Leadership Centre

Private company boards can expect their oversight and corporate governance processes to be tested by an array of challenges in the year ahead – including global economic volatility, the war in Ukraine, supply chain disruptions, cybersecurity risks, and a tight talent market. Expectations for growth have dampened and, according to the KPMG 2022 CEO Outlook, private company CEOs are even less optimistic on earnings and headcount than their public company peers.

The business and risk environment has changed dramatically over the past year, with greater geopolitical instability, surging inflation, and the prospect of a global recession added to the mix of macroeconomic risks companies face in 2023. Private companies are not immune to the decline in valuations, or the increase in financing costs brought about by rising interest rates. The effects of these dual shocks are reverberating through the private equity and venture capital markets with venture capital investment reportedly falling to a near two year low and M&A activity sharply declining. Yet, as valuations stabilise and rate hikes moderate, financial sponsors and strategic buyers are expected to revive the transaction market – albeit with extended due diligence.

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

Maintain focus on how management is addressing geopolitical and economic risks and uncertainty

Heading into 2023, developments in the Russia-Ukraine war, tensions with China, supply chain disruptions, energy shortages across Europe, cybersecurity, inflation, rising interest rates, market volatility, trade tensions, and the risk of a global recession will continue to drive global volatility and uncertainty.

This environment will call for continual updating of the company's risk profile and more scenario planning, stress-testing strategic assumptions, and analysing 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 at speed.

Oversee management's reassessment of the company's processes for identifying and managing these risks and their impact on the company's strategy and operations.

— Is there an effective process to monitor changes in the external environment and provide early warning that adjustments to strategy might be necessary?

— Is the company 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.

— Are they robust, actively tested or war-gamed, and updated as needed?

— Do they include communication 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 discussion. Resilience is the ability to bounce back when something goes wrong and the ability to stand back up with viable strategic options for staying competitive and on the offense in the event of a crisis, such as ransomware, a cyberattack, or a pandemic.

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.

Developing and maintaining a high-performing board that adds value requires a proactive approach to board-building and diversity – of skills, experience, thinking, gender, and race/ethnicity.

Boards of private equity and venture-capital backed companies, particularly those working towards an initial public offering or other company-defining transaction, may find their timeframes for a transaction extended, allowing for a re-evaluation of who occupies a board seat and how each director adds value.

The focus of public company investors on board diversity has also affected private company boards. Global private investment firms have vowed to increase board diversity for their majority-owned companies. Limited partners, including state pension funds and sovereign wealth funds, now expect diverse investment teams and, in turn, portfolio company boards. Yet, available data shows that there is more work to be done.

Self-reported data from the ESG Data Convergence Initiative (EDCI),[1] a consortium of global private equity investors, including general partners and limited partners, show that 45% of nearly 2,000 private-equity owned companies reporting to EDCI had no women on their boards, compared to just 12% in a custom global index of public companies.[2]

Monitor management's projects to build and maintain 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 projects to rethink, rework, or restore critical supply chains are carried out effectively, such as:

— Updating supply chain risk and vulnerability assessments

— Diversifying the supplier base

— Re-examining supply chain structure and footprint

— Developing more local and regional supply chains

— Deploying technology to improve supply chain visibility and risk management

— Improving supply chain cybersecurity to enhance resilience from disruption and reduce the risk of data breaches

— Developing plans to address future supply chain disruptions.

Importantly, are supply chain projects being driven by an overarching vision and strategy? Who is leading the effort, connecting critical dots, and providing accountability? And don't lose sight of the customer impact. (Many CEOs are reporting that "modifying products to meet stakeholder expectations" would be their top strategy for mitigating supply chain issues in the next three years.)

At the same time, the board needs to sharpen its focus on the company's efforts to manage a broad range of ESG risks in the supply chain.

Such risks – particularly climate change and other environmental risks; important "S" risks such as human rights, forced labour, child labour, 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.

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. Given the current risk environment, many boards are revisiting how they oversee risk, including the risks assigned to standing committees.

The challenge for all boards is to clearly define their risk oversight responsibilities, as well as those of each standing committee (if applicable), identify any overlap, and implement a committee structure and governance processes that facilitates 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:

— 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 new directors with skill sets or experience to help the board oversee specific risks?

— Recognise that rarely does a risk fit neatly into a single, siloed category. While many companies historically managed risk in siloes, that approach is no longer viable and poses its own risks.

— Identify risks for which multiple committees have oversight responsibilities, and clearly delineate the responsibilities of each committee. Also see On the 2023 audit committee agenda.

Essential to effectively managing a company's risks is maintaining critical alignments – of strategy, goals, risks, internal controls, incentives, and performance metrics. Today's business environment makes the maintenance of these critical alignments particularly challenging. The full board and any standing committees 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.

[1] Founded in 2021, the ESG Data Convergence Initiative is building benchmarking data for private-equity owned companies on several ESG factors. Members include over 230 general partner and limited partner organisations with aggregate investments topping $24 trillion. The initiative is tracking Scope 1 and 2 greenhouse gas emissions, renewable energy consumption, work-related injuries, board diversity, net new hires, and employee engagement.

[2] "New data shows how private equity stacks up on ESG," BCG, October 12, 2022.

Make talent, HCM, and CEO succession a priority

Most companies have long said that their employees are their most valuable assets. 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 changed the employer/ employee dynamic. This phenomenon of employee empowerment has prompted 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, expect continued scrutiny of how companies are adjusting their talent development strategies to meet the challenge of finding, developing, and retaining talent amid a shifting labour market. How might mass layoffs, particularly within the technology industry, impact the company's outlook on talent? Does the board have a 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? 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?

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. The board should help ensure that the company is prepared for a CEO change – planned or unplanned, on an emergency interim basis or permanent. CEO succession planning is a dynamic, ongoing process. The board should always be focused on developing a pipeline of C-suite and potential CEO candidates. 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? In many cases, those strategies have changed over the last two years. 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?

Keep ESG, including climate risk and DEI, embedded in risk and strategy discussions and monitor UK and global regulatory developments

How companies address climate change, DEI, and other ESG issues is viewed by many investors, employees, customers, and regulators as fundamental to the business and critical to long-term value creation.

Counter to the rapid mobilisation for ESG transparency and disclosure focused globally on public companies, private companies and their boards are arguably under less pressure to make pronouncements on ESG issues.

And, in fact, private company directors said in a recent US KPMG BLC survey that they saw oversight of environmental and social issues as only a mid-level board priority.[3]

That said, the importance of various ESG issues will vary by company and industry. For some, it skews toward environmental, climate change, and emission of greenhouse gases. For others, it skews toward DEI and social issues.

- How is the board helping to ensure that management has assessed which ESG issues are most material to the company and its business?
- 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?

SASB Standards offer a starting point for identifying relevant quantitative and qualitative ESG metrics by industry. And, for private-equity owned companies whose investors participate in the EDCI, anonymised data, parsed by sector, stage, revenue, region, ownership, and employees, can provide directional guidance on Scope 1 and 2 greenhouse gas emissions, renewable energy consumption, board diversity, work-related injuries, net new hires, and employee engagement.

Investor, employee, and customer expectations for clarity on environmental and social goals should be prompting private company boards and management teams to assess whether their governance and oversight structure is keeping pace with the company's progress on these issues, as well as how metrics are established, gathered and verified.

Clarify when and if the company should speak out on social issues

Polarising social and political issues are moving front and centre in the boardroom as employees, customers, investors, and stakeholders sharpen their scrutiny of a company's public positions – or silence. When will the CEO speak out on controversial issues, if at all, and what are the potential consequences?

Consider what role the board should play in establishing parameters for the CEO as the voice of the company. Some boards have written policies; others have an informal understanding that the CEO will confer with board leadership before speaking on a controversial issue. Some companies have cross-functional management committees to vet issues on a case-by-case basis to determine when speech is appropriate.

Directors and business leaders we spoke with identified a number of criteria or considerations for determining whether or not the CEO should speak out on highly charged social and political issues:

— Is the issue relevant to the company and its strategy? Is it in alignment with the company's culture, values, and purpose?

— How will speaking out resonate with the company's employees, investors, customers, and other stakeholders? In a tight labour market, employees often choose where to work based on company values, including its willingness to speak out on certain issues, such as DEI.

— Not speaking out can be as powerful as speaking out on certain issues. How do the CEO and the board come to terms with that ambiguity and risk, and weigh the consequences of speaking out or not?

— As the views of stakeholders are not uniform, how should CEOs and companies manage the inevitable criticism of their choice to speak or not speak? Having felt the backlash of speaking out on social/ political issues, some companies have adjusted their approach to take action without trumpeting what they're doing.

— Make sure that the company's lobbying and any political contributions are aligned with its speech.

Approach cybersecurity, data privacy, and AI holistically as data governance

Cybersecurity threats are dynamic and related impacts continue to intensify. The acceleration of AI and digital strategies, the increasing sophistication of hacking and ransomware attacks, and the lack of definition for 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 cybersecurity expertise on the board and relevant committees (although that expertise is in short supply). Other efforts include company and business-line specific dashboard reporting to highlight and prioritise critical risks, vulnerabilities, and 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 and the complexity of cyber risk management point to the continued challenges ahead.

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, used, shared, and disposed. Data governance also includes policies and protocols regarding data ethics – in particular, managing the tension between how the company may use customer data in a legally permissible way and customer 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 oversee cybersecurity and data governance more holistically:

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

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

An increasingly critical area of data governance is the company's use of AI to analyse data as part of the company's decision-making process. Boards should 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. Nevertheless, 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. That does not mean that directors must become AI experts, or that they should be involved in day-to-day AI operations or risk management. But directors at companies with significant AI programs should consider how they will ensure effective board-level oversight with respect to the growing opportunities and risks presented by AI.

The KPMG Board Leadership Centre

The KPMG Board Leadership Centre offers support and guidance to non-executive directors, whether managing a portfolio non-executive career or embarking on a first appointment. Membership offers you a place within a community of board-level peers with access to topical and relevant seminars, invaluable resources and thought leadership, as well as lively and engaging networking opportunities. We equip you with the tools you need to be highly effective in your role, enabling you to focus on the issues that really matter to you and your business.

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