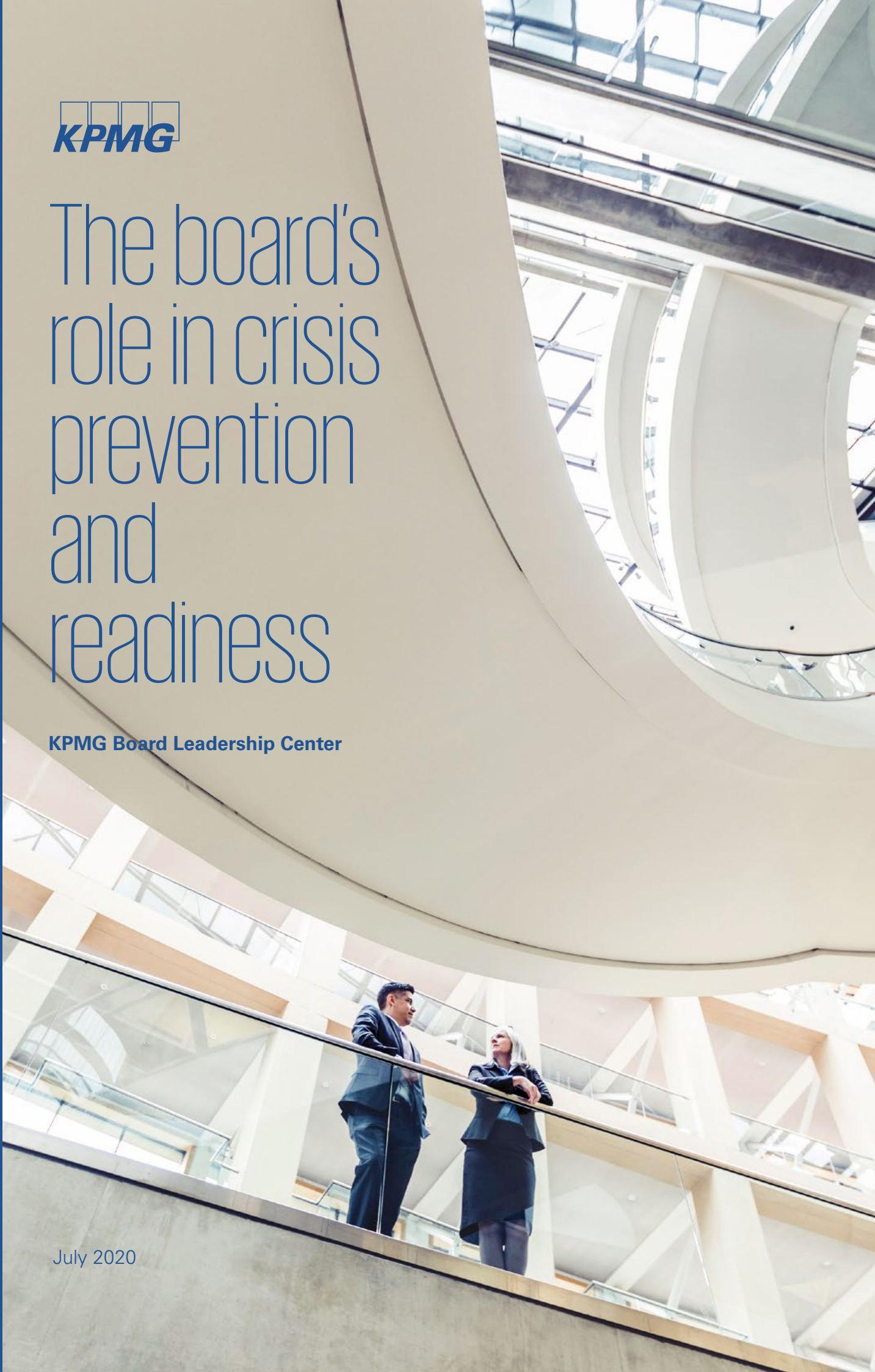




The board's role in crisis prevention and readiness

KPMG Board Leadership Center

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External interest in board activities is on the rise as board members are more and more held to account as the ultimate protectors of corporate value. While regulators and investors are increasingly seeking greater transparency and accountability, the most senior board members, led by the Chair, should be taking the initiative in setting the agenda and the tone of the board.

In this paper, the KPMG Board Leadership Center has tapped into the experiences and insights of seasoned non-executives on what it takes to lead an effective board.

When it comes to balancing the responsibilities of each non-executive board member there is no 'one size fits all' solution. Some chairs will regularly lean on senior board members and other non-executives for opinion and insight. In other cases they may only be a safety valve in the event of crisis at the top. There is, however, broad agreement on the importance of board leadership in harnessing the skills and experience of each director such that the value of the whole board exceeds the value of the individual members. Our research¹ has surfaced some practical techniques and approaches that all senior board members can apply.



The increasing likelihood of externally triggered crises occurring – cyberattack, natural disaster, terrorist act, supply chain failure or spread of disease such as COVID-19 – should be prompting a hard look at crisis readiness and response plans.



¹ Accrued through conversations and interviews with non-executive directors in the UK and the US



Crisis prevention and readiness

Crisis prevention and readiness have taken on greater urgency for management and boards as corporate crises – either self-inflicted or externally imposed – continue to make headlines. If the cause was unheeded warning signs, corporate culture, or the company's inadequate response, or that the organization was overwhelmed by the event, one question quickly takes center stage: Where was the board, and could it have done more to help prevent the crisis, mitigate the impact, or improve the response?

If anything demonstrated the need for a crisis resource plan that can be deployed quickly, effectively and at scale, it was the rapid spread of COVID-19. Together with the likelihood of other externally triggered crises such as a cyberattack or natural disaster, terrorist act or supply chain failure, a hard look at crisis readiness and response plans is crucial. In particular, companies must answer the following questions: Where is the company vulnerable? What is the crisis response plan and has it been practiced? How well prepared is the company? Does management have the resources, skills and plan to handle a major crisis? What is our plan if the CEO is unavailable or otherwise disqualified?

The reputational impact of crisis response can be deep and long lasting. Self-inflicted crises can raise serious questions around product quality, worker safety, unethical sales practices, or legal and regulatory compliance. And externally triggered crises can threaten the confidence of key stakeholders such as customers, employees, investors and regulators in the company's ability to respond – or even survive – a significant and potentially sustained event.

All of this calls for an ever brighter spotlight on crisis prevention. How effective are the company's crisis-prevention efforts, particularly given the speed that news (accurate or inaccurate) travels globally, as well as high stakeholder expectations for companies to 'do the right thing'?

As highlighted by the board members and business leaders we spoke with, the starting point is to make sure the fundamentals are in place, are visible, and are working effectively – this includes culture, tone at the top, ethics and compliance programme, whistleblower hotline, employee training, and a robust risk management process. Indeed, recent corporate crises offer important lessons to consider in mitigating risk and being prepared for a crisis. Our interviews add important color and insights to those lessons – particularly the role of culture in crisis prevention and desktop exercises in crisis readiness, including:

- Making it safe for people to do the right thing
- Monitoring culture and incentives enterprise-wide, with healthy skepticism
- Calibrating board/committee processes and communications for a better line of sight
- Not simply having a crisis plan in place – but practicing it

And when a crisis does occur, the keys to an effective response and timely recovery are transparency and accountability, being clear about who is calling the shots, keeping the board informed, and maintaining the board's independence.

In connection with crisis prevention and readiness, the board and management certainly have related duties, but nonetheless separate roles. While boards should not usurp management's role (assuming no extreme circumstances), recent corporate crises create an imperative for boards to reassess their level of engagement in this critical area.

Make it safe for people to do the right thing



A company's leadership, particularly the CEO, needs to be visible and approachable.



Beyond setting the tone and walking the talk, the board, CEO and senior management should create a culture that makes it safe for people to do the right thing.

A company's leadership, particularly the CEO, needs to be visible and approachable. "The goal is to create an open and comfortable atmosphere that encourages people to come forward and speak up – not just vertically but laterally – 360 degrees, really. You have to make it okay for people to ask questions, disagree, and bring up difficult subjects. They need to feel empowered to speak up when they see problems, even if the problem isn't fully formed yet."

The starting point

Make sure the fundamentals are in place and visible – tone at the top ethics and compliance programs, employee training, whistle-blower hotline, a robust risk management process. "But then focus on the culture and incentives surrounding those mechanisms."

Be clear about the behaviors for which the company has zero tolerance

Companies typically have zero-tolerance policies for certain behaviors such as violence, fraud, racial discrimination, and sexual harassment – but there cannot be a zero-tolerance policy for everything and it is essential that companies get this right. How should a board and management team go about developing a zero-tolerance policy? What makes a zero-tolerance policy effective? The #Me Too movement provided some important lessons for boards as to how to establish absolute clarity regarding a zero-tolerance policy for harassment and abuse.

Create a culture of accountability

"People pay attention to who gets hired, fired, and promoted. There is no substitute for being objective about leadership and holding them accountable and paying for performance. It gives all employees a sense of what is expected and what is rewarded."

These issues are often more nuanced than simply reporting wrongdoing. One company created a dedicated "advice hotline" in human resources (HR), separate from the whistle-blower line. "We found that employees are more inclined to call a line that's staffed with professionals who can help them think through an ethical question."

"If you see something, say something" is a useful mantra, but it doesn't work if the power dynamic is wrong, or if there's an implicit downside for speaking out."

Emphasize values and purpose in the decision-making framework

Be clear that the company will stand behind employee decisions that are grounded in the company's values whether it's safety, customer service, or kindness to others. Also, recognize that corporate loyalty is less of a motivator than it once was. Millennial and other younger generations may care more about the larger purpose behind their work, which is values based not company based. "Values and purpose are becoming north stars."

Understand how employees are onboarded, core values are communicated, and expectations are set

What is the messaging that new hires hear first? How are values articulated and reinforced? Make sure new employees understand expectations and enable them to live up to those expectations with training and regular reminders.

At a leadership level, “any senior-level hire should meet with the board – when they’re hired or departing from the company – to talk about the culture.”

Recognize the power of performance targets

“Most people want to do the right thing, but generally speaking, they will aim for the targets they’re given.” Leadership may have all the right intentions and ideas for putting balanced targets in place, but cascading that down through a large, extended, and diverse organization is not easy to do. “You can end up with unintended consequences and behaviors that can lead to a crisis.”



And when a crisis does occur, transparency and accountability, being clear about who is calling the shots, keeping the board informed, and maintaining the board’s independence are all cited as keys to an effective response and timely recovery.



Making it safe for people to do the right thing – challenging questions for the board

Bringing culture to the top of the board agenda is crucial when looking to protect the company from crisis. While good culture won’t guarantee success, persistent bad culture will undoubtedly cost.

Do we understand our cultural risks – particularly those associated with tone at the top and incentives and pressures – and how are we addressing them?

- What are the tools or common methods that we use to gauge culture at all layers of the business?
- What are our metrics and do they reflect our values?
- What pressures are we creating? Are performance targets unrealistic?
- What is our zero tolerance policy?

Do we use a ‘reputation lens’ to assess, manage and oversee risk?

- Do we consider the reputational implications of what may seem like financially immaterial risks?
- Does this yield better outcomes?

Do we have a robust risk and control culture?

- Do we understand our key operational risks and have the right controls in place?
- Are we sensitive to early warning signs regarding work place conduct, safety, product quality and compliance?
- Is internal audit properly focused and resourced?

How much, and what kind of information does the board require to provide effective oversight?

- Who decides?
- How involved are board members in determining their information needs and when additional information is warranted?

Monitor culture and incentives with skepticism



It's easy to hold back on skeptical questions when things are going well, but 'don't mess with a good thing' is not a good answer.



Red flags are usually too late. Spotting yellow flags early enough to respond requires a combination of probing dialogue in the boardroom and exposure to the everyday culture of the company. What gets rewarded? What is driving behaviors and results?

Focus on outliers – negative and positive

How did an individual or a business unit get such phenomenal results this quarter? How did we beat our peers' performance by a factor of three?

"It's easy to hold back on skeptical questions when things are going well, but 'don't mess with a good thing' is not a good answer. If it sounds too positive, ask more questions. Insist that the board be informed about anomalies – good ones and bad. Ask for the outliers and have a constructive conversation about them. Be skeptical. That's the board's job."

Conduct a formal risk assessment of incentive programs

Is pay driving too much risk taking or the wrong behaviors? "If all the focus is on the dollars, people may start cutting corners on maintenance, treating others poorly, etc." A formal risk assessment by internal audit or a compensation consultant can help determine whether incentives are working as intended.

"Our board's independent compensation consultant conducts a risk assessment of compensation incentives going all the way down to the sales associate level. The consultant reviews the formulas and documentation to see if there are checks and balances to account for risk factors-unusual activity, a disconnect from returns, etc. If the leadership team knows that the compensation committee and board are getting this type of report, it sends a message to management about the board's expectations."

Assess the effectiveness of sexual harassment policies, including reporting channels and investigative processes

Is there a robust process for management to review and update the company's policies on sexual harassment to ensure that they remain appropriate and relevant? How well are the avenues for raising sexual misconduct concerns communicated throughout the organization? Do employees feel comfortable raising concerns? What is the escalation process? Does the board know about a complaint concerning an executive as soon as it is reported? What about complaints deeper in the organization? Is there a protocol for reporting sexual misconduct complaint trends to the board?

Ask the auditors – and others – what they are seeing

Auditors are naturally attuned to the pressures facing employees and business units, for example, lack of resources, tight deadlines, or tough growth targets – most organizations are doing more with less, and that is not sustainable over time. And yet, “Internal auditors are too often underutilized. My interactions with internal audit are always helpful – and not just whether technical procedures are being followed. They understand the general attitude in the organization, when things are getting lax or are running well.”

Private discussions with the others who have a line of sight into the business – e.g. external auditor, head of HR, general counsel, chief compliance officer – can provide important insights and context in crisis prevention efforts. “It’s also another opportunity to reinforce expectations and strengthen relationships.”

“Don’t allow anyone to script your time out in the business. Ask unconventional people questions about audit related matters.”

Spend time outside the boardroom and corporate headquarters

There’s nothing better than spending unstructured time in the business, without executives present, visiting plants, and facilities. A few hours with the local management team and interfacing with employees can give you a first hand feel for what’s happening on the ground. Does it line up with what you’re hearing in the boardroom?

“Site visits are a useful way for an audit committee to develop its understanding of the business, whilst at the same time building constructive relationships and reinforcing the board’s commitment to strong governance.”

Between meetings it’s good to sit down with the key people in their ‘natural habitat’ without an agenda. Just sit in their office and have a conversation about things that are on their radar ... or yours!”

Lessons from COVID-19

- Send clear messages that protecting the workforce and customers is a top priority, and remind management of their duty of care
- Identify the critical business decisions that must be brought to the attention of the board
- Discuss the company’s ability to continuously monitor red flags in a rapidly-evolving situation
- Make enquiries about certain issues such as whether the infrastructure and processes are in place to enable employees to move rapidly from office-based to home-based working
- Enquire about the effectiveness of internal and external communications in keeping key stakeholders informed
- Request information about improvements needed to business continuity plans and the operational resilience strategy
- Address learning points post-crisis regarding how the board could more effectively support the company during such an event



COVID-19 provides some important lessons for boards about how to respond to a crisis and help steer a company through a time of unprecedented uncertainty.



Build a better line of sight



Committees often have different access into culture, ethics, and incentive risks.



Calibrate board and committee processes and communications to enable a better line of sight – particularly into culture, ethics, and compensation risks.

Consider the role of the committee chairs

Committees and their respective chairs can play a significant role in the context of crisis prevention, particularly as the business environment becomes more complex and uncertain. Committees often have different access into company culture, ethics, and incentive risks, and, therefore, different views as to potential vulnerabilities and risks, for example:

- **The compensation committee** has a good understanding of how incentives are intended to drive behavior as well as associated risks posed by the incentives. That said, “What is going on further down in the organization in terms of incentives and pay driving behaviors? Does the compensation committee need to take a step back and a fresh look at the balance of targets? Other committee chairs may have related concerns.”
- **The audit committee**, working with auditors and overseeing enterprise risk management, ethics and compliance, and the whistleblower hotline, has a different line of sight into cultural issues and risks. Audit committees are well positioned to help focus internal audit on risks posed by incentives – and to spot-check and question results that seem too good to be true.
- **The nomination committee**, with responsibility for CEO and leadership succession, may also have a unique perspective on talent and incentives.

Periodically bring the committee chairs together to coordinate and calibrate

Have the committee chairs discuss each committee’s role – in conjunction with the full board – in overseeing tone at the top, culture, and incentive risks.

Could the chair attend all committee meetings to help ensure coordination? Or could cross membership be an alternative to achieve the same end?

Are there special roles for each committee? Is it time to re-examine board committee roles/charters?

Testing the crisis response plan

Have a crisis response plan in place – and practice it. Companies that are prepared tend to weather a crisis better. “It might be time consuming and expensive, but identifying likely crisis scenarios and practicing responses is well worth the investment.”

Use desktop review and planning exercises

“Every company should conduct desktop exercises starting with a cyber breach scenario. What do we do in the event of a major cyber breach? What are the critical elements of successfully managing a cyber breach, and how can we apply those elements to other crises?”

Take a risk management approach to crisis planning

What are the categories of crises that could occur? Ask the question of the board, of management and possibly of others around the business, to canvas a broad spectrum of opinion. What are the five worst things that could happen to our business? What alert systems are in place for quickly escalating issues internally? What is the impact on our company when something happens to another company?

“Bring in buy-side investors and bankers, and ask them what they think is the worst thing that could happen to the company. Learn from other companies’ mistakes.”

For each category of crisis, develop a response plan

- **Who will act as an internal lead for each category of crisis** – do we need backups? Remember that whilst some individuals thrive in every day ‘peace time’ leadership roles, they may be less effective in a crisis. Conversely, others who may not stand out on a day-to-day basis, may display amazing talent under pressure.
- **What is the role of each member of the crisis team** – organizations may have expertise from within the business who could be drafted in; such as sales team members with a communications background. Consider if external support might be needed.
- **Who is responsible for communications to each constituency** – for example, regulators, investors, employees, customers, media, the public? And do we have a clear communication plan for each?
“Dealing with the business section of the newspaper is very different to being on the front page.”
- **What is the role of the board versus management** – should the chair be on the crisis response team to keep the board informed, facilitate communications, and maintain appropriate involvement?

Management should have a blueprint and communication protocol to follow

Key questions for the board to challenge them on: How well prepared are we? Do we have a comprehensive, executable crisis response plan? What don’t we have a game plan for? Does management have the experience, skills, and resources to manage a crisis?

Keep in mind that many companies don’t have people with first hand experience managing an existential crisis. There needs to be a blueprint to respond quickly. Know who needs to be at the table for any given crisis and connect with them early on, before a storm hits.



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Remaining transparent and accountable



The company needs to step up and take ownership and responsibility in a crisis situation. Accountability and credibility are everything.



When a crisis does occur, it is crucial to be transparent, accountable, and clear about who is calling the shots. “The company needs to step up and take ownership and responsibility in a crisis situation. Accountability and credibility are everything.”

An effective response and quick recovery – particularly in the eyes of customers, employees, and the public – will hinge on transparency and speaking with a single, clear voice whether the news is positive or negative. “Run all the traps and avoid reaching a convenient but premature conclusion.”

Understand the scope of the crisis and how management is responding

Three key questions every board should ask: Have we determined the full scope of the crisis? Are the board and management all together and of the same mind as to what is being done and what is required? Do we have benchmarks and checks on progress as the crisis management and mitigation efforts go forward?

Seek insight but retain responsibility

Whilst it is important for boards to seek expert insight and advice, ultimately boards are accountable for their own actions and must determine the appropriate course of action based on the specific circumstances, facts, and culture of the organization. Sometimes this may run contrary to the expert advice that they receive.

Make sure everyone knows what the company’s values and priorities are when a crisis happens

“Be clear in your own mind – and to the public – about what the company stands for, what its values are, and where its loyalties lie” – i.e. product quality and worker safety versus financial performance.

Be clear on how management is to communicate this to employees down the line. “Don’t short-change the response. Management should have all the resources it needs to do the right, best thing.”

“Media and reputation is important, but do what really matters first. Doing the right thing will increase the likelihood of success.”

Be as transparent as possible

“Gather the relevant facts and, without jumping to conclusions, share as much as you can. ‘Going dark’ or having a bunker mentality will leave questions lingering and invite rumors and inaccurate information to build up.”

“Use social media to help understand what marketplace perceptions are and stay ahead of the story:

“Customers (and other stakeholders) value open and honest communications – even if it means admitting a mistake – and such an approach can be a powerful catalyst for regaining customer trust.”

Be prepared to roll your sleeves up

Crisis management can rely on people taking on tasks vastly different, and often seemingly menial, in order to keep on track. This can also be a great opportunity for team members to flex underused mental and creative muscles – “individuals are capable of so much more.”

Be clear who is 'calling the shots'

Assuming the CEO is not disqualified or unavailable, the CEO is in charge and the board's role is oversight. The CEO is the face of accountability, and external communications should flow through the CEO.

Individual boardmembers should generally not speak for the company – unless a board response is determined to be necessary.

Remember that a crisis cannot distract from the needs of individuals

It is crucial for senior people to offer frontline teams the tangible support that they need, not only during a crisis situation, but afterwards from a staff wellbeing perspective.

Focus on the root cause and recovery

If the crisis was caused by an underlying problem, understand how management is getting to the root cause and fixing it. "If culture was the culprit, be prepared for a long-term effort."

"It took a long time, it cost us a lot of money, it wasn't a good thing to happen ... but my business is now stronger."

Three near term steps for a better line of sight on culture and crisis readiness



Meet with the committee chairs

Is the right focus and attention being brought to culture and incentive risks?

Is anything falling between the cracks?



Ask for a risk assessment of culture and incentives

What is our culture?

What behaviors are incentivised by compensation practices?

Are the behaviors motivating people to 'do the right thing'?



Request management to take the board through a desktop crisis response

Starting with a cyber breach scenario, where are the gaps in our crisis management plan?

What lessons can be applied to other crisis scenarios that the company might face?



The KPMG Board Leadership Center

The KPMG Board Leadership Center offers support and guidance to board members. We equip you with the tools and insights you need to be highly effective in your role, enabling you to focus on the issues that really matter to you and your business. In addition, we help you to connect with peers and exchange experiences.

Learn more at kpmg.ch/blc

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