

EY Center for Board Matters

Top priorities for boards in 2019



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Top priorities for boards in 2019

In today's world of unrelenting disruption and innovation, a company's board plays a more active role than ever before in overseeing strategy and risk management amid digital and emerging technologies, industry convergence and workforce transformation, shifting consumer attitudes, increased climate risk, diminishing trust in organizations, political polarization, rising income inequality and various other megatrends shaping the business environment.

As a result, the board agenda is packed and the roles and expectations of directors continue to grow. To help boards navigate the challenges ahead, the EY Center for Board Matters presents five priorities for 2019, along with actionable questions for boards to consider.

- 01** Embrace the duality of strategy
- 02** Transform the governance of risk management
- 03** Accelerate the talent agenda and activate culture as a strategic asset
- 04** Strengthen communication and engagement with stakeholders
- 05** Continue to enhance board performance

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Embrace the duality of strategy

Questions for the board to consider

- ▶ How is the board helping to shape an agile, multistakeholder strategy that drives current business while considering future innovation and opportunities?
- ▶ Should the board bring in outside perspectives to understand the forces shaping the competitive environment?
- ▶ Has the board confirmed that management and director bias do not impede innovation?
- ▶ How is the company preparing for competitors that may emerge? Is the board challenging the current business model by widening its view into edge geographies and adjacent industries?
- ▶ Does the executive compensation program help balance short-term performance goals and long-term transformation?

Companies today must strategize for challenges beyond the horizon while driving current business. This duality is key to surviving and thriving in this period of seismic disruption. The life-span of S&P 500 companies is shrinking. *Innosight* reports that by 2026, the average tenure of S&P 500 companies will be only 14 years, with around half of the index being replaced over the next decade.¹

We are witnessing the reinvention of industry, consumption behaviors and the future of work. To endure, businesses must initiate and respond to disruption.

The need to focus on driving near-term growth while pursuing innovation that supports long-term opportunity and sustainability presents management with an inherent challenge. They must demonstrate short-term performance while simultaneously investing in the future, which can dampen short-term results. The board's role in helping management navigate and find balance within this tension is an especially critical one.

The board should lean in with management in a collaborative manner to help guide a strategy that positions the company for long-term success. Rather than see the duality as a tension, boards can help management embrace it as a synergy that can help inform a stronger and more resilient strategy. Asking "What can be done today to make the company better and stronger tomorrow?" can provide a clear and motivating path forward while considering multiple dualities: short-term vs. long-term, disruption vs. sustainability, profit vs. investment, risk vs. opportunity and use vs. conservation.

To allow for these strategic discussions, the one-off, annual board strategy session needs to be challenged. Boards should work with management to frequently revisit the strategic plan and its key elements and assumptions. They should encourage management to regularly evaluate the full potential of the company and its existing business units, products and solutions, including critically evaluating underperforming assets or operations most at risk from technology, digital and customer disruption.

Boards also should challenge whether reinvestment in existing businesses, products or solutions makes sense or whether a new strategic path should be forged. This is not only about creating new products, but finding efficiencies and new ways of working. They must confirm that management has embedded an agile strategy and innovation process into the company's culture and talent agenda. Without the right culture and the right people to effectively activate innovation and strategy, a company is likely to face competitive challenges and potential failure.

With record levels of shareholder activist campaigns and increasingly coordinated stakeholder interests and demands, chances are that if the board isn't challenging management on the status quo, others will. Boards should take an informed and forward-thinking view of the company's operating environment, industry and business. They need to look for shifts in customer and employee behaviors and expectations, current and potential competitors, and how the company can ethically fulfill its purpose over time.

Boards should embrace an activist mindset and seek third-party data about future business, talent, revenue models and transformation opportunities. This data will help the board constructively challenge biases, identify blind spots and unknown unknowns, and bring an objective perspective and new ideas to the strategic planning process.

Finally, it's important that the board and management review the objectives, related processes and effectiveness of stakeholder communications and other disclosures about the strategy. These communications should clearly and effectively present how the organization is governing and executing on the strategy. If the company's stakeholders have a clear understanding of how the company is addressing today's challenges while focusing on the future, they are more likely to support the company in the long run.

The board should lean in with management in a collaborative manner to help guide a strategy that positions the company for long-term success.

¹ <https://www.innosight.com/wp-content/uploads/2016/08/Corporate-Longevity-2016-Final.pdf>



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Transform the governance of risk management

Questions for the board to consider

- ▶ Are the board composition and committee structure appropriate to provide effective oversight of the company's risk profile?
- ▶ Is the board periodically evaluating data to validate the company's culture and to determine if values are being lived by everyone in the organization?
- ▶ Have messaging and education increased within the company's employee base related to the importance of their overall role with risk management?
- ▶ What external data is the board using to evaluate emerging and disruptive risks? What third-party resources are being used to validate the company's risk mitigation on such things as cybersecurity, data privacy and geopolitics?
- ▶ Is the board taking part in tabletop exercises that test the company's crisis readiness across various scenarios?

As companies transform their business models, leading boards are transforming their governance of risk management. Enhanced board oversight coincides with the Committee of Sponsoring Organizations update of its enterprise risk management (ERM) framework in June of 2017. With management executing on the updated framework in calendar 2018, 2019 presents an opportune time for boards to go through a similar evaluation process with how they exercise their oversight of risk management.

Fundamentally, the governance of risk management starts with having the right composition of board members aligned with the company's strategy and risk oversight needs. A board that brings expertise aligned to the company's strategic goals and risks, and one that has the character and leadership needed to challenge management and seek external insights as appropriate, is foundational for effective risk oversight.

Boards are revisiting their overall tone, engagement and messaging to management to echo the utmost importance of living the values of the company. This includes periodically obtaining data to better understand and monitor the company's cultural norms and confirm management's adherence to the company's core values and desired culture.

Most boards outside of the financial services industry have historically charged their audit committee with oversight of the company's ERM program. Boards should evaluate the overall effectiveness of this approach. Several regulators and audit committee members themselves have voiced concern about the overloaded audit committee agendas given their primary mandate for oversight of financial reporting. While some boards are forming new committees, others are creating ad hoc committees to address key strategy and risk management issues, or at a minimum, the full board is taking greater ownership for the oversight of strategic and operational risks while the audit committee continues their focus on financial reporting and compliance related matters.

Leading boards are also enhancing their approach to critical enterprise risks by obtaining third-party research and analyses to understand investments and changes occurring within their industry that may portend future disruption. They are monitoring risks related to their company's processes for initiating and harvesting innovation over the longer term. Third-party resources are being leveraged by the board to validate risk mitigation and the consideration of strategic opportunities in areas such as culture, workforce transformation, the environment, geopolitics and regulation, along with the ever-evolving cybersecurity and data privacy landscape.

Boards should challenge whether management is intensifying its efforts and focus with educating their employees broadly on their personal responsibilities related to risk management. This includes verifying that employees have a thorough

understanding of the company's values, code of conduct, ethical business practices, and are exercising the appropriate compliance hygiene related to cyber and physical security.

Compliance functions need to be reviewed to confirm that coverage is appropriate with the growing risks of cybersecurity, data privacy, social media and geopolitics and to make sure that reporting lines are sufficient (i.e., should the CISO have some form of reporting outside of the technology function?). These functions are also being evaluated to determine whether contingency plans are in place with various scenarios evaluated through stress testing and simulations to enhance business resiliency.

Boards are also challenging audit functions to update their risk assessment process in a more continuous manner and to drive greater efficiency and effectiveness through the use of predictive analytics and the leveraging of technology tools. Postmortems of both internal and external risk events over a relevant time period are also being conducted to determine what has been missed (including near misses) to further enhance the control environment and embed continuous learning and improvements in risk management.

Finally, leading boards are challenging the overall risk reporting they are receiving from management. They are seeking a greater focus on more strategic risks along with risks that are close to or exceeding tolerance levels on key performance indicators established by the board. In turn, less time is spent on risks of lesser importance or risks that are being appropriately managed.

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Accelerate the talent agenda and activate culture as a strategic asset

Questions for the board to consider

- ▶ Is the board continuously reviewing its governance of culture, talent and innovation given the ever-growing significance of intangible capital to competitive advantage?
- ▶ What talent-related metrics is the board reviewing and how often?
- ▶ Has the organization evaluated the required competencies, skill sets and structure required to successfully carry out its strategy and business objectives?
- ▶ Does the board have a good understanding of the health of the organizational culture at the top, middle and bottom of the organization (tone at the top, mood in the middle and buzz at the bottom?). What metrics are being considered to support such conclusions?
- ▶ How much visibility, access and reporting is the chief human resources officer (or equivalent) providing to the board around human capital management/talent related risks and opportunities?

Intangible assets now average 52% of an organization's market value (up to 90% in some sectors),² and part of that capital can be attributed to a company's workforce. Talent is playing a much greater role in driving value, and talent strategy is taking a front seat as human capital becomes increasingly critical to competitive strength.

Boards understand the need to oversee talent and culture more closely to boost the company's performance and enhance its reputation. With this recognition, some boards are looking beyond the C-suite to better understand and oversee talent issues and culture across the organization. This is especially true following reports in the past year of high-profile managerial behavioral issues, toxic work environments and the unintended consequences of certain business models.

Research shows that today's talent, from top executives to early career professionals, seek to work for companies that have a clear purpose, strong culture and respected reputation. They prefer organizations that at least consider and address environmental and social issues and those that provide learning and growth opportunities. It is critical that boards investigate and understand these evolving talent trends.

A company's culture must be a strategic asset. The board should have a strong pulse on how executive, mid-level and lower-level management demonstrate and communicate the company's values. They should also understand how a company's programs promote culture and drive the right behaviors and actions. This requires the board to review culture across the organization and look at talent-related performance metrics, including employee engagement scores, attrition rates, diversity and inclusion metrics, learning and development ROI, whistle-blower hotline activity, themes from employee onboarding and exit interviews and code of conduct violations. Compensation committees should review the company's broader compensation practices to see if they align with its values and goals and consider any unintended consequences of such practices.

To attract, retain and motivate the right talent, boards must help create a culture that is clear and understood throughout the organization. The culture should enable innovation to thrive, promote diversity and inclusion, and acknowledge that employees need clear learning and growth opportunities and fair compensation.

A culture of innovation should flow down from senior executives to junior-level employees, providing a channel for potentially game-changing ideas to come to fruition. However, a recent survey of 1,000 workers³ reveals a growing chasm between how senior-level and junior-level employees view their ability to be innovative at the organization in which they work. Only 54% of entry-level employees said that new ideas are celebrated internally, compared with 91% of senior executives. Similarly, just one-quarter of entry-level employees believe that their company fosters a culture of innovation, compared to more than half of senior executives. With the escalating war for talent, and given that today's ideas are tomorrow's competitive advantage in our disruptive marketplace, such an innovation disconnect creates strategic risk.

Companies should have internal processes that promote employee engagement and accountability. New ideas should be encouraged and where appropriate incorporated into the strategy and further incubated and translated to new products, services and process improvements. Companies should also work to diversify their talent base in terms of traditional diversity as well as a diversity of backgrounds and innovative mindsets. Furthermore, leadership and future pipeline should reflect the company's diversity goals.

Digitization and the impact of robotics, automation and analytics in business processes and services will continue to transform business and the workforce. Companies must be flexible by expanding the use of technology, retaining more contingent and remote workers, and reskilling and redeploying their traditional labor to focus on more strategic work.

These developments also highlight the strategic role of the chief human resources officer (CHRO) in helping the board understand the workforce of the future and be effective in guiding management on where and how to invest in talent and technology. Leading boards are having regular interactions with and reporting from the CHRO in a manner similar to the CFO as they assume a greater role in overseeing the company's culture and talent goals and assessing the company's overall return on invested talent.

2. <http://brandfinance.com/knowledge-centre/whitepapers/global-intangible-finance-tracker-gift-2018/>

3. <https://www.ey.com/us/en/newsroom/news-releases/news-us-workers-report-innovation-disconnect-between-executive-and-junior-level-staff-new-ey-survey>

A company's culture must be a strategic asset.

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Strengthen communication and engagement with stakeholders

Questions for the board to consider

- ▶ Has the company considered how it might harness purpose to reveal a path through business model disruption and concurrently prioritize stakeholder engagement and communication efforts?
- ▶ Is the company familiar with key multistakeholder groups and other organizations focused on leading environmental and social metrics and disclosures, such as the Climate Action 100+, the Task Force on Climate-related Financial Disclosures (TCFD) and the Sustainability Accounting Standards Board's (SASB) disclosure frameworks?
- ▶ How is the company communicating to all stakeholders – in a consistent, comprehensive manner – its efforts to provide sustainable, inclusive growth integrated with core business strategy?
- ▶ To what extent is the company familiar with the governance specialists, as well as the portfolio managers and equity research analysts, who follow the company? Has the company engaged in outreach and established a relationship such that it can quickly engage as appropriate?

As boards and executives work together to tackle ever-more complex and quickly evolving challenges, they're also finding that a growing range of stakeholders – corporate leaders and employees, customers and suppliers, communities and investors – are increasingly focused on the broader purpose of the corporation. These diverse stakeholders increasingly seek greater insights into how companies are strategizing for business sustainability, including addressing environmental and social matters that impact long-term value.

Companies are paying attention. There is growing evidence of a significant shift in corporate efforts to increase engagement with stakeholders and enhance disclosures and other communications – far beyond traditional financial reporting requirements. For example, in the US, there is continued year-on-year growth of voluntary corporate disclosures to address an expanding range of stakeholder interests, primarily through proxy statement filings and sustainability reports and other disclosures around environmental and social matters – and these disclosures are starting to include information on a company's core purpose and strategy.

Groups like the Embankment Project for Inclusive Capitalism (EPIC) are helping companies drive decision-making and communication around their long-term value proposition. Including how they are creating sustained, inclusive, long-term value for key stakeholders and society more broadly.

EPIC's November [report](#) identifies key value drivers, as agreed by companies, asset managers and investors, and ideas on how these drivers can be leveraged to enhance broad-based inclusive growth. Focus areas include:

- ▶ **Talent** – the way companies manage compensation and benefits, recruitment, training and development, diversity and inclusion, well-being and creating a purpose-driven culture of engagement
- ▶ **Innovation** – fulfilling unmet needs, maintaining focus on the end user during the innovation process and fostering trust in the organization
- ▶ **Society and the environment** – the impact on external stakeholders and communities by contributing to business-relevant social and environmental goals
- ▶ **Governance** – the board's effectiveness in providing appropriate oversight, governance mechanisms to determine board quality and independence, and the ability of management, in conjunction with the board, to develop and assess long-term strategy

Other organizations are also applying a multistakeholder approach aimed at enabling more multistakeholder partnerships and collaboration. For example:

- ▶ The World Economic Forum (WEF) promoted the [New Paradigm](#) in 2017, which aims to recalibrate the relationship between public corporations and their major institutional investors and views corporate governance

as a collaboration among corporations, shareholders and other stakeholders working together to achieve long-term value. Since then, WEF has obtained more than 100 commitments from corporations and investors who said they would take positions consistent with the philosophy.

- ▶ The Coalition to Encourage Corporate Philanthropy (CECP) CEO Force For Good effort encourages cross-sector CEOs to share their long-term business plans for sustainable value creation with institutional investors. CECP discloses corporate contributions of over US\$18 billion in societal investment and 4 million hours of employee engagement since its creation in 1999. Their [site](#) highlights ways that companies can consider building the capital market infrastructure for long-term value creation and includes examples of company presentations on long-term strategy to institutional investors.
- ▶ Other groups encouraging longer-term focus in business and investment decision-making include [FCLTGlobal](#), which conducts research and encourages stakeholders to problem-solve and test capital allocation approaches that create long-term value.
- ▶ Similar themes are being advocated, too, by the CEO-backed [Commonsense Corporate Governance Principles 2.0](#), the Business Roundtable's [Principles of Corporate Governance](#) and the Investor Stewardship Group's [Corporate Governance Principles For US Listed Companies](#).

Well-governed companies understand that they need to be responsive to these initiatives and key stakeholder interests. They also can demonstrate their responsiveness through both continued positive engagement and enhanced disclosures directly addressing these interests. If companies respond to customer needs, invest in their employees for the long-term, do right by the communities and physical environments in which they operate and have a strong, fundamental purpose, their shareholders should benefit.

The real opportunity for boards and companies in 2019 and beyond is to drive a long-term-oriented strategy. This includes strong stakeholder communication and engagement practices. Companies that effectively execute this model and communicate their multidisciplinary, multistakeholder efforts in a comprehensive and transparent manner are those that are best positioned to develop and maintain the support of a broad base of stakeholders even in this highly disruptive and transformational time.

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Continue to enhance board performance

Questions for the board to consider

- ▶ How does the board, its committees and directors stay fully informed? What steps does the board take to make sure its knowledge and perspective enable agile and effective decision-making and identification and solving of problems?
- ▶ Does the board represent the right mix of relevant skills and specialized expertise, industry knowledge, understanding of key stakeholder views, diverse backgrounds, experiences and perspective that stimulates effective oversight and direction? How is this disclosed?
- ▶ Do board discussions and decisions demonstrate that all board members are highly informed and engaged, respectful even when challenged, appropriately inquisitive, and attentive to and informed about both big-picture concepts and important details?
- ▶ Is the board engaged with the company's investors, employees, customers and regulators such that it clearly understands their key views and priorities and can appropriately incorporate them into the company's strategy?

To more fully address the growing demands and complexity of their work, boards should rigorously and continuously examine and evaluate their performance. While most boards still formally evaluate performance annually, leading boards do so more regularly. Intra-year evaluation enables boards to conduct a deep evaluation in phases that focus on one or more of the multiple aspects of overall board performance. More regular evaluation also encourages more candid, real-time feedback that can be quickly acted upon, improving information flow, decision-making, dynamics and performance.

When conducting evaluations, boards should use a tailored process that demands thoughtful and objective self-inquiry and raises questions that elicit feedback cutting to the core of performance, such as: How did our prior thinking and decision-making impact company operations, strategy and competitiveness? Were we proactive enough in responding to and initiating disruption? Were we successful in engaging with stakeholders in ways that enhanced mutual understanding and stakeholder support? Did we help management communicate company culture and strategic vision in ways that make the company more attractive and valuable to employees, customers and investors? Did we support the company's expanded use of technology in ways that make systems, processes and controls more efficient and secure? Did the performance goals we approved for CEO incentive compensation positively and measurably impact CEO performance and corporate value in the past year? Did our succession planning and talent management programs give rise to new leadership and innovation and increased employee engagement?

An equally (and related) key purpose of evaluation is for boards to regularly consider, objectively within the right context, the fundamental question of whether the current directors have, collectively and individually, all the experience, background, perspective, foresight, integrity and communication skills needed to consistently exercise informed judgment and effective oversight of their many complex duties and responsibilities. And, even if so, does the board support a culture that fosters rigorous inquiry and deliberation that promote agile and effective decision-making?

As boards make composition determinations, they should simultaneously consider board structure. Boards should ask whether adding a new committee or establishing an ad hoc committee may enhance oversight capabilities or ease workload issues, whether committee membership should be refreshed, and whether reallocation or expansion of duties and responsibilities can improve performance.

Today, boards and their committees are seeing reasons to expand their oversight into new areas. For example, as talent becomes increasingly critical to strategy and value, compensation committees should consider expanding

their oversight to broader employee and talent matters, including how to attract, retain and motivate the workforce needed to further support and activate the company's strategy and purpose.

It is critical for boards to continually focus on how to get the right information from the right sources at the right time. Boards have a responsibility to maintain a deep understanding of the company's internal issues and current and prospective business and competitive environments. To stay ahead of the information curve, boards need to strategically plan sessions with management and independent third-party experts. Directors also must actively seek information and perspectives on their own, through peers, former colleagues, self-inquiry and self-education.

As boards work throughout the year, they need to have a mindset of continuous self-evaluation, from the quality of the information they are receiving to the outcomes of their processes and decision-making. Boards that proactively optimize their effectiveness should also identify ways to more clearly communicate their efforts and key results to stakeholders. Improved stakeholder engagement and related proxy disclosures around board composition, in particular on the process used by the board to evaluate composition in light of the company's long-term value proposition, can measurably enhance stakeholder understanding and trust and, in turn, further increase corporate value.

Today, boards and their committees are seeing reasons to expand their oversight into new areas.



Conclusion

2019 will certainly bring more to the board's agenda as they continue to consider the duality of meeting today's demands and disruption with an intense focus on future opportunities and growth. Things will continue to change rapidly and new risks will arise. Stakeholder voices are likely to get louder too, but by asking thoughtful questions, considering different perspectives, clearly communicating and focusing on governing in the most effective way, boards can help organizations flourish in the next 12 months and beyond.



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Effective corporate governance is an important element in building a better working world. The EY Center for Board Matters supports boards, committees and directors in their oversight role by providing content, insights and education to help them address complex boardroom issues. Using our professional competencies, relationships and proprietary corporate governance database, we are able to identify trends and emerging governance issues. This allows us to deliver timely and balanced insights, data-rich content, and practical tools and analysis for directors, institutional investors and other governance stakeholders.

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