

2022 **OUTLOOK** FOR CORPORATE BOARDS

A director's guide to
challenges and opportunities
across every aspect of board
oversight, including:

STRATEGY
RISK
**EXECUTIVE
COMPENSATION**
ESG
**DIGITAL
TRANSFORMATION**
M&A
HUMAN CAPITAL



FROM CORPORATE BOARD MEMBER NETWORK:

French writer Jean-Baptiste Alphonse Karr once wrote, “The more things change, the more things stay the same.” When we look back at the agenda of our annual Boardroom Summit 10 years ago, featured sessions included “Living with Uncertainty - The Risk Agenda,” “Juggling Management’s and Institutional Investors’ Expectations for Executive Pay,” and “The Next-Generation CEO.”

A decade ago, we were discussing what felt like a dizzying speed of technology change, globalization and systemic risk. Boards were trying to make sure they had the right leader at the helm to drive long-term business strategy—and trying to make sure they were paying their CEO in a way that wouldn’t ruffle ISS’s feathers. Sounds familiar, right?

Fast forward 10 years and directors at America’s public companies face a new set of enormous and continuous challenges—lingering Covid-19 variants, inflation, supply chain issues, new technologies laden with new cybersecurity considerations, societal unrest, bitter politics, stakeholder capitalism, among others.

No matter how much change occurs around us, the board remains central to the success of every company. Without a doubt, the job of stewarding a business as a corporate director is more difficult than ever before. It takes courage and an ability to tackle big challenges to be a public company director today.

Since 1998, public company directors have relied on Corporate Board Member to help them strengthen stakeholder trust in the organizations they represent and improve their contributions as individual directors and as a group.

The Corporate Board Member Network connects the community of 25,000 U.S.-based public company directors to each other and to leading governance experts through peer networking opportunities and a suite of best-in-class tools and resources specifically designed to enhance board performance.

Unlike any other organization, Corporate Board Member promises to exclusively serve directors of publicly traded companies, giving directors assurance to engage in off-the-record peer meetings, annual surveys and training that address key board issues and elevate boardroom impact.

Amid all the tumult—and opportunity—of our times, Corporate Board Member Network is here to help you.

GET IN TOUCH WITH US

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CORPORATE
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Strategy

‘GO AHEAD AND GO FOR BROKE’

Our sister publication, *Chief Executive*, convened a roundtable of big-cap business leaders for a candid talk about Covid-19’s role catalyzing technological changes that made them quicker, tougher and better positioned for the future. Excerpts from the conversation:

Arvind Krishna (IBM): Digital transformation is accelerating because we are in a triple crisis. We have the health crisis of Covid-19 that led to an economic crisis that has led also to the amplification of social justice issues. These are accelerating three vectors of change. First, because we all went remote in mid-March, we are seeing a much greater acceleration of technology of all forms but specifically digital transformation because that has become the primary way we interact with our clients and with our employees.

Second is the usage of cloud technologies. On a global basis, only 20 percent of enterprise workloads have moved to cloud, and, if you look at regulated industries, it’s about 10 percent. That can go a lot higher, and the business value unlock can be a lot more.

The third transformation is around data and artificial intelligence. The amount of data we all produce is exploding. How do you take advantage of all that data to unlock it, to give great insights back to your client, to give insights back to the economy? Are you going to monetize it? All these questions are

there, and the only technology we have on the horizon that can unlock that value is A.I. I think it was PwC that put out an estimate that A.I. can be \$16 trillion worth of productivity, not the technology costs, productivity improvements, but rather real business improvement over the next decade, but we are only 4 percent of the way into that journey.

So, if you look at those three vectors, just to keep it simple, how fast are we going to go on digital transformation?

Brian Moynihan (Bank of America): The key aspect at the start of this is the customer and the change the customer has gone through. If you’re dealing with consumers, you can’t get ahead of them. We always tried to follow a path that led to deploying more and more things to help them along. We did it by studying what consumers are doing and platforms that may not be financial services platforms but other platforms and how to apply that. The second thing was the scale we had to have to ensure that the experience was what it was supposed to be. You can’t discount that, because when big companies make massive transformations, in our case, 60 million customers, if you aren’t ready to support that scale, then you blow it. I remember sometimes

our mobile would go down, and people would really get upset and say, “You asked me to do it this way, and the thing doesn’t work.” So, you had to be ready to support the scale, and then you had to be able to dismantle the systems to make them less complex so they could operate.

That’s what we did. We followed the customers, we kept making it more simple, we kept thinking about how to make it more natural. And, after coaxing people along for years, in the last six to nine months, we’ve seen people use mobile deposit with checks who never had before because they really had no choice. You weren’t going to get in your car, drive down and walk in that branch when you thought everybody else around you was infected. We went from 5 million mobile users, probably, in 2010 to 30-odd million today. So, it’s been a heck of a ride.

Stefano Pessina (Walgreens Boots Alliance): In the past, companies were inclined to think about what, according to them, was best for customers, and the customers would follow. Now, the customers have a lot of information. They have the ability to decide by themselves. This means that you have to understand what they want and follow their needs.

The concept of the traditional store

will not work in the future. We had to work to transform the company and to invest a lot in technology in our company here in the U.S., working with a very traditional company, a great company with great people and great locations but with severely obsolete technology. The basis, the IT was 30 years old. We had to make an enormous effort to rejuvenate everything, to start from scratch practically and build the new technology [to deliver] what the customer is looking for. After a year, we can start to see that we are much closer to the customers than we were before and will continue to be closer and closer to them.

STAYING IN SPRINT MODE

Tricia Griffith (Progressive): We've always considered ourselves a technology company that happens to sell insurance. We have different generations of how customers want to buy their insurance—people who want to go to agents, some who want to call direct, some who want to go online. Seeing what we were all able to achieve in the middle of March, I'm pushing toward much more urgency to give even the older cohorts the ease with which to do insurance transactions on their mobile devices because it just makes sense. My biggest thing right now is really not to lose the sense of urgency when we get out on the other side of this but rather reimagine how our companies can be different from a technology perspective and really be able to use that to gain market share and to reduce costs.

Marc Lautenbach (Pitney Bowes): Often, the question gets posed, how do you digitally transform your company? But CEOs tend to think about it in terms of customers and markets and value. The technology, the digital technologies, the mobile technologies tend to be a means to an end as opposed to the end in and of itself.

It's a subtle but really important difference because companies that transform tend to have, almost 100 percent of the time, a view of a market that they want to evolve to, it's, "I want to move from mainframe to cloud" or "I want to move from this to that." The technology ends up being an enabler. That's certainly what we've found.





Digitalization, cloud, IoT, all of this is now a necessity of how we interact with our end customers.”

*—Arvind Krishna,
Chairman & CEO, IBM*

Michael Neidorff (Centene Corporation):

We have a product, a system that looks at all 25 million lives that we cover every night in about five minutes. It has a five-year record of their health and their treatment. And let's say somebody's potassium is off in a test they just had done, the algorithms are there to notify the doctor that there could be a cardiac event pending before he's had a chance to get the record.

Another example is precertification of certain procedures; it's taken as long as 18 minutes to pre-authorize. We have developed the algorithms to do a pre-authorization in just seconds. So you end up with a patient getting care faster and a doctor delighted that he got that authorization that fast.

Alan McLenaghan (SageGlass): Never before has a purpose of an organization been more important, to unite people and to constantly remind people of why we are here beyond their day-to-day responsibilities and jobs, that the purpose of the organization is very clear and allows them to unite. At the moment, throughout the world, the politicians and the leaders have not been [inspiring] trust from people. I think they look to business leaders more now than ever to allow them to unite again together, to have a sense of purpose in what they're doing every day.

So, being in connection with them—whether it's physical, virtual, constantly talking about the purpose of what we're doing, why we're doing it and giving them guidance on how to react in these situations—has been a wonderful opportunity for companies.

Nelson Griggs (Nasdaq): I think we have more information now about our teams than ever in terms of getting very specific in our questionnaires to employees about what they want. And some really like this environment, quite frankly, and don't want to change it. The technologists to a large degree don't want to come back; others are dying to come back. So, the idea that we can tailor different opportunities for our employees, to find a more

productive way to work and more enjoyable way to work... it does feel like there will be different scenarios we all have to plan for to make this effective.

Nick Pinchuk (Snap-on): More than half our people work [in factories] every day. Then you have the white-collar people, about 75 percent of them are working at home sheltering in place. I don't think the idea of digitalization is particularly challenging in this environment. What's challenging is to keep the people together, to have them feel like they're part of the enterprise.

For the workers who can't work from home, you have to be sure you tell them that they are doing it for a purpose. They're actually keeping our society from disintegrating. You buy a roll of toilet paper, it's vended to you by a grocery clerk who can't work from home, delivered by a truck driver who can't work from home, loaded by a warehouse worker who can't work from home and made by a factory worker who can't work from home.

As CEOs, we have to keep those people aware that they're doing something really special. And for everybody else, you have to worry about making sure that they feel part of the corporation. We try to tell the people at home, "Okay, you're working from home now. We don't see you every day. But when all this goes away, you're still gonna be part of Snap-on." Because what you need going forward, particularly for digital transformation, is to get those people working in their individual natural workgroups to figure out how to use digitization to make their jobs better. We'll need their enlistment when they come back, so you have to give them purpose and self-interest today.

McLenaghan: Nick, I recall a story many years ago, a friend who ran a power plant in Europe. And he described the control room operators as the guardians of society. And his logic was simple: How many days after we run out of power before society falls apart? It certainly makes you think of the value and the purpose that we all bring to our jobs. We don't

just monitor the voltage on a particular transformer. We are providing something for society to function, and every single one of our companies provides a piece of that—the uniting of people behind that common purpose. It has never been more important or opportunistic for us to get a great sense of a collective being within an organization.

Judy Marks (Otis Worldwide): Our concern is that we not create a dual-class society. Some of you talked about white collar versus blue collar, and we couldn't have our business without our field professionals. We've decided to use technology investments to make sure we're not just talking about hybrid and remote work from home or any of those. It's all about how we make sure everyone benefits from this.

OFF-SITE ARDING

Moynihan: One of the things that's been on my mind is creating culture among young people. Think about the people you hired a year ago—they had six months in the office and six to eight months out. And think about the cohort we just hired. They've never met their boss [or been in] the office. For the cohort that's two years in, it was a year and a half-ish to a half year. So, we flipped around to look at, if they feel comfortable, getting those teammates back because if they go two or three years without ever having been in a culture of our offices, that's going to be trickier than somebody who has worked for 30 years. How do you get them to understand the culture if they've never met their boss?

Greg Hayes (Raytheon Technologies): That posed a unique challenge as we brought Raytheon Technologies together. That was the aerospace businesses out of UTC and then the Raytheon business. It all happened on April 3, and we had been working from home to do the merger and to do the spins. To this day, I have yet to have a staff meeting in person, I've yet to have a board of directors meeting in person. I have been out to some of the facilities just to try to introduce myself all with proper social

distancing and masks and all that.

With 100,000 people working from home, our productivity over the last seven months has actually been better on the work-from-home crowd than it has been historically when people were coming into the office. People are putting in more hours because they're not commuting. We measure productivity by the number of hours you charge on a job to get a program done. And all those productivity metrics are up because people are more focused. But the number of patent applications within our portfolio is down by over 50 percent this year. So, we're getting work done, but we're not getting innovation done because we're not collaborating as well. And I think we will keep doing this for another year probably. My question is, how do we work better to get people to collaborate and innovate in a digital world? That's something we haven't quite figured out yet.

Krishna: Of the two populations that we declared essential back in March, one was our front-line or plant workers, and the other was our most extreme research employees, because I was dead afraid that if they couldn't get together in person, that deep innovation pipeline that does materials, science, quantum computing and mainframe processes, etc. would not be able to function. My fear is that we are living on social capital.

So, in about six months or one year, we can have a discussion. You can live off your prior social capital but at some point, you run through it. I worry once you run out of all the things you accumulated, how do you create that? That's why I go back to maybe we won't bring people in for 50 hours a week into the office; maybe they'll come in for 10 hours a week, juice up some ideas and go back and work on it remotely. For certain marketing functions, for deep R&D functions, certain client-facing functions, you need that creative spark of being together, I'll call it serendipity. We build off of each other. It really does get people's mental juices flowing.

Hayes: I am fearful if we don't figure out

a way to bring the, I call them the kids, along and socialize them into the culture, in a year or two, it's going to be too late. I have personally been doing a video every two weeks, no more than 5 or 10 minutes, that I send out to every single employee. I always include my email address, and it's amazing the response you get with just those few minutes. It's also important for those people working from home that their supervisors reach out and talk to them, not just on Zoom about the day's meetings but that personal interaction, "How are you doing?" People are isolated, and we have seen a huge spike in the number of folks taking advantage of our employee assistance program. I expect we're not alone in that.

Moynihan: Colleagues from Teladoc and other healthcare providers here admit that the usage has gone up, probably across the board. The numbers are getting staggering. I close every discussion with my team saying, "You know, you've got physical health but you also have mental health responsibilities." We've got to help people.

Krishna: Collectively, what we all have said is digitalization, cloud, A.I., IoT, all of this is now a necessity of how we interact with our end customers. Even those of us who are in B2B or enterprise companies who sell to other enterprises, they, in turn, sell to their end users.

Nick Pinchuk said that a CEO's job is belief. We've got to have a North Star we all believe in, we've all used the word *purpose* in here. If you have your North Star or the vector you're going in on the business, you decide how you're going to do it, you got to bring everyone along on that journey, you've got to use technology as the vehicle through which you do it because I don't think we have another tool for that. And you've got to do it with a real understanding of the environment they're in. They're remote, some of them are disaffected; there are all these elements coming into play. It's all real. We've got to take all this into account and use technology as a way to mitigate these ills. **CBM**

BARRA'S BOARD

ONE OF THE NATION'S MOST INFLUENTIAL BOARDS IS ALSO AMONG ITS MOST GENDER-DIVERSE. HERE'S HOW GM'S CHAIR AND CEO PULLED IT TOGETHER—AND WHY.

BY DALE BUSS

Last spring, Mary Barra created another stir in the auto business, this time by changing the top board title at General Motors—which she holds—from “chairman” to “chair.” Ford soon followed similarly, and Barra got huzzahs from diversity mavens around the world.

But the title change was far from merely symbolic. It also was highly reflective of how GM's leader has hitched gender recognition to a remarkable new heyday for America's largest automaker. Barra shattered a thick glass ceiling when she rose to CEO of GM seven years ago, becoming the industry's first female head. Since then, as chair, she has put together one of the few majority-women boards in the Fortune 500—and, certainly, one of the most important. GM is among only 5 percent of companies in

the Russell 3000 index at which women account for at least half the directors.

“It's something I personally feel strongly about, and [diversity is] something General Motors counts among its company values,” Barra tells *Corporate Board Member*. “It has long been a top priority of the board and the governance committee to ensure that GM has a board composed of directors who bring diverse viewpoints, possess a variety of skills, professional experience and backgrounds, and effectively represent the long-term interests of shareholders.”

She notes that GM was the first Fortune 500 company to seat an African-American director, Rev. Leon Sullivan, in 1971. GM elected its first woman director, Catherine Cleary, in 1972, whereas Ford's first female director wasn't elected until 1976. When Alexandra Ford



MARVIN SHAOUNI



**It's one of the best
boards I've ever seen
in terms of how it
functions."**

*—Tim Solso, former
Non-Executive Chair, GM*

English joined Ford's board in May, she became the first female member of the founding family to sit as a director in the company's 118-year history.

Barra says "the fact that some of [GM's directors] happen to be women was a bonus, not a dictate." But Tim Solso calls the fact more intentional. "I think it's a great accomplishment to have a female-majority board," says the former CEO of engine maker Cummins, who left the GM board as lead director early this year after a nine-year stint on the board. "It makes a statement about the company and how progressive it is. And it's one of the best boards I've ever seen in terms of how it functions and how it is involved in helping the company become what it can become."

Traditionally, industrial CEOs and CFOs steered GM's board along with insiders—nearly all white males. But a board with seven females out of 13 is how Barra is addressing a future for GM aimed at dominating in electric and automated vehicles and being the industry standard bearer for leadership diversity.

Patricia Russo, GM's lead director, says the company's evolved board is ready for the challenge. For example, Jami Miscik, CEO and vice chair of a consulting firm founded by former Secretary of State Henry Kissinger, joined the GM board in 2018 and "really understands geopolitical issues and risks around the world," says Russo, who is chairman of Hewlett Packard Enterprise. A director since 2015, Linda Gooden "understands the criticality of safety and quality" after serving as executive vice president of information systems for Lockheed Martin. And the newest female director, Meg Whitman, former CEO of Hewlett-Packard and eBay and candidate for governor of California, "brings an incredible breadth of experience in the startups and venture world."

Barra is continuing to lead a corporate transformation at the board level that she launched after emerging from the ranks of upper management in 2014 to take over a company just beginning to find its way out of bankruptcy and the Great Recession. She rumbled through GM's

ignition-switch debacle, sold its long-held European operations, closed some U.S. plants, deep-sixed many sedans, invested heavily in digital-tech startups, committed the company to make its own electric-car batteries, and then promised to spend \$35 billion to convert GM's fleet nearly completely to EVs and automated vehicles by 2035.

Along the way, Barra has dazzled industry veterans with her performance as CEO—and with her approach to the job. "She's inherently a team person and a very effective communicator across the various verticals of the business," says David Cole, chairman emeritus of the Center for Automotive Research in Ann Arbor, Michigan, who has observed and consorted with many automotive CEOs over the decades. Barra contrasts with past chiefs who "were sort of king leaders," such as Roger Smith, GM's chairman and CEO through the 1980s. "It was all about him," Cole says, "and not much about the team."

Still, it is possible to look at all Barra has accomplished as CEO and conclude there is much unfinished business, including in the area of gender engagement. U.S. automakers and their dealers have progressed light years from the days when women were considered mere auxiliaries to the auto-purchase process. Companies aim brands and vehicle personae at female sensibilities now, recognizing not only that women buy many vehicles on their own but also that their opinions score heavily in the majority of purchases. So, women today are the marketing chiefs at GM, Ford and

the U.S. operations of Stellantis, Hyundai, Toyota and more.

That's why, of all the changes Barra has made, GM's board makeup may be among the most important. "Boards talk all the time about having people sitting around the table who reflect the customer base, especially if it's a consumer-oriented company," Russo says. "And women in a company like to look up to a board that is heavily populated with women who look like them. Talking the talk is very important for recruiting."

GM's governance makeover began 12 years ago, after its bankruptcy and bailout, when the governments of the United States and Canada dictated a new board.

Carol Stephenson was the Canadian appointee. "It was a pretty unnatural situation to take 13 of us, and—boom—you're a board," says Stephenson, former dean of the business school at the University of Western Ontario, with stints on a dozen corporate boards. "We didn't have a lot of experience in the industry. No one knew each other. We were on a huge learning curve, and survival was top of mind. And when we were recruiting board members, we didn't know the culture or what we were trying to accomplish."

Solso says the GM board "was dysfunctional. We didn't force people out, but people retired, and when they retired, there was the opportunity to implement" a new approach. As GM climbed out of the chasm and an industry recovery took hold in the early 2010s, its board pivoted to the future.

The board elected Solso non-executive chair in 2014 and selected him and Barra to join Russo, Stephenson and James Mulva, former chairman and CEO of ConocoPhillips, on the governance and social responsibility committee. They formed a vision of a fresh board that could best leverage GM's renewed prosperity into an even brighter future.

"We needed people who'd been through challenging times and understood what it takes for a large company like GM to make changes that need to be made and become more agile and efficient and externally focused," Russo

WHO'S WHO

General Motors Chair and CEO Mary Barra led the creation of a female-majority board over the last five years, adding new members and phasing out others, but, she says, “the fact that some happen to be women was a bonus, not a dictate.”



MARY T. BARRA
Chair and Chief Executive Officer
Director Since: 2014
Additional Boards: Walt Disney Company, the Duke University Board of Trustees and the Detroit Economic Club



WESLEY G. BUSH
Retired Chairman, Northrop Grumman Corporation
Director Since: 2019
Additional Boards: Dow and Cisco Systems



LINDA R. GOODEN
Retired Executive Vice President, Information Systems & Global Solutions, Lockheed Martin Corporation
Director Since: 2015
Additional Board: The Home Depot



JOSEPH JIMENEZ
Retired CEO, Novartis AG
Director Since: 2015
Additional Board: Procter & Gamble



JANE L. MENDILLO
Retired President and CEO, Harvard Management Company
Director Since: 2016
Additional Board: Lazard Ltd



JUDITH A. MISCIK
CEO and Vice Chairman, Kissinger Associates
Director Since: 2018
Additional Boards: Morgan Stanley and HP



PATRICIA F. RUSSO
Chairman, Hewlett-Packard
Director Since: 2009
Additional Boards: KKR Management and Merck & Co



THOMAS M. SCHOEWE
Retired Executive Vice President & CFO, Wal-Mart Stores
Director Since: 2011
Additional Boards: KKR Management, Northrop Grumman and the Ladies Professional Golf Association



CAROL M. STEPHENSON
Retired Dean, Ivey Business School, the University of Western Ontario
Director Since: 2009
Additional Board: Maple Leaf Foods



MARK TATUM
Deputy Commissioner and COO, NBA
Director Since: 2021



DEVIN N. WENIG
Retired President and CEO, eBay
Director Since: 2018



MARGARET WHITMAN
Technology Leader and Former CEO, Hewlett-Packard
Director Since: 2021
Additional Board: Procter & Gamble

says. “At the time we were looking for a combination of skills: people who’d led large, complex, global companies; people with financial expertise. We were looking for technology expertise, as we had a lot of work to do with respect to information systems. We wanted people who’d had some consumer-marketing experience, too.”

At the same time, the committee began guiding board succession in an additional direction. “Our goal was first and foremost to have the best board we could possibly have, and that meant we needed to have as diverse a board as we possibly could,” Solso says.

Soon after they elected Barra chair in 2016, the board wrote a strategic plan for how its makeup should further evolve to reflect the challenges and opportunities ahead for GM. “It was clear the company was going through a fundamental transformation,” Russo says, “so we laid out a five-year view of what directors would be leaving and what skill sets we believed we needed, and that has really informed a lot of the additions we’ve made to the board over time.”

The board hired Heidrick & Struggles, the New York-based executive-search giant, landing on Bonnie Gwin, co-managing partner of its global board prac-

tice, to be GM’s sole recruiter of new directors. They’ve stuck with her, which is an unusual practice, board members and governance experts say.

“We found [Gwin] a good adviser who understood our needs and our set of values, not just the skills we were looking for but also character and other things that needed to go along with them,” Stephenson says. “She came up with great candidates for us who turned out to be great board members, so we’ve continued to use her.”

Gwin declines to comment specifically on her work for GM. But she describes the Heidrick & Struggles



approach as “putting together a skills matrix and a strategy for 10 years. What are the experiences that will be helpful and important? What boxes do current directors check, and what are the gaps?” Gwin says a board should “hold a search firm accountable for a diverse plate and consider itself accountable for considering women as part of the slate. Everyone needs to own it.”

The committee considers “a skills and

In every case, director candidates must be able to contribute significantly to the discussion and decision-making.”

qualifications matrix for current directors and any additional characteristics that it believes one or more directors should possess based on an assessment of the needs of the board at that time,” Barra explains. “In every case, director candidates must be able to contribute significantly to the discussion and decision-making on the broad array of complex issues facing GM.”

To fill an opening, the governance

DRIVING THERE

Progress in women achieving corporate board seats in the U.S. slowed overall in 2020, yet pressure to achieve boardroom diversity continues to build, as evidenced by Nasdaq’s recent requirement that listed companies have two diverse directors or explain why they do not. Some ideas on how to drive board diversity:

ACCEPT NO EXCUSES. The argument of a “pipeline problem” for women qualified to be directors is specious. Strong candidates exist, boards just need to double down on finding them. As Diane Hesson, a board member at Brightcove, says, “Pardon me, but when Mitt Romney said [in a 2012 presidential debate] that there are ‘binders full of women’ who would be qualified candidates for his cabinet, he was absolutely right: The city of Boston alone is a testament to that.”

USE A WIDER LENS. Look at qualifications more broadly. Most directors are still CEOs or CFOs, the two areas of the C-Suite where women have least penetrated to date. So, consider CMOs, CHROs, CIOs and chief digital officers, where women are much more numerous. There are “general managers on their way up, division presidents, heads of nonprofits and academics,” says Bonnie Gwin, chief of Heidrick & Struggles’ board practice.

Helene Lollis, head of Pathbuilders, which advocates for women in business,

says “many top women executives today are in marketing and HR roles, not the ones where they’re typically coveted for the board. So, you have to open your lens on what makes a corporate board member.”

Sometimes it’s a matter of thinking more broadly. “Someone may have a compliance or HR or consulting background, and they’re active in their industry and their community,” says Nicole Crum, head of board practice for the Sullivan & Worcester law firm. “They may have leadership and engagement experience and an overall impressive background—but they don’t show the climbing of a particular corporate ladder.”

FOLLOW THE RULE OF THREE. No matter how large the board, having three female directors tends to create a transformative critical mass. “When there’s one, she’s like a token,” Lollis says. “When there’s two, it still defaults to, ‘What do the women say?’ But when there are three, there’s an opportunity for them to be actual individuals.”

Idie Kesner, member of a number of corporate boards and dean of the business school at Indiana University, says, “Sometimes three women, regardless of the size of the board, can get the flywheel going, even if it’s not 50 percent represented by women.”

AVOID RESIZING THE BOARD. Companies may dilute the impact of new female directors by simply adding them to the board instead of subtracting existing directors. “This

strategy can be beneficial because you don’t have to wait for a male director to turn over, but then, male directors continue to outnumber female directors by a large margin,” says Seema Pissaris, a business professor at Florida International University.

Also, boards may add women only to replace other diverse directors in a sort of counterproductive quota system. “There can be a sense that white men stay at 80 percent, and the rest of the board—you figure out what kind of diversity you want, but you only get 20 percent,” says Patricia Lenkov, head of Agility Executive Search.

ROLL DOWNHILL. Companies are also seeing more female candidates for inside-director jobs. “Technology and STEM jobs are pulling more young women along, making for a lot of extremely intelligent, experienced women who are making a move on corporate governance,” says Amy Rojik, a partner with BDO’s national assurance practice.

Crum notes, “Once women are in these positions, they have networks and relationships with people who also are open to being on a board. It’s a dimension of diversity. You’re hoping for a snowball.”

Gwin advises companies to “think of this as a long-term succession-planning project. Then you can proactively meet great [female] talent even if you don’t have a board opening today.”

“

I never remember a discussion where we said, ‘We must have five female board members.’ But we said, ‘We can find really talented, skilled, qualified women.’”

—Carol Stephenson, Dean, University of Western Ontario

committee has worked with Gwin to generate a list of as many as 15 candidates, insisting on diversity in the pool as a main criterion. The committee and Gwin select two or three finalists and interview them.

At the same time, Barra says, while GM “does not have a formal policy governing diversity among directors, our board strives to identify candidates with diverse backgrounds and experiences.” She believes “they can make us a better company in ways that transcend even the specific expertise and experiences they bring with them.”

Solso sees it similarly. “It wasn’t necessarily a goal that we wanted to have a female-majority board,” he says. “But we wanted people with different backgrounds and perspectives who would ask the right kinds of questions. The consequence of the process was that we have a female-majority board.”

Stephenson also concurs. “I never remember a discussion where we said, ‘We must have five female board members,’” she says. “But we said, ‘We can find really talented, skilled, qualified women, so let’s do that.’ And one day we woke up and said, ‘Our board is half women.’”

Now that she’s shaped a board that happens to have more members of her gender than males, how does Barra work with them? It’s a special point for Stephenson because in Canadian corporate governance, the CEO and board chair roles typically are kept separate. “So, I was a little skeptical,” Stephenson says. But Barra “works beautifully.” The chair “is a great listener. She doesn’t feel like she has to come in and have all the answers.” Russo calls Barra “transparent and authentic.”

Barra’s reputation for strong and effective collaboration was one of the things that got her the CEO job, and fellow directors say she has taken that



practice to a new level with them. For example, Barra phones and conducts Zoom meetings with individual directors who have particular expertise.

“She genuinely wants to know what people think,” Solso says. “More than any other executive I’ve worked with, she wants input from the board and asks the board to comment on strategic issues, and she takes that input and responds to it. She may not agree with it, but she responds to it. Some execs go through a routine process, but Mary does a deeper dive, and as a result, board members feel they can add value and contribute.”

Even with all of this, some critics say

Barra’s scorecard on diversity isn’t perfect. Early this year, executives of Black-owned media targeted the automaker in full-page newspaper ads for not spending enough advertising dollars in their channels, going so far as to call Barra a racist. They included Byron Allen, a former comic who’s now a media mogul as chairman and CEO of Allen Media Group, which owns the Weather Channel and provides video to broadcast and mobile devices.

GM hosted what Barra calls “a productive summit” with representatives of 200 such companies, resulting in the automaker’s commitment to boost advertising via the complainant group. “Among many actions, we will increase our spending with diverse media, which will drive economic empowerment and a sustainable ecosystem,” she says.

Regardless of how Barra handled the episode, Russo says, the charge was spurious. “The last thing anybody could call Mary is not inclusive or insensitive,” she says, adding that the board “has never questioned Mary’s commitment to inclusion and diversity in all aspects of how she runs the business.”

In the wake of George Floyd’s murder in 2020, for instance, Barra created an inclusion advisory board and has reiterated her goal of making GM the most inclusive company in the world. For good measure, GM’s latest board appointments included Mark Tatum, deputy commissioner and chief operating officer of the National Basketball Association, who is Black.

Ultimately, however, Barra acknowledges that even with a new cast founded on diversity, GM’s directors have a huge task ahead. “What we have done with the board has been widely recognized and well received,” Barra says. But, she adds, “The board would like to receive credit not for what it is but for what it does. And that, I’m confident, will come in due time.” **CBM**



Greg Brenneman, Lead
Director, Home Depot; Board
Member, Baker Hughes, The
Baylor College of Medicine

A SIMPLE STRATEGY

Greg Brenneman is one of the most successful turnaround CEOs of our time and one of the most well-respected public-company directors, with a winning track record at Home Depot, ADP and Baker Hughes. His secret? Finding and focusing on what really matters.

BY DAN BIGMAN

For most executives, leading the successful turnaround of a huge, multi-billion-dollar household name is a singular, career-capping moment. Greg Brenneman has done it at least four times: at Continental Airlines, where he took the air carrier from worst to first in less than a decade; at Burger King, where he led a return to the front row of fast food after years of losing customers; at PwC Consulting, which he picked from the ashes of Dodd-Frank, fixed and flipped to IBM—all in a matter of months, not years.

Given that record, it's little surprise he found a successful home in the world of private equity, first as CEO of \$3 billion AUM CCMP Capital Advisors, assessing, buying, shaping and refloating dozens of companies. He's now executive chair there, continuing the work by serving on portfolio company boards, assessing opportunities and helping management teams deliver.

This blend of investor-operator insight makes him an in-demand direc-

tor, as you'd imagine. He's been on the board of Home Depot since 2000 and serves as lead director there. He's also a director at oilfield supplier Baker Hughes and at The Baylor College of Medicine.

Through all of it, Brenneman has relied on a five-step process (see sidebar, p. 16) that he honed as a young Bain guy brought in to help fix Continental, a consulting gig that soon turned into the CEO job at the beleaguered airline. The essence of his approach, detailed in his 2016 book *Right Away and All At Once: Five Steps to Transform Your Business and Enrich Your Life*, is to be on constant guard for becoming a "satisfactorily underperforming" company—firms that are doing "just fine" but could be doing a lot better.

He attacks the problem with vigor and simplicity, relying on a one-page strategy document that examines four things: market, financial, product and people. He outlines the value drivers he can use to improve performance in each of these areas. If he can't find easily them, then he won't take on the project.

As directors head into 2022, we talked with Brenneman about how he engages in strategy, what he's learned from PE that he brings to a public-company



If you've seen a whole bunch of different cycles, you know that the event always looks different, but you have to manage it largely the same."

board and how he's planning to help the companies he works with grow in these uncertain times. The conversation was edited for length and clarity.

You've been through a lot of tough times, some crazy and historic turn-arounds. How did the last couple of years rate for you in terms of things you've seen in your career?

It's been an interesting couple of years in a whole bunch of different ways. When the pandemic first started, there was a tremendous amount that wasn't known and fear that was kind of out there.

I was talking to a number of CEOs on a Zoom call and somebody asked the question: "If, in one sentence, you could describe what it is like to be a CEO in times when things are difficult—and Covid or the financial crisis would be an example of that—what do you do as a CEO?" I thought for a second, and I said, "You need to absorb fear and exude hope."

Everybody is just running around not knowing what's going to happen. You need to absorb it from people and say, "Hey, you know, we'll get to the other side of this." If you've seen a whole bunch of different cycles, you know that the event always looks different, but you have to manage it largely the same.

Then, part of exuding hope is laying out a plan that says: How can we, as a team, as dire as this might look, how can we take advantage of this? Are there new opportunities for us here? Are there new ways to grow?

One of the things all of us walked out of the pandemic with was figuring out how we can digitally enable our businesses in a very different way. If you're in medicine, it became telehealth. At a company like Home Depot, you say: "How do we really use this multi-channel retail to our benefit? To buy online, shipped to home, to buy in-store, deliver at the curbside. How do we do that?"

A lot of technology was enabled and turbocharged during Covid because people didn't have a choice. What do they say? Crisis is the mother of invention or something like that? I can give you example after example of this.

Private equity is such a huge part of business now. What should directors be learning from that world?

First of all, it's great having diverse boards. Part of diversity is diversity of viewpoint. Having somebody who actually is in [private equity], that has maybe a slightly different view of just kind of how fast can you go, can have a slightly different view as activist shareholders have come in, taken on companies that are satisfactorily underperforming.

How do you almost think a little bit like an activist, not short term, but how do you think about your balance sheet? How do you think about speed? How do you think about strategy in a way that if somebody was to come in and buy some of your stock, you could sit down with them and have a very logical conversation about where you're going, what you're doing and why you're doing it? And at the end of the day, they'd say, "Yeah, that makes pretty good sense, I see exactly where you're going there."

I think some of those viewpoints [are helpful in] reverse engineering businesses and putting them through the process. I have a one-page plan process of laying out the key value drivers that's a good exercise for any business, public or private. It's just good to have diversity of viewpoints. You wouldn't want every business to have all private equity investors on the board, but having one or two is not a bad idea.

As a board member, how do you get a sense of whether your company is ripe for transformation? What do you do about it if you get the sense that it is?

As board members, you really have two responsibilities. One is to make sure you help the CEO and the management team get strategy right—that you're doing the right things for the right reason. And the other is selecting the CEO and succession planning. Those are two really fundamental things.

There's a third bucket around protecting the corporate asset; that includes reputationally, financially, from an ESG perspective, those kinds of things. But just taking those first two, as you walk

into a boardroom, you oughta back up and say, “Okay, what is the real strategy for this business?” What are the key value drivers that are actually going to allow you to understand whether this business is fully performing?

There are a few tools to do that. I always try and take out a piece of paper and write four columns on it: market, financial, product and people. Then think through the business and think through each of those categories—what are those key levers? Is the company executing on those levers well?

Then, strategically, sit back and say: What are we missing here? I try to mentally go through those exercises as a board member pretty continually.

How do you make sure the board is carving out enough time for strategy?

You need to go through your board calendar for the year. This is what I do with Craig Menear at Home Depot. Craig is the chairman and CEO; I’m the lead director. So we go through the calendar.

I personally interview all the directors every year-end. They are great at laying things out: Here’s what I think we maybe should cover that we haven’t covered, the things we need to dive deeper on. We accumulate that off of the whole board. Then, we work on an agenda together that strategically covers each of those areas.

Then, we have one session every October—I’m just using the Depot example—that’s solely dedicated to strategy. There are no committee meetings in that session, we have five board meetings a year, it’s entirely a strategy session. It’s one of the most enjoyable board meetings we have every year.

The night before that, we have a dinner with just the board. Usually, we have the board and senior management team, just the board, and the CEO and the head of human resources, and we do succession planning. It’s not the only time we do it, but those are dedicated times for: What’s your strategy, and what team is executing the strategy?



How do you run that strategy session? How does that actually take place?

We spend a little time in advance based on the interviews we do at the first of the year, but then also based on the feedback we’re getting from the board throughout the year. We’ll actually take that and frame it out in terms of identifying the key elements that we really want to make sure we cover to dive deep on the strategy. This is really in every business I’m on the board of.

We leave the management team some creativity in terms of how they want to cover that and how they think about it. Because they need to internalize the issues that we’re feeling and thinking about. They need to make that executable. That’s not really our job. I mean, it’s our job to make sure it gets done as a board, but that’s management, right? That’s not a process we should be dictating. We should be commenting but not creating.

So, the management team will go away and, in most cases, do a phenomenal job of thinking through those things. Maybe some things we missed as a board that they’ve been worried

about and putting that in a framework. Generally, that one-page plan is a pretty good framework to come back and think through those issues.

Certainly in all the businesses we own at CCMP, we have a one-page plan, and we use that as the guidepost for how to think about the big issues and make sure we’re not spending all our time on minutiae as opposed to the big strokes. What might you be missing that’s coming at you from around the corner?

Speaking of which—there is so much liquidity in the world right now. Money is essentially free, and there’s trillions more on the way. And we’re looking at the worst inflation in a generation. How are you as a director thinking about this? How does it affect your strategy?

It’s a tremendously uncertain time. So, you have to stay really, really flexible. If you think about things economically, we have had very loose monetary policy. And we’ve had an enormous amount of fiscal stimulus. Regardless of what comes out of Washington going forward, one thing we can be pretty certain of is we’re not going to mail checks to

Brenneman's Five Steps

In his book, *Right Away & All At Once*, Brenneman outlines his playbook for turnarounds—at any company, of any size.

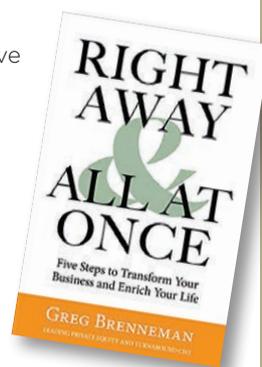
Have a plan and track your progress. “Identify three to five actions, that, if executed, will fundamentally improve your business. Write them in a one-page plan, communicate them... in an understandable way, and relentlessly measure your progress.”

Build a fortress balance sheet. “Make sure you have adequate time to execute your plan by having plenty of liquidity (cash), along with debt covenants and maturity that match your company's needs.”

Think money in, not money out. “Profitably grow your business to optimize returns for your shareholders and job opportunities for your co-workers.”

Build a team (clean house if necessary). “Build a board and organization capable of executing your plan, then properly motivate everyone involved.”

Let the inmates run the asylum. “Empower, motivate and encourage your coworkers to make decisions consistent with your plan.”



ing to do next year? And sometimes the three most unused words in the English language are: *I don't know. I don't know what the guidance should be.*

Certainly, during the pandemic, at some of the companies I was on the board of, we just suspended guidance. We just said “I don't know.” And in most cases, we did unbelievably well—way better than we thought. And it's lasted way longer than we thought it was going to last. But the reality is, we just didn't know.

Be honest about that with investors and say: “I'll tell you when I know, but I don't know. I'm not going to mislead you, we're preparing to be flexible. If demand is up, 5 percent, 10 percent, 15 percent, we want to be flexible to fulfill it. But if it's down 5 percent, 10 percent, 15 percent, we want to be flexible enough to manage our business so that financially we're not harmed by that too badly.” Flexibility is the key.

How does the board help with that? When you're a director, how can you help management be more flexible?

I just say not to get so financially oriented that you lose track of your culture and what's important. At the Baylor College of Medicine, when the pandemic hit, we had to set our clinical operations basically on hold. Obviously, the temptation is to pull out massive amounts of cost.

You go through, and you look at: what am I spending money on? And what can I defer, delay? You go through that process. But, by and large, we just supported our docs and nurses and employees and made sure they weren't harmed during that process. We said: “We need to be able to start this back up to help people with really tough moments of their life, and we need to help them in emergency cases.” So you carry a little bit of excess headcount, probably, than you would carry if you were kind of downsizing for the optimum.

At Home Depot, they run off an inverted pyramid that Bernie Marcus, Arthur Blank, Kenny Langone—the founders—created. It starts with customers, but then it's store associates. And then it's store-level management, and then it's

individuals forever, right? That was pandemic-related. So you're going to have a pretty decent pullback in 2022.

At the same time, the Fed's looking at inflation and supply chain. Everybody wants to say it's transitional. I can pretty much promise you this isn't that transitional. If you look at what's happening with wage rates, what's happening with commodity costs, it's going to be here a lot longer than we think.

Put all that together, there are early signs of recession next year, certainly the back half of next year it could be a possibility. I'm not saying it'll happen, but at least the odds of it are much higher than they've been for a while. Maybe we'll find a way around it. I don't know.

It just means that you have to stay super flexible. Public investors love guidance, right? What are you going to do next quarter? What are you going to do the quarter after that? What are you go-

corporate management, and then it's the CEO. And we really believe that.

So, when the pandemic hit, Craig Menear, the chairman and CEO, asked a simple question: "What do we need to do if we have to shut down for 60 days so that we can pay our associates?" We never got shut down—we were essential—it didn't happen.

But we came to the number with Craig and the rest of the board that we needed \$11 billion to be able to pay people for 60 days. And we had \$3 billion in cash, and we're in a \$5 billion commercial credit program with JPMorgan. And then the bond market was closed.

But we had a conversation and thought, "Well, if Home Depot can't open the bond market who can?" So we went out and opened the bond market, asking for the last \$3 billion because, three plus five plus three equals 11. We had \$27 billion demand for \$3 billion worth of bonds within two and a half hours. We took \$5 billion to have a little bit extra. We never needed it, but we knew we actually had enough cash to pay our associates if we shut down for 60 days.

So, we took and prioritized culture ahead of financials, essentially. And we did that back in the financial crisis too, where we were one of the few companies not to cut pay in that time, not to cut 401(k) matches during that time. You just want to create a history of treating people with dignity and respect.

You can imagine the enormous amounts of loyalty you create when you do stuff like that.

Talk about keeping strategy simple in the boardroom. How do you keep going back to that when you're engaging in strategy at the board level?

At the last strategy session Home Depot had in October, the management team came up with this thing called "Customer-Back." Thinking about the customer and then moving backward into how we handle and deliver to the customer what they want. In every aspect of the business, how do you think about that? And I thought that was pretty creative and pretty genius.

As a board, it really helped us to focus on: let's start with the customer and think backwards: How does the customer want to buy the product? How do they want it delivered to them? Do they want it installed or not installed? So, it's things like that. Thinking about the customer: What do they really want?

Can you talk about how the board engages with management on strategy without overstepping?

I view our job as directors to kind of look around the corner and say, "Hey, have you thought of this? Have you thought of that? You know, here's kind of our strategy, we all agree to it. What are we missing?" And probing on that.

The management teams I'm engaged with really respect and enjoy it because they're really busy. CEOs are massively busy doing the day-to-day, and it's not that they're not strategic; some of them are very strategic, some of them are more operational. But they really do want the thoughts, the inputs and the insight.

As a CEO, you need to be willing and able to take your board's comments in and then synthesize them and come back with, "Here's what I heard. Here's what I'm going to do about what I heard. And here are the things I think are probably not relevant or not relevant today, something that we just don't have time to do given how we're focused on executing what our plan is."

Board members of those boards I'm on don't view their role as managing the company. They view their role as being very thoughtful in helping the CEO and management think through those issues, and then having the CEO or the management team re-articulate what they heard and iterate that a little bit until it gets kind of right and everybody agrees, yeah, that makes total sense. That's kind of the process.

If you're a board member, you don't want to walk into a board meeting with 20 things. You know, "Here are the 20 things I want you to change." Walk in with one or two key points. If every board member does that, you have enough.



Sometimes the three most unused words in the English language are: *I don't know.*"



You have to be able to answer the question: How is the digital world going to change my business?”

As a PE investor, you walk away from about 90 percent of the companies that you look at. What has doing that repeated due diligence taught you about deal-making and your approach to deal-making when you're in the boardroom?

That same discipline: you have to be able to walk away. Some of the traditional private equity investors who have been in private equity their whole careers are financiers, they have a little different paradigm.

In our firm, we always have someone who has my background as an operator and someone who is a traditional private-equity dealmaker. That “two-heads-are-better-than-one model” really brings out the best. When you get to the boardroom and you're looking at M&A, you can use that same paradigm.

So, as a director, from an M&A perspective, you really need to think about what this deal strategically does for the business. What difference is it going to make to the business, to the growth, to the growth trajectory, to the customers? And the financials will take care of themselves. Anybody can run the numbers, right?

A really strategic thing that costs way too much is not a good deal. And a non-strategic thing that's cheap is not a good deal. So you're looking for those strategic things that are in the wheelhouse of affordable on the M&A side. Usually the conversation starts with: What does this do for the customer? What does it do longer term? If it's a fairly big deal, then you can get into the financial piece of it more.

If it's a smaller deal—there are some deals we do in all the companies I'm engaged with where we're just picking up technology or know-how—and you can actually pay a bit for those because if they're small, they don't really change your trajectory, other than they might be very strategic in kind of how you can lever the business and grow differently. It just kind of depends.

As you said, the two places where the board can be the difference-maker are strategy and picking the right CEO.

What's essential for you when you're looking for a leader?

There are two simple tests of assessing a leader. One is what I call the IQ dipstick test. We all used to check the oil in our car. If you put the dipstick in, it comes out two quarts empty, it's not going to work, no matter how good that person is.

The other one I call the “fly across the Atlantic test.” Is this somebody I'd want to sit by for eight hours across the Atlantic? In other words, are they a good person? Are they a team player? Do they have followership? Can they pull together people as a team? Have they been a good follower? Do they want to be followed? So those are the kind of top-level tests.

Then, as CEO for a specific situation, the board has to stand back and say: What do I need for the next five to seven years in the business? What am I looking to do with the business, what's my strategy?

You hopefully have several internal CEO candidates you've been mentoring and grooming and giving experience—you can then look at the skillsets of each of them and say, “For the next rodeo, for the next five to seven years, this skillset is a skillset base I need.” Let's assume they all pass the IQ dipstick test and the fly across the Atlantic test, then it really comes down to where you see the business going and whose skills best match that challenge.

So, what are the skills—for CEOs, but also for directors—that you think are going to be most essential over the next five years?

You have to be able to think digitally. You have to be able to answer the question: How is the digital world going to change my business? In a pool equipment company we own, it was about driving to the best app so you can control your pool off your phone.

At Home Depot, it's thinking about how to open up the app so that customers can buy however they want. They can go to their phone, type in a store and type in an item, and it'll take them right to it—we have that technolo-

gy now. That's going to be a key skillset. How do you think about digitally transforming your business?

So what's more important, imagination or the technical/execution part?

The imagination. Once you as a team—you and your management team—can imagine what the customer wants, thinking “customer back” again, you can actually find people either externally or internally who can execute that. So those people are very important. But you don't have to know how to code it, you just have to know: What do I want to do? That's going to be critical.

The other thing that will be critical is thinking through this whole nature of supply chain. What's the balance between my cost basis and my products and services, and where I source them from? Because more and more people will start making sure their supply chain is a little bit closer to home than it necessarily has been in the past. The pandemic has set that up certainly in many, many industries.

Did Lean get too lean for our own good? Did we hurt ourselves?

Especially when financial costs are low, carrying a little bit more inventory is not that costly, particularly if you carry it in the raw material state. If you're going to take a motor and turn it into a variable-speed pool pump, or you're going to take anything, if you're going to transform yourself, you probably carry a little bit more inventory in the system as a result of that.

Sometimes that can actually reduce your system costs too because transportation costs are so high. Sometimes you can do a truckload of something with a little bit more inventory, and the cost of transportation goes way down. It depends what you're selling, but it's worth looking at that total system cost.

The other thing you have to be able to do as a CEO is think about distribution. More and more people expect things as they want them, when they want them. That time has done nothing but speed up. So you need to think about “how do I have my distribution



and supply chain network set up so I can actually deliver on that promise?”

What other things will be most essential for boards in the years to come? What are you going to look for in the directors that you bring aboard the boards you're involved with?

Start with diversity of gender, race, thoughts and ideas, and background. Having a diverse board is really important to get the best ideas on the table. Then you've got to back up and say: “Where are we going as a company, and what do we need? What are we missing in the director group we have?”

Having the company strategy and knowing what it is, knowing what the management team to execute that strategy looks like and then thinking about what kind of board do we have that can help the team execute that? And more importantly, what are we missing?

Often, in older businesses and more traditional-economy businesses, you'd love to have someone on your team who has imagined or created as a founder, a digital idea that's transformed something. If you're a software company, maybe you're really good at that and you need somebody who's executed.

Final thoughts for directors and boards as we head into yet another crazy year?

It's going to be a really interesting year for everybody. It's almost impossible for the market and the stock prices to keep doing what they've done the last two years. They've defied gravity a little bit. It's a great time for folks to step back and say: What have I learned during this time? What can we do better? What should we cut out, and what should we spend more time on?

Are we all going to be in the office? Are we going to be doing calls on Zoom? Are we going to be doing some of both? How do I get the most productivity out of the team at the least cost, right?

I'm not sure business travel is ever coming back to what it was because folks are used to Zoom. It'll come back some, maybe 60 percent, 70 percent. So, how do I optimize what I've learned? None of us would have imagined two years ago we could actually carry on a lot of conversations like this over Zoom or Teams or whatever. But we've been doing it for a couple years now, and guess what? It's actually worked pretty well. **CBM**

WHAT DIRECTORS THINK 2022

Corporate Board Member's annual survey of U.S. public-company board members, conducted in partnership with Diligent Institute, reveals directors' top concerns, challenges and agenda items for the year ahead. What's on your mind? Cyber, talent and that oh-so-volatile economy.

BY MELANIE C. NOLEN

STRATEGY SHAPERS

LOOKING AHEAD AT ELEMENTS LIKELY

to influence strategy in 2022, 50 percent of directors participating in this year's survey cited the economy, inflation levels unseen in decades and potential Fed tapering. Many, however, are less concerned about economic growth than the ongoing supply chain issues plaguing businesses.

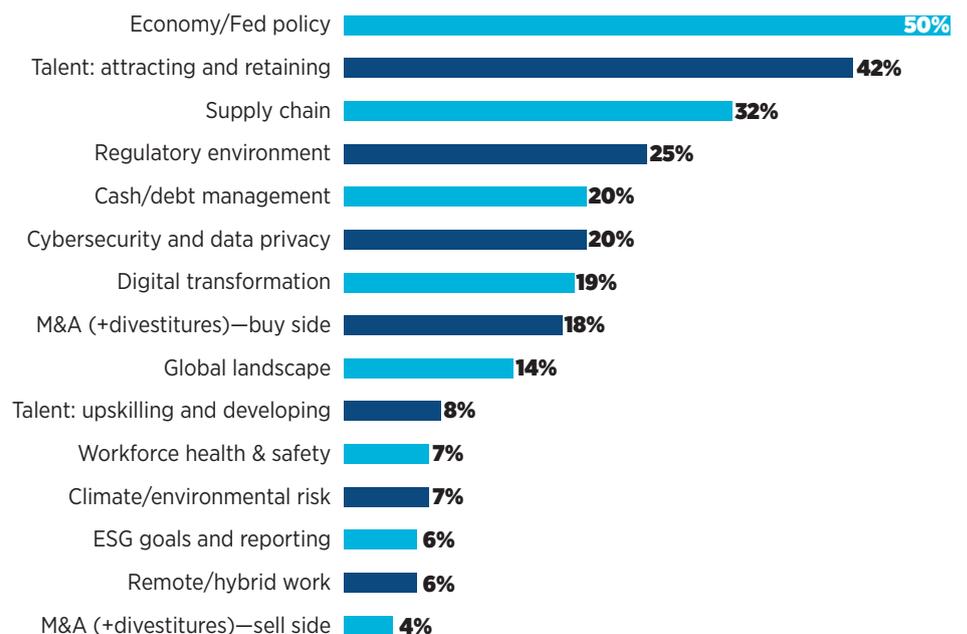
Although there are some early indications that the supply chain is easing, "we have yet to see the costs of a freight transport drop," says Kathleen Camilli, board member at Toronto-listed AGF Management and NYSE-listed UniFirst Corporation, who serves on the audit and compensation committees. "So that's the top-of-mind issue for us. It's a big, big problem. It's also a big problem that there's a labor [shortage] in the ports and the unloading of the ships, and then getting the goods from the ships onto the rail to the location. It's been extremely challenging this year, and I don't see it really going away."

The disruption has led companies to weigh a bigger-picture supply chain question, she notes: "Do you want to bring it closer to home?"

FORWARD FOCUS

Which of the following issues do you believe will bear the greatest influence on the success of your company's strategy in 2022?

**Respondents were asked to select top three*



CYBER & TALENT TOP CONCERNS

BOARDS HAVE BEEN TACKLING AN

unprecedented range of issues for the past couple of years. From a global health pandemic, coping with the Great Resignation and growing stakeholder pressure for corporate accountability to a changing regulatory landscape and a drastic shift in customer behavior and tech-fueled innovation, there's no shortage of items on today's agendas.

Which ranks most highly on the list of issues keeping directors up at night today? According to our survey of 400 U.S. public company board members, it's a near-tie between cybersecurity (41 percent) and talent (38 percent). Long among the top director concerns, cybersecurity jumped from third place last year to claim the top spot.

"[Cybersecurity] is a topic in every board meeting," says Robert Shapiro, a director of the board of Overstock.com and a former advisor to top White House officials, including President Bill Clinton, Vice President Al Gore and Secretary of State Hillary Clinton.

Heightened awareness of the need for a multifaceted cybersecurity strategy is fueling the sense of urgency, he explains. "Most people focus on preventing attacks. Well, you can't prevent all attacks. What you need to focus on is not as much prevention or protection as resilience, how quickly you get back up.... Anybody can be taken down, but the question is, can you get back up in 15 or 30 or 60 minutes—or a catastrophic two or three days?"

As criminals in the world of cyber evolve, so must mechanisms for defending organizations against that activity, adds John Hayden, director on the boards of the E. W. Scripps Co. and Tiberius Acquisition Corporation. He says the board's role to keep asking who, what, when, where and why—questions that challenge management to think at the next level.

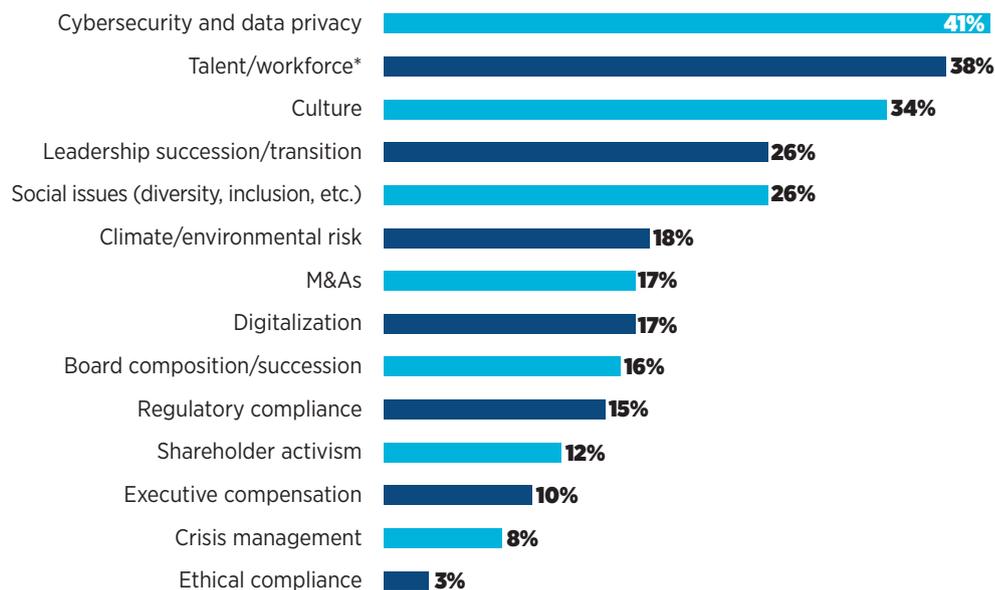
"Boards need to continue to say, 'Okay, what's new in this arena? What are we likely to see next? How can we best look around the corner and try to position ourselves to defend effectively against it?'" he says.

Directors also need to be cautious, as they can be among the most vulnerable to attacks, points out Scott Gibson, a director on the boards of Northwest Natural Gas Company and Pixelworks. "Some of them wouldn't have the slightest clue whether or

TOP OF MIND

What issues do you find most challenging to oversee?

**Respondents were asked to select top three.*



**(hiring, upskilling, safety, diversity, etc.)*

not their router has a password," he says, noting that board members often resist implementing cybercrime preventive measures they perceive as invasive. "I don't think people appreciate that it only takes one weak link if the bad guys figure it out, and remote work because of poor router protection is rife with opportunity for the right bad guys."

While boards typically bring in outside expertise to assist in their cybersecurity oversight, Herman Bulls, who sits on the boards of Host Hotels & Resorts and Comfort Systems USA, says having directors with cyber as a core competency is helpful, "because they know how to appropriately articulate the issues, the risks and the possible mitigating factors."

Talent, meanwhile, is a new contender topping the list of issues keeping directors up at night. Talent issues—lack of skilled labor, shifting of work policies, Covid-related mandates, rising wages, etc.—are affecting companies' ability to execute on growth strategies amid strong pent-up demand.

"Everyone's losing talent, no matter how good your culture, policies or pay packages," says Gibson. "The velocity of change

is unprecedented, and expectations are so much higher in terms of freedoms and allowances and work-from-home percentages, vaccination policies, to go down the list of complicating factors. Then [for] some jobs you really want people in the office more, some you don't. So again, there's a complexity that's affecting talent. It's a really, really challenging time."

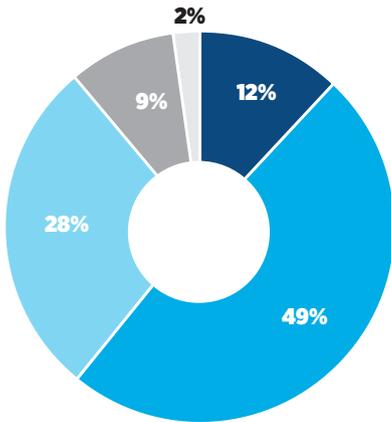
Camilli says this is a topic that's discussed at every board meeting. "Our turnover has gone up to 70 percent for our line workers," she says, noting that Amazon or Walmart set the bar for the country in terms of wages, and the environment has become much more competitive. "You have to [increase wages], because you can't run a company without labor."

Gibson says this highly competitive environment is also causing companies to make "more hiring mistakes than they have when they had some physical connection"—which he likens to conducting M&A in a virtual setting. "Maybe there's a desperation element that makes that batting average worse in the pandemic in terms of colossal mistakes on talent."

THE CULTURE DILEMMA

CULTURE CONFIDENCE

How confident are you in your board's culture oversight tools and resources?



- Absolutely confident (100%)
- Significantly confident (80-99.9%)
- Somewhat confident (60-79.9%)
- Uncertain (40-59.9%)
- Doubtful (less than 40%)

CULTURE HAS CONSECUTIVELY RANKED

as a challenging issue for directors to oversee, and it was awarded third position on the list for 2022. Its consistent ranking in our list can perhaps be attributed to the difficulty many directors report in assessing and overseeing culture. While 12 percent of directors say they're fully confident in the reliability of the tools and resources at their disposal to oversee culture, nearly as many (11 percent) say they're doubtful or uncertain.

Still, 49 percent report significant confidence in their culture oversight tools and resources, suggesting that most directors feel comfortable with the measures at their disposal. Camilli, for instance, says she hasn't found the issue particularly challenging to oversee, yet acknowledges that employee surveys can often be inadequate "in terms of really getting a sense of what people are thinking." Despite that potential gap, 49 percent of board members in our survey say they find employee surveys to be the most reliable way to oversee culture—well ahead of any other method.

Some directors, however, find combining multiple measures most effective. "The more ways you can assess culture, the better, as one reading of culture can be calibrated by or informed by another technique," says Jan Estep, director at ACI Worldwide.

Bulls advocates for direct engagement between board members and employees. "I think for any board it's important to make

"The more ways you can assess culture, the better, as one reading of culture can be calibrated by or informed by another technique."

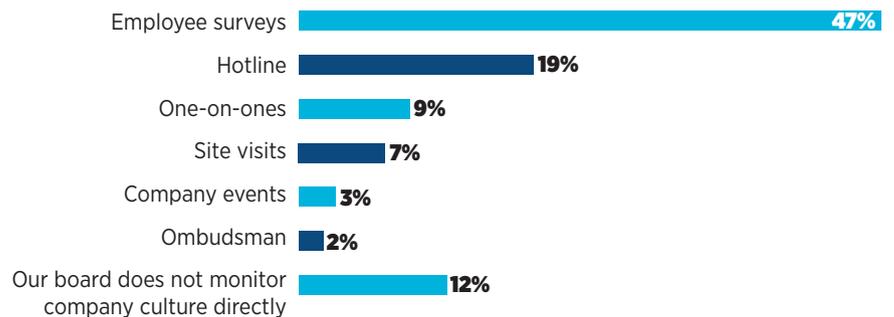
—Jan Estep, Director, ACI Worldwide

sure that you are seeing people other than the C-Suite," he says, noting that his board periodically invites employees to board meetings. "Number one, it gives you an opportunity to see that next level of talent. Number two, believe it or not, it's a big deal for people to come meet the board. So, it's also a motivating factor for the employee."

Bob Ducommun, director of Ducommun, a Tier 1 supplier in the aerospace sector, echoes the value of one-on-one meetings. "We try to have some of our annual slate of board meetings at various facilities around the country, and part of the schedule is dedicated to meeting and interacting with our employees, sometimes just by walking around," he says. "It gives us the opportunity to meet with some truly impressive leaders, and with employees who in many cases have been with the company for decades."

CULTURE TOOLBOX

Which of the following methods does your board rely on the most to oversee culture?



FRONT AND CENTER: M&A OPPS

M&A RANKED AS THE MOST PROMINENT topic on board agendas in 2022—suggesting that deal-making opportunities are a post-pandemic focus for companies—trailed closely by talent, at 45 and 44 percent respectively.

Several directors reported difficulty finding acquisition opportunities at reasonable prices in the current environment. Yet, acquisitions remain a critical growth strategy for companies like Ducommun, an aerospace manufacturer striving to strengthen its value to customers in terms of capability and scale. “To get there, we will continue to make selective acquisitions that supplement organic growth,” says Ducommun.

While Shapiro also anticipates robust M&A activity, he sees greater opportunity on the sell side. “The market is supported by the enormous credit bubble. That doesn’t mean it’ll burst, but it means you need to go way underneath the financials in order to understand what it is you’re buying or... the price that this inflated market has produced.”

CRISIS VULNERABILITY

GIVEN THE SUPPLY ISSUES issues so many companies are struggling with, it’s not surprising that supply chain disruption ranked second, behind cybersecurity, in vulnerability to crisis. Forty-six percent of directors rated it the area where they’re most concerned about confronting a crisis.

Few companies had the foresight and wherewithal to create contingency plans for the current disruptions, notes Gibson. “The rapidity of demand nearly ceasing to exist in March of 2020 to suddenly exploding in certain areas like supplying work-from-home needs, everything from furniture to PCs—I can’t imagine how someone could have anticipated that,” he says.

Those who did, however, benefitted. Ducommun recounts an overhaul of its supply chain agreements a few years before the pandemic hit. “We reduced the number of critical suppliers significantly,” he says. “When combined with the aggregation of our purchasing power across the enterprise, that rationalization resulted in a commitment to place much more of our business with those that survived that pro-

cess.” The company was able to set clear expectations on pricing, availability and delivery, with the understanding that suppliers who perform will earn larger chunks of its business.

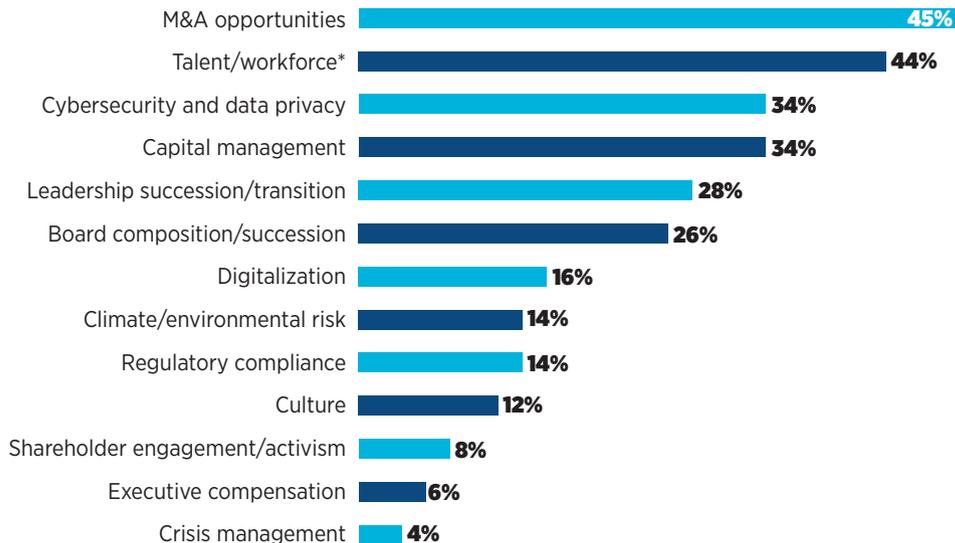
And therein lies the lesson. “The truth is

the companies that do best at this are the ones that had been thinking about these issues before this arose,” says Shapiro. “They already had the personnel, and they know how to approach these issues. Like the way we deal with cyber. You have a plan.”

ON THE DOCKET

Which of the following topics will be most prominent on your board’s agenda in 2022?

**Respondents were asked to select top 3.*

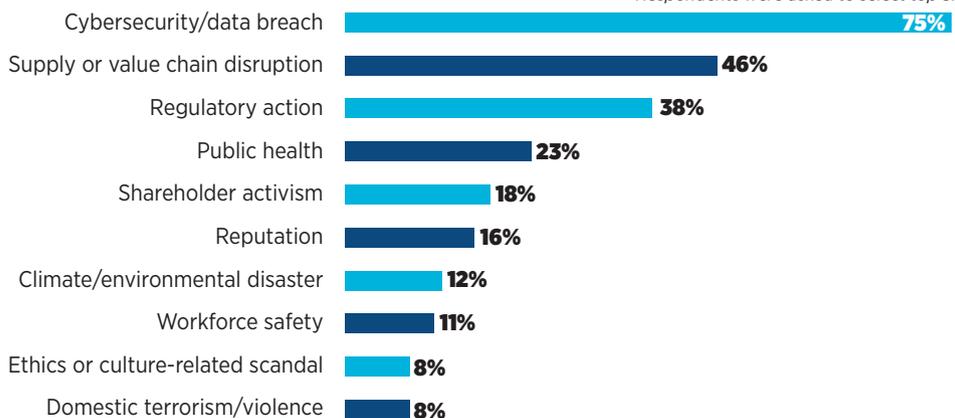


**(hiring, upskilling, safety, diversity, etc.)*

MOST POTENTIAL FOR A CRISIS

In which of the following areas are you most concerned about your company confronting a crisis?

**Respondents were asked to select top 3.*



ASSESSING ESG EXCELLENCE

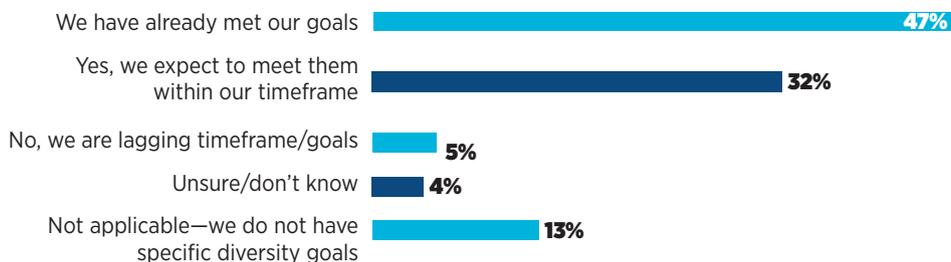
Several years of initiatives aimed at bringing greater diversity to boardrooms seem to have paid off, with 79 percent of directors reporting that their boards have met or are on track to meeting their diversity goals.

“While accomplishing your diversity goals in a short amount of time is a good thing, the journey should continue from those initial successes,” says Kira Ciccarelli, lead research specialist at the Diligent Institute. “No respondents indicated they had a timeframe of more than five years to meet diversity goals, which would be the first step to thinking about DEI as part of long-term strategy.”

What’s more, industry expertise and leadership experience are now back at the top of the list of attributes boards are now seeking in their next director appointment—a shift from last year’s top three criteria of background, racial and gender diversity last year. Anecdotally, directors say they have the diversity they need at this time and are therefore focusing on onboarding certain missing skillsets.

DRIVING DIVERSITY

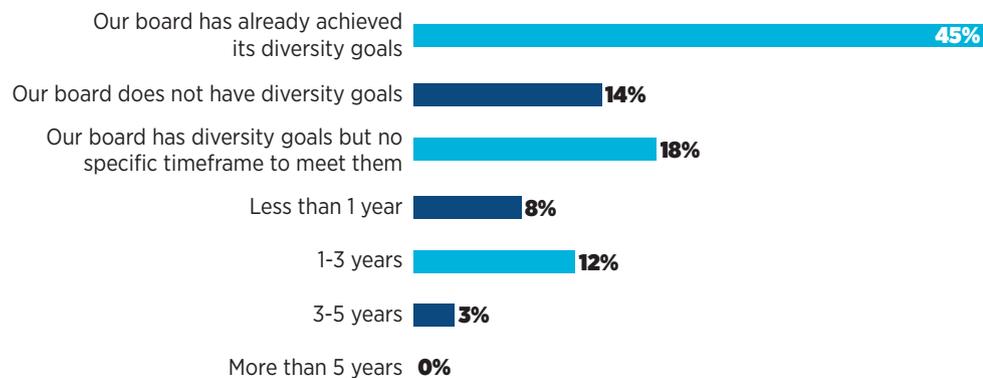
Is your board on track to meet its board diversity goals?



“While accomplishing your diversity goals in a short amount of time is a good thing, the journey should continue from those initial successes.”
—Kira Ciccarelli, Diligent Institute

TIME FOR CHANGE

Has your board set a timeframe to meet its board diversity goals?



Data from the survey also shows a slight uptick in the integration of ESG considerations into corporate strategy. Thirty-nine percent of directors say their boards decided to move forward with tying exec comp to environmental metrics—up from 26 percent just a year ago, when we asked directors whether environmental issues were informing their executive pay programs.

Similarly, 40 percent are doing the same with respect to social considerations. Part of the challenge that remains, directors say, is lack of guidance or standardization.

Hayden, whose board is already

CANDIDATE CRITERIA

Which attributes are most important for your board to consider in making your next director appointment?



tying social metrics into executive compensation, reports: “Hard metrics are very difficult in this arena because I think that’s where it can become counterproductive. In our case, the evaluation is subjective, not an objective approach, so it’s a modifier in the equation as opposed to an arithmetic element of the equation.”

One of Gibson’s boards is a fossil fuel distribution company that has set 2050 carbon neutrality goals but does not tie those goals into executive compensation formulas. “No one is a climate change skeptic, but how does it get measured?” he asks. “No company can fill out 13 different forms and 13 different frameworks. And to put it in executive comp before these frameworks are solidified and condensed? I think that that hesitation is just saying, ‘Well, let’s wait until this congeals. And then we can put it in the execu-

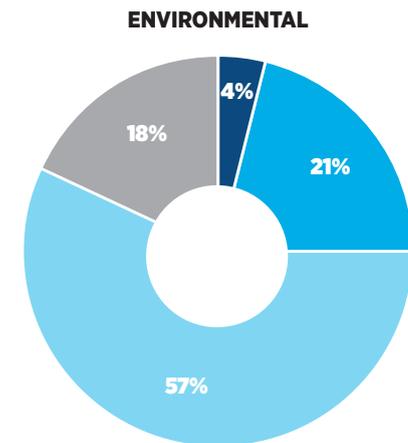
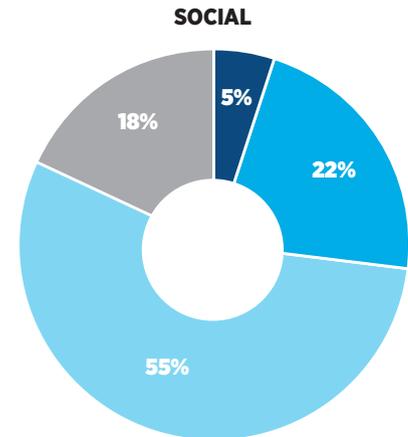
tive comp system, but right now, what would we put in there? We’d put in a framework that might become obsolete.”

Although Bulls’ board isn’t tying these issues into executive compensation, he says when it comes to setting metrics, it’s up to the board to determine precisely what the targets are and then to hold management accountable for meeting these milestones.

“What are the objectives you want to accomplish? And why is that important?” he says. “There is an opportunity for senior management to look at their teams and decide how they will prepare to compete for the future. And the most important thing around that is understanding the business imperative and helping everybody on the team understand the why—why is this important?” **CBM**

INCENTING ESG

Is your company considering tying environmental or social metrics to executive compensation?



- Yes, but opted against it
- Yes, and planning to do it over the next 12-24 months
- No
- Already doing it

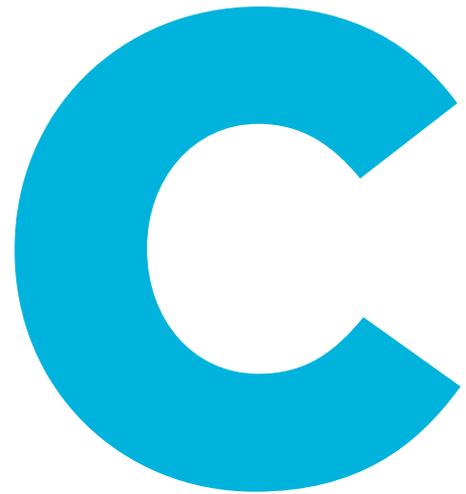
¹ 2021 CBM-EY Research Study, Four Opportunities for Enhancing ESG Oversight, BoardMember.com/White-Papers

IS YOUR CEO THE RIGHT CEO?

The biggest risk—and opportunity—in your business today? Your leadership. The right person at the wheel will nail exponential growth and win in a digital age. The wrong one? You're a goner. A frank guide to who you need—now.

BY RAM CHARAN





Companies are created, expanded, allowed to wither and die or get revived by their leaders. Walmart started to digitize in 2001, but those efforts didn't go anywhere until Doug McMillon became CEO in 2014. Microsoft was treading water until Satya Nadella took over. Larry Page and Sergey Brin created a new competitive field. So did Mark Zuckerberg. These are reminders of what should be obvious: that leadership matters to the success of a business.

We are now in a period when leaders are tested continuously against changing conditions and against one another. Digital leaders so far have an edge, not because they are younger and tech savvy but because they lead in ways that are inherently better suited to a digital company in the digital age.

Understanding what is different about digital leaders will help everyone who has been successful in a traditional setting and must now change their habits and mental gears. It might sound harsh, but those who find they do not match up against what leadership demands in the digital age should consider taking a different role and clearing the path for someone else. Rupert Murdoch of 21st Century Fox and Frank Lowy of Westfield conceded all or part of their businesses to others who were presumably better suited to run them. More of these leadership changes will come.

But no one is predestined for success or failure. It is an open game, and we are seeing the challenge to current leaders playing out in real time.



MAKING DISNEY DIGITAL

Take The Walt Disney Company, an American icon. Bob Iger became its CEO in 2005 following a decades-long career in broadcast television. The company pumped out a more than respectable EPS and dividend for many years under his leadership. But as media watchers saw Netflix taking off, they saw no discernible match from Disney. Some began to question how and when Disney would respond to the steepening decline of broadcast and rise of video streaming.

For much of Iger's tenure, he had sought to reinvigorate the company's content production, especially animation, which had lost its mojo. The most direct path to refreshing Disney's creativity, he believed, was to acquire Pixar, which had been wielding its creative and technology skill to produce everyone's new animation favorites, including *Toy Story* and *Finding Nemo*. Iger made the persuasive case to Steve Jobs that a deal would be good for Pixar and Disney, Jobs agreed, and the deal was finalized in 2006.

The pursuit of quality content led to two other major acquisitions that soon followed: Marvel Entertainment in 2009, with its library of comic book characters, and Lucasfilm in 2012, with its Star Wars franchise. The acquisitions lit Disney's box-office success on fire. In 2016 (also the year Shanghai Disneyland opened), four new releases generated more than \$1 billion each in worldwide box office receipts.

Still, while digital technology had been on Iger's watch list for many years, there was no indication that the media giant was taking video streaming seriously. Until 2017. Suddenly Iger's references to disruption and digital technology led to action. Disney jumped into video streaming in a big way.

BAMTech, a Manhattan-based start-up created to stream live baseball games, would be key. It had built Hulu's streaming service, as well as HBO Now's and others. Disney had earlier made a small investment in the company; then, in 2017, it negotiated to expand its stake to 75 percent. BAMTech built a streaming service for Disney-owned ESPN that launched in

2018, and another, which we now know as Disney+, that launched in late 2019. Having BAMTech build the digital platform was faster than building it in-house but required a commitment of \$1.5 billion.

That dollar amount was small in comparison to what became another piece in the Disney digital puzzle. In mid-2017, shortly after Disney expanded its BAMTech investment, Rupert Murdoch opened a conversation with Iger about 21st Century Fox assets. That got Iger and his strategy chief, Kevin Mayer, thinking about which parts of Fox could enhance Disney's offerings and increase its scale. Fox's movie studios and presence in India's growing market would be major boosts to Disney's global expansion. Fox also had a sizeable stake in Hulu, which would add to its own and give Disney majority control of a third streaming service that it could use as the conduit for content that did not match the Disney+ family-friendly brand.

Negotiations followed, and the Fox deal closed in 2019, with Disney taking on yet another big acquisition and financial commitment—to the tune of \$71 billion—in the midst of the transition to streaming that was already under way. By the end of 2019, Bob Iger had placed his bets and committed tens of billions of dollars to connect directly with consumers and ensure an ample supply of quality content. Disney had begun to reclaim the content it had licensed to other companies, eliminating a reliable source of revenues. And it established a price of \$6.99 a month for Disney+, low enough to appeal to average families.

All of those decisions meant that earnings and cash would take a hit in the short term and the moneymaking model would change. Instead of earnings per share, Iger focused on the number of subscribers as the more important measure of performance.

Iger made his case convincingly to investors and had to do the same for those inside the company. The old moneymaking model was being disrupted and so was the organization. A new group was formed to create content specifically for the direct-to-consumer

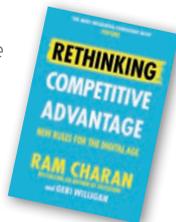


Ram Charan, a world-renowned business advisor and bestselling author, has spent the past 35 years

working with CEOs and boards of many top companies. He has served on a dozen boards.

Excerpted from *Rethinking Competitive Advantage: New Rules for the Digital Age* (Random House, April 2021) by Ram Charan and Geri Willigan.

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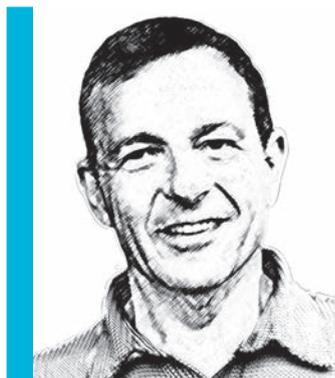
market. New business segments, with labels such as “Direct-to-consumer and international” and “Parks, experiences and consumer products” reflected the new orientation and separated the creators from the data crunchers. To bring Disney employees, investors and consumers along, Iger traveled the globe to explain Disney’s plans and to listen. And he got the board to support a new incentive structure.

So, is Iger a digital leader? It was not a given that Iger would adapt to the tenets of competitive advantage in the digital age, given his experience and background. Any leader coming of age in a stable business environment and especially those in a company that has been dominant, if not monopolistic, can struggle to adjust to the dynamics that exist today. But he seems to have followed the new rules:

- Seeing what consumers value most: great content, lovable characters, and wanting to consume entertainment in new ways
- Using a digital platform to connect with and learn about individual consumers with the potential to personalize their connection with Disney characters and stories
- Creating a moneymaking model that focuses on building scale
- Engaging eco-partners—such as Verizon, offering Disney+ to its customers—to scale up the number of subscribers
- Changing the social engine to support the company’s new positioning and moneymaking model

As CEO, Iger seemed to think and act like many of the digital leaders I have observed. He had an open mind; kept learning and discerning new patterns; and was imagining something new, thinking big and steering the organization to boldly pursue it despite the risks. In short, he had the mindset, skills and courage to lead in the digital era.

Any company that is or wants to be digital must have leaders who match up against the criteria a digital company requires. Iger was not expected to be



By the end of 2019, Bob Iger had placed his bets and committed tens of billions of dollars to connect directly with consumers and ensure an ample supply of quality content.

a digital leader when Disney’s board of directors gave him the CEO job in 2005, but by the time he announced his retirement on February 25, 2020, he had become one. The same can be said of B2W’s CEO Anna Saicali and Fidelity Personal Investing President Kathy Murphy, both of whom developed their careers in traditional companies and became digital leaders.

WHAT IS A DIGITAL LEADER?

The most significant differences I see in the leaders of digital companies versus the leaders of traditional or legacy companies have to do with their cognition, skills and psychological orientation. What is particularly relevant is how these things blend together to link big-picture thinking with pragmatic matters of moneymaking, execution and speed. Each of the descriptions below captures an aspect of how digital leaders succeed.

- They have the mental capacity to think in terms of 10x or 100x, to imagine a future space that doesn’t exist, and the confidence that they will overcome whatever obstacles they might encounter. They are knowledgeable about and supremely focused on the customer and have the imagination and vision to conceive of an end-to-end customer experience and a large-scale future space. They can see how the moneymaking and the company’s ecosystem will work together in new and sustainable ways. They are willing to make big bets and to

withstand initial losses of profits and cash amid doubts and skepticism from Wall Street because they have a clear picture in their minds of how things will work. They are able to build ecosystems on an enormous scale and believe every market they enter is expandable.

- They have a facility for and are comfortable with data-based analysis. Facts and knowledge—not predictable outcomes—give them the courage to act. They blend data with intuition, examine future trends and adjust their actions and offerings as new data and facts emerge.
- There is a fluidity to their thinking. They welcome change and even seek it. They are, in fact, the source of what others perceive as relentless change. People talk about how digital companies are disrupting industries, but most of their leaders don’t start with that intention. They are motivated to create something new. Their fluid, iterative thought process makes the once-a-year strategy review obsolete. Instead, it is ongoing.
- They are hungry for what’s next and are willing to create and destroy. Their psychology is geared toward high speed, urgency and continuous experimentation. They constantly search for what can be improved and what can be created that could be important to consumers and provide a new source of revenue. They are not afraid to cannibalize what they have or abandon what isn’t working. While legacy company leaders expect a formal

Today's fast-paced digital economy is not an era for the timid. But leaders who take bold action without having the requisite skills are merely reckless.

presentation with every “i” dotted and every “t” crossed before they approve an initiative, digital leaders are willing to make big bets without the formal apparatus. They focus on the customer benefits and allow for uncertainty. Their psychology, habits and DNA are predisposed to explore, experiment, learn and adjust, and to quickly cut losses when necessary.

- They have the observational acumen to absorb hard data and piece together what does not yet exist.
- A.I. and algorithms can help digitally adept companies sort out operational complexity, but the leaders of these companies must be able to juggle many variables as they change the basic components of their business. They are not overwhelmed by the speed of change and are comfortable with the concept of creating MVPs, or minimally viable products—a good-enough version of an offering that can be tested and iterated quickly based on customer feedback. Their ability to handle the constant flood of new information allows them to react quickly to the speed of social media and word-of-mouth and to continually look to shift resources and rebalance short-term and long-term goals.
- This kind of fluid thinking and ease in taking in new and complex information goes hand-in-hand with continuous learning. Such leaders stay abreast of what is new and challenge themselves to learn about things they know nothing about.
- They are literate in the application of algorithmic science and value fact-based reasoning. But they know that data is not always sufficient.
- They rely on metrics and transparent data to drive execution. They are highly disciplined in ensuring that their people deliver results on time.
- They are skilled in selecting the right people for the right jobs and are quick to move people to other positions who are not suited to the job as it changes.
- Digital leaders are willing to recon-

ceptualize the organizational structure so that decision-making takes place closer to the customer to improve the speed and quality of decisions. They are comfortable giving those under them the freedom to act, while using data and incentives to increase accountability and execution.

- The word courage has been associated with strong leadership throughout history in every walk of life, from war to sports to politics. For digital leaders or traditional leaders becoming digital, courage has a specific granularity. They have the courage to act decisively, often making bold moves despite the fact that the emerging landscape is often based on incomplete information and unknowns. Their courage and boldness come from their ability to take in and sort through a flood of new data and information, combined with the raw nerve to take risks.

This final bullet is certainly true of Bob Iger, who entered the streaming race later than many expected. He took on a lot of debt to buy Fox and Hulu, knowing full well that pricing could be a race to the bottom, while incurring heavy cash expenditures that will reduce earnings and could invite attacks from the media, investors and activists. If the repositioning of Disney proves to be untenable, it could damage the Disney brand as well as Iger's reputation. But Iger had the cognitive ability to figure out a path for Disney and the sheer nerve to place a big bet on it.

TESTS OF LEADERSHIP

Today's fast-paced digital economy is not an era for the timid. But leaders who take bold action without having the requisite skills are merely reckless.

When leaders fail, it is usually because their business skills do not fit the challenges of the job. Poor judgment in allocating cash and the failure to hire and train the necessary talent are common shortcomings. For example, we know that autonomous (or self-driving) vehicles (AVs) are coming in the near future, but no one knows when, where,

how quickly they will be adopted and who will dominate.

Companies in that space will rise or fall based on how well their leaders can navigate the fog of uncertainty in that emerging market space. AVs depend on huge amounts of data, and their development entails a great deal of risk. As we've already seen, accidents in the testing and development phase can have an outsize impact on consumer acceptance. Some leaders are pursuing AVs aggressively despite the risk, while others are moving more cautiously.

Ecosystems will inevitably compete against each other, and mistakes here, including moving too slowly, may be an existential threat. Leaders have to imagine how the moving parts will fit together, build the relationships and be comfortable sharing information with eco-partners, versus going it alone, as they are accustomed.

The total revenue of the global mobility market is unknown, but total car ownership is in decline worldwide. Leaders vying to compete in that space will have to find a moneymaking model that works. That is an especially big challenge for leaders of traditional automakers. Ford, for one, has a cash problem. Ford got a new CEO in October 2020 who is hastening development of electric and autonomous vehicles. Ford spent \$1 billion to convert its German manufacturing plant to EVs only. Can Ford outcompete Tesla and newly minted EV makers? Is its partnership with Argo on AVs a winning combination? Will it have sufficient cash to fund its investments in those areas?

Ford is testing AVs in three cities, while most other automakers are testing in just one. Ford stands to benefit by getting data from varied settings, but can it afford to do so for an extended period of time? The CEO has to be willing to shift resources as necessary, withstand a barrage of criticism over suppressed earnings and have the skills to deftly explain the narrative to investors and employees.

These are business issues leaders in the auto industry have to reckon with, and their decisions have serious consequences. Note the turnover in the CEO positions at BMW, Ford and Daimler.

Bob Chapek, who succeeded Iger as Disney CEO in February 2020, had to weather



Will CEO Reed Hastings be able to continue to attract funding for Netflix as the competitive landscape shifts?

whatever impact the new moneymaking model would have on the cost of capital. Disney's stock price held up well at the end of 2019 in light of high initial subscription numbers for Disney+, but it was unclear if those numbers were sustainable and if investors would accept lower earnings per share. In 2018, Disney earnings estimates for 2020 were \$8.20. By late 2019, estimates for 2020 had fallen below \$6. Covid-19 wreaked havoc on earnings, but Disney+ was a bright spot: by early 2021 subscriptions had jumped to more than 94 million.

Will CEO Reed Hastings be able to continue to attract funding for Netflix as the competitive landscape shifts? Netflix's continued success depends on Hastings's ability to keep the moneymaking model working, even as other companies attempt to lure consumers away with new entertainment options. Netflix has been able to raise prices in recent years without significant blowback. Would the company become unattractive to funders if Hastings lowered prices at some point to attract new subscribers? In April 2020, on the heels of adding 15.8 million new subscriptions in the first quarter and having positive cash flow for the first time in six years largely because of a slowdown in production, Netflix announced that it was raising \$1 billion in low-cost debt split between euros and dollars. In January 2021, it had 200 million subscribers and announced it would not need to assume any more debt to fund day-to-day operations.

CULTIVATING DIGITAL LEADERS

Leadership obsolescence is a reality. Many leaders in traditional companies developed their cognitive skills around incrementalism versus rapid and exponential growth. Many

used price increases or acquisitions to boost revenues rather than to create new market spaces (note Procter & Gamble's pattern of premium pricing and Disney's price increases at its theme parks). Many lack technology skills and knowledge to survive in today's landscape or may have a weaker appetite for risk.

Understandably, it is hard for them to imagine what technology makes possible and to enthusiastically drive exponential growth. They may have no experience in building relationships with eco-partners and no exposure to the power of a digital platform. Most leaders in positions of power in legacy companies have come up through functional or vertical silos—from marketing, finance or operations. If they started at the bottom, they had to rise up six layers or more. That kind of career progression gives them little if any consumer experience or few opportunities to build their business savvy. Even leaders who have run a profit and loss unit probably did so without balance sheet responsibility and may be handicapped in trying to conceive moneymaking models that are suited to the digital age.

Up-and-coming leaders had to fight for resources, play politics and be evaluated based on how well they met the numbers. Reviews in legacy companies are largely focused on the rearview mirror. Some had performance metrics around customer satisfaction or a Net Promoter Score index, which are not forward-looking metrics and do not reflect imagination or vision.

Leaders who came up through consulting



**I feel confident that
a new generation
of leaders will arise
to meet the
challenges of
today's digital world.**

firms had their DNA shaped by analyzing multiple industries and massaging facts to get meaningful insights. They tend to be very good in cutting through internal and external data and can often see the big picture. But a large percentage ultimately fails because they lack experience managing a large organization or building top teams, or because of their personality. Their expertise and intelligence allow them to think they are the smartest person in the room. But as a result, they stop listening and are unable to develop and steer the company's social engine.

Turnover among CEO leaders at traditional companies will likely increase. A good percentage will find it near impossible to convert their mindset and skills or will be unable to do so fast enough. Traditional companies intent on transforming into a digital one should consider whether their leaders can make the shift. If not, they may need leaders from the outside. Amazon has become a talent factory and a popular source for recruiting.

At the same time, companies that do a deeper search might unearth potential digital leaders in their midst. I have observed a number of situations, beyond those at Fidelity, B2W and Disney, where a leader from a traditional company put the organization on a digital trajectory.

Leadership "potential" should be based on the qualities that digital leaders share: a basic knowledge of algorithms, a customer orientation and business savvy, as well as personal leadership traits such as imagination and a drive to execute. In particular, the blend of skills and personal traits must result in good judgment.

People can learn and change. I have seen experienced executives at the highest levels of traditional organizations eagerly learning what platforms, algorithms, and data can do for their company, and the scope of their thinking and imagination has been enlarged. Some of these leaders now believe that achieving 10x growth is possible, whereas they did not before. They are able to imagine satisfying a customer need that stretches out further in time, seven years or more,

and have begun to experiment and test what that market space could be. They know that competition is inevitable and are learning to experiment faster and accept some failures.

Millennials represent a richer vein of leadership hope for the future, but they may need to develop their social skills. Those with a background in computer science can nail coding and platform and app development, but their thinking has a downside. It is binary. Such experience can condition people to see things in black and white. They may lack empathy or nuanced social skills, which are critical in a digital company's team-based organization. Coaching can help. And on the whole, taking a risk on a younger person with expertise in the digital world but who lacks experience running an organization may be a better bet than turning to traditional leaders who lack the relevant cognition, skills and psychology.

The digital giants are few in number. There are only about 20 worldwide. But their leaders, too, face competition. Many succeeded as a first mover in their space, with little to no competition. They now have to think about whether they can continue to grow on the path they've chosen or whether to succumb to pressure to boost earnings per share at the risk of slower growth. Even with well-developed moneymaking models, platforms, brands and consumer connections, new challenges are emerging, such as dealing with regulators or taming culture.

I feel confident that a new generation of leaders will arise to meet the challenges of today's digital world, probably from many different sources. Clarity about the criteria these leaders must meet will help identify them. Clearing a path for their growth will allow them to develop, probably much faster than we think. It may mean overlooking others to favor the necessary skills over extensive experience. Organizations that understand how digital leaders are different, and search them out and nurture them, will have an edge over companies that do not.

That's competitive advantage in the digital age. **CBM**

**CORPORATE
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NETWORK 

Risk

RISK



CYBERSECURITY MEETS REALITY



Cyber risk can't be eliminated, but it can be managed. Directors shared oversight strategies at *Corporate Board Member's 2021 Board Risk Forum*. Some ideas.

The notion of cybersecurity as a systemic risk for companies is not new, but the past year of remote work and the increased frequency of cyber crime certainly underscored that it has become one of the biggest risks facing boards today. Digital transformation and the Internet of Things have opened up points of entry in every area of operations, as well as all along the supply chain, and the resulting decentralized networks are trickier than ever to safeguard.

At the same time, regulators, investors, customers and other stakeholders are stepping up pressure on boards to actively demonstrate diligence in the area of cybersecurity; they expect personal information to be protected, systems to

be resilient and processes to be in place to quickly address attacks when they happen. When companies fail to deliver on that, shareholder lawsuits inevitably follow, and directors have been increasingly named in derivative suits.

But for most board members, who typically have no background in technology or IT security, cybersecurity risk remains one of the most challenging areas of oversight. In March, directors gathered virtually to hear from industry experts and corporate chief information security officers about how to wrap their arms around this mushrooming risk and how to recognize it not only as a threat but an opportunity. Takeaways from *Corporate Board Member's Board Risk Forum* follow.

CISOS SPEAK: WHAT THEY WISH THEIR BOARDS KNEW

From making sense of analytics to supply chain partner considerations, these are the most critical questions you should be asking.



Niall Browne, Senior Vice President and Chief Information Security Officer, Palo Alto Networks

The CISO's shift from primarily defensive triage and toward proactive offense has created a learning curve for directors accustomed to asking questions about reactive measures. "It's been a process, I'd say in the last five to 10 years, to get the board to understand that the questions they should be asking are quite a bit more about how are we securing our products and services? How are we getting this right from day one?" said Erinmichelle Perri, CISO for The New York Times.

Along those lines, the panelists recommended boards prioritize the following questions for their CISOs:



Dawn Cappelli, VP, Global Security and Chief Information Security Officer, Rockwell Automation

WHAT IS OUR "SHIFT LEFT" STRATEGY? It is no longer an option to build products, or really anything inside a company, without considering security from the ground up, said Niall Browne, senior vice president and CISO, Palo Alto Networks, who likened it to building a house without considering plumbing or electricity. "Then suddenly the electrician turns up and says, 'Oh, by the way, we've got a wire here, we're going to rip down the walls.'"

In most operations environments today, trying to update security piecemeal is complicated by "tremendous scale," says Browne. "You've got dozens of clouds. You could have hundreds of thousands of images that are spun up every single second and spun down. It's ephemeral, it's dynamic, it's continuously changing. So if you're using traditional models to go back there and try to fix the issues after they've occurred, it's game over. There's no way anybody can ever keep up."

HOW IS SECURITY BEING ADDRESSED HOLISTICALLY THROUGHOUT THE ORGANIZATION?

Dawn Cappelli, VP, global security and CISO for Rockwell Automation, recalled that after the WannaCry ransomware attacks in 2017, Rockwell realized they had some potentially dangerous silos in their security programs, where manufacturing, products, services and other areas were individually protected. "But we needed to bring all of that together," she said.

To do that, the team developed what it called

the connected enterprise ecosystem cybersecurity strategy. "Big mouthful there, but basically what it means is we have one comprehensive strategy that encompasses the entire ecosystem," says Cappelli. That includes IT, manufacturing, supply chain, third parties, the company's own products, security, M&A partners, services, connections to customers and cloud providers and all third-party software the company uses. "So, when we talk with our manufacturing or supply chain departments about risk in their area, it's part of this comprehensive program," she said.

WHAT IS OUR THIRD-PARTY RISK? The SolarWinds cyberattack—which involved thousands of companies' networks being infected by Russian malware downloaded via a simple software update—made clear that a company's products can be put at risk by any partner company's security breach. "A lot of companies haven't thought a lot about that," said Cappelli, who recalled another recent case of a company's file transfer product being infected with ransomware, which was then downloaded to customers, whose information was then stolen and who were then extorted for its return.

To get the full scope of the risk, Browne recommended conducting a tabletop exercise specifically focused on the supply chain and what the impact might be if attacked. "You want to have at least 10, 15, 20 departments in the room—legal, finance, etc.—and you want to run it from end to end. If there is a compromise, how do you detect it?" Then, consider what would be done in the first 24 to 48 hours to remediate "because that's going to be the most critical time," he said.

Companies that fail to do that end-to-end scenario-planning will wind up trying to come up with a solution during those first hours—and 48 hours can quickly become 72 or 100-plus. "That's a disaster," said Browne, "because you're creating material on the fly."

Rather, the whole team should sit down and figure out exactly what will happen in the event of a breach. What is the canned questionnaire that will be sent to every vendor on the network? Which team is set up in house to deal



Erinmichelle Perri, Chief Information Security Officer, The New York Times

with the responses and do a risk assessment? “Oftentimes, if you have a breach, it’s not the fact that you’ve been breached—because a lot of organizations have been,” said Browne. “It all comes down to how transparent you were, how quickly you responded, how quickly you notify the customers. I’m a huge believer in that transparency, making sure you’re prepared for that.”

WHAT DOES OUR COMPANY’S SECURITY AWARENESS PROGRAM LOOK LIKE? The human element “is always the wild card, the weakest link,” said Cappelli. And that was exaggerated during Covid with everyone dispersed and working from home. “We’ve had to keep security front of mind for them.” To do that, Cappelli’s team makes videos about the latest security-related news, holds monthly security lunch-and-learns with the entire cadre of engineers and invites in outside experts to give talks on relevant topics. “We had an Emmy Award-winning journalist come in and give a talk on social networking security because a lot of these attacks now are coming in using information gleaned from social media activity,” she said. “Our security awareness has never been higher. My goal is, once we get back to the office, let’s keep this online security awareness going.”

WHAT POSITIVE LESSONS HAVE WE LEARNED? Perri noted that being forced to pivot over and over to solve challenges brought on by Covid and remote work stress-tested the system in real time and demonstrated the creative potential of the team. “So, I think really going into 2021, we’re stronger than ever,” she said. “In terms of opportunities here out of chaos, we’re going to see a lot of great lessons learned.”

She also emphasized the need for both management and the board to keep in mind the toll this past year has taken on IT employees. “The workforce is burnt out” after Covid, Perri said. “We need to keep the human element in mind. We need to be flexible, empathetic, meet employees where they are.”



RANSOMWARE: AN EVER-EVOLVING RISK

Stats

Ransomware toll
in 2019:

\$11.5 billion

Estimated toll
in 2021:

\$20 billion+

Average cost of
remediating in 2020:

\$761,000

Average cost of
remediating in 2021:

\$1.85 million

Average ransom paid per
company:

\$233,817

Average downtime:

19 days

In March, a ransomware attack against insurance company CNA again illustrated how smaller companies can easily find themselves the victims of a larger hack, if the stolen data is used to extort money from the original target's customers. And the data demonstrating the prevalence of ransomware attacks shows no signs of abating. Since 2016, there have been more than 4,000 cases every day, according to FBI figures. "But that's likely a very low estimate," said Scott L. Howitt, SVP and chief information officer for McAfee. "They're using the stats that were reported to them and in a lot of cases, people don't report it because they don't want the bad press to follow them."

That's understandable—particularly considering the high financial toll this particular cyber crime has taken on targeted companies. Howitt offered steps to mitigate risk:

SEGMENT NETWORKS. Howitt recommends boards ask their CISOs about creating divisions between networks to ensure that when one is infected, the malware doesn't spread as easily to the rest. For example, as CISO of MGM Resorts International prior to McAfee, Howitt worked on segmenting the networks of the casino's hospitality, restaurant, retail and entertainment networks in order to mitigate potential damage to the whole business.

Internet of Things (IoT) applications have made the job of securing all points on the network even more complex, adding new risks, he added. At MGM Resorts, the refrigerator technology allowed temperatures to be regulated remotely. "So now [we had to consider], what if somebody came in and raised the temperature of the chicken, so now suddenly I've got poisoning risks, and it's a life safety issue instead of being a data leakage issue."

IDENTIFY THE POTENTIAL THREAT ACTORS.

While active monitoring for potential attacks is critical, it's not enough. Your CISO should be able to identify the bad actors most likely to target the company and then ask what they are doing proactively to prevent those attacks. "Because that's one great thing about threat actors—they're not very inventive," said Howitt. "They only have to get it right once or twice, so they throw an attack against 1,000 people and if one or two catches, it's worth the money."

MAKE SURE THERE IS A COMPANYWIDE PREVENTION/AWARENESS PROGRAM—INCLUDING THE BOARD. Most malware is spread initially through a

phishing email sent to an employee with network access, which is what happened to CNA. "They had a very robust cyber program, but that's the trick—it only takes one click for something bad to happen," Howitt said.

MAKE SURE SECURITY IS BEING ADAPTED FOR THE FUTURE. Most security people grew up primarily in a physical network environment, said Howitt. As companies go to the cloud and transition to a software-based world, how is your CISO retooling the security organization to adapt? To that end, he or she should be having conversations with all the company's business owners—not just internally with the security team. "It's okay to put your CISO on the spot and say, 'So, as the world changes to a network-based world, tell me what you know about the business. How are you adapting that to meet the strategy?'" he said. "If the CISO isn't thinking about it in terms of business strategy, it's checkbox compliance. That will get you past the audits, but it won't necessarily keep you secure."

TO PAY OR NOT TO PAY?

To be sure, ransomware attacks only thrive in a world where victims pay the ransom. But whether or not to pay is an age-old question without a clear-cut answer. "It's easy to be morally right and say you should never pay, but it has to be a business decision," said Howitt. Factors will include the ransom amount, the files that have been targeted, the cost to the business of having files stay locked, etc. According to the latest data, only 26 percent of firms pay, and that may be because their cyber insurance firms require it.

"From an actuarial standpoint for them, it's cheaper if they just hurry up and pay the ransom and take the chance of getting the attack over with," said Howitt. But he points out that payment does not guarantee the return of the data that was stolen. "It's always a very dicey proposition to pay them off because they might not unlock your files, and they'll just take your money and run."

Howitt recommends conducting a tabletop exercise that looks in detail at the potential impact of a ransomware attack on each area of the business. "The frequency of tabletop exercises should be every quarter," he said. "And it doesn't have to be a full day. You can accomplish a lot in an hour or two. It should be a very specific scenario."

"The ask is, what we need to do, and then is it working? Should we do more or less? Kill it? The data-driven decision is becoming more and more important."

WHAT ISS THINKS ABOUT YOUR CYBERSECURITY OVERSIGHT



Mark Brockway, Head of Corporate Solutions, ISS

Cybersecurity ranked first on the list of concerns for 67 percent of investors, according to the 2019 RBC Responsible Investing survey. That number isn't likely to decrease, given the escalating costs to companies. The annual economic cost of cyber breaches is estimated to run as high as \$1.5 trillion, according to Marsh & McLennan's Cyber Risk Center. And, in addition to the \$8 million direct cost, on average, to U.S. companies, the indirect costs, including reputational risk, stock price performance risk and litigation risks—the last evidenced most recently by a recent class-action lawsuit against SolarWinds—are enormous.



Marija Kramer, Head of ESG Analytics Business, ISS

Among ISS's Russell 1000 constituents over the past four years, almost all sectors were negatively affected when it came to financial returns post cyber breach. "Investors care about cybersecurity for many reasons, but most importantly because it can really impact the bottom line," said Marija Kramer, Head of ISS ESG Business.

As the investor community attempts to quantify cyber risk across its investments, many rely on ISS's Governance QualityScore to help assess and benchmark boards' information security risk oversight. Here are some key indicators ISS is looking at on behalf of investors:

1. TRANSPARENCY. ISS looks not only at whether companies are providing disclosure related to cybersecurity risks but also at the quality of that disclosure, said Mark Brockway, head of corporate solutions at

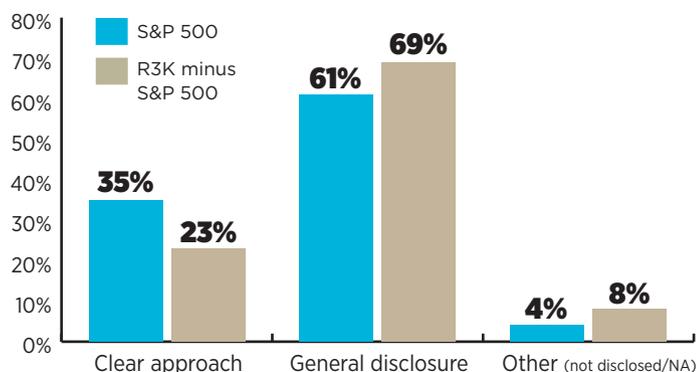
ISS. "So, is it more general in nature or do they have what we call a 'clear approach'?" A clear approach means a detailed discussion of the information security risks specific to the company and the strategies to mitigate this risk, Brockway explained, noting that while more companies are disclosing, few are taking a clear approach. (See chart, below.) Kramer added that investors want to know the expected costs of a potential breach so they can factor that in.

2. A COMMITTEE TASKED WITH OVERSIGHT. "That committee can either be on a standalone basis or part of an existing committee, oftentimes audit," said Kramer, who noted that a little more than three-quarters of the S&P 500 now have this in place. She added that there is also evidence that investors are going to hold portfolio companies to outside standards and assurance of their policies and practices being monitored by an ISO or other standard setter.

3. BOARD EXPERTISE IN CYBERSECURITY. This is becoming increasingly common among larger-cap companies. ISS found 92 percent of the S&P 500 and about 55 percent of Russell 3000 companies have three or more directors with information security expertise. "This is quite prominent in certain sectors where exposure is more significant," said Kramer, "but it's really front and center to the needs of investors is they're doing their assessments and looking to engage with portfolio companies."

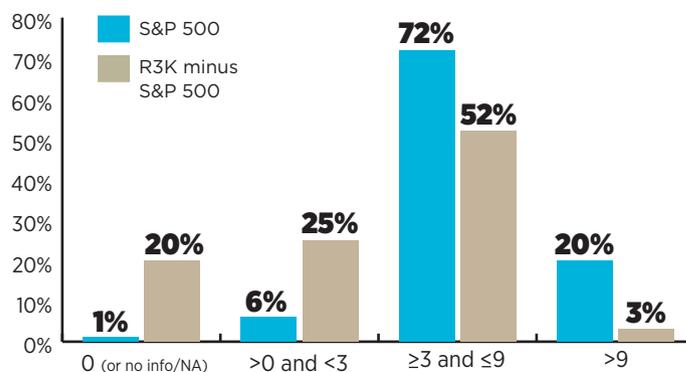
STILL LACKING CLARITY

Most U.S. companies are disclosing general information about information security risk, but few are taking "clear" approaches, which would include a detailed disclosure of risks and strategies to mitigate them.



CYBER EXPERIENCE ON BOARD

Most boards have information security expertise, which ISS defines as either the company disclosing that directors have these skills or that directors' experience suggests skills in this area.



Source: ISS Corporate Solutions Governance QualityScore data for factor Q402-412. Data as of March 2021.

GETTING CYBERSECURITY OVERSIGHT RIGHT

It's complicated, overwhelming and seemingly impossible, but directors can play a critical role in staving off and recovering from cyber events. Here's how.



Melissa Hathaway,
President, Hathaway Global
Strategies

By now, we're all a little cyber fatigued. The names of cyber attacks and the high-profile companies victimized by them appear in headlines with such regularity that infiltration feels inevitable. At the same time, intensifying regulatory requirements demand that boards remain vigilant about safeguarding data.

The good news? Understanding four types of risks and what can be done about them can help directors vet a company's cyber practices, says Melissa Hathaway, the former head of cyberspace policy review for President Barack Obama and the former leader of President George W. Bush's National Cybersecurity Initiative. Her breakdown:

TECHNOLOGY RISKS

As a board member, you don't need a deep understanding of technology to ask questions that can help your company strengthen its defenses. One area to check is your technology debt, or how much of your hardware and software is outdated and no longer supported by the provider.

"If you've got no way of keeping the systems current—no patching cadence—your systems are 100 percent vulnerable, 100 percent of the time," notes Hathaway. "So, how are you managing that risk, and what is your timetable for a capital refresh? Those are board-level discussions."

OPERATIONAL RISKS

Boards also need an understanding of which assets, services and data that might be compromised in an attack are most critical and how quickly the company will be able to recover them. Topping most lists is the active directory, a frequent target of malware.

"The active directory is essentially the Rosetta Stone for what employees are allowed to do in your company," says Hathaway, who says part of the recent SolarWinds hack involved infiltrating active directories to create new personas, then escalating their privileges to gain data access. "Companies can mitigate that risk by keeping an up-to-date active directory offline."

LEGAL RISKS

Staying on top of a constantly evolving regulatory landscape is also critical, particularly for global companies operating in countries with increasingly strict requirements. "If you operate in Russia or China, for example, you have to allow those governments to put their equipment on your infrastructure," says Hatha-

way. "And the definition of personal protected data is much broader in certain places—Brazil and California—than others."

Given the penalties running afoul of mandates can incur, directors should be asking for regular briefings about compliance across all jurisdictions in which a company operates in areas like data protection, data privacy and breach reporting requirements. It's important to acknowledge that some requirements, such as accommodating content takedown requests or continuity of service requirements, will apply more to some businesses than others, as well as that meeting them all may not be feasible.

"Then it becomes, what's our risk appetite?" says Hathaway. "Do we want to change the technology, change the way we operate, or maybe even rethink being in that market if the revenue doesn't justify the risk?"

FINANCIAL RISKS

Often intertwined, technical, operational and legal risk all lead to potential costs. Companies may need to devote funds to upgrading cyber insurance policies, invest in replacing outdated systems in order to enable regular security updates or boost liquidity to cover the cost of an inevitable eventual event. Europe's General Data Protection Regulation (GDPR), for example, allows the EU's Data Protection Authorities to issue fines of up to €20 million.

Cyber risk assessments of target companies should also factor in M&A valuations. "Consider what happened to Marriott, which really should have treated Starwood as a tainted asset when it had a major breach during the deal process," says Hathaway. "They went ahead and integrated anyway, and the second breach ended up incurring one of the largest GDPR fines plus class action lawsuits."

Directors don't need to be technology experts to help companies strengthen their defenses in these three areas. Rather than a deeply technical conversation, the board's approach should be holistic, asking: What do we, as a company, need to do from a technological perspective to mitigate risks of delivering our product or services in the markets we're in?

"Then, for the risks we can't mitigate, the question is, 'What are we going to do to manage through them, whether that's recovery planning, insurance or a reserve on the balance sheet?'" says Hathaway. "Boards just need to tackle it in a comprehensive and intelligent way."

—Jennifer Pellet

MAKING DATA PRIVACY A COMPETITIVE DIFFERENTIATOR

Companies that falter on data privacy practices risk running afoul of regulators—and missing an opportunity.



Myrna Soto, Board Member, CMS Energy, Spirit Airlines and Popular Inc.

Technology permeates every aspect of life today, creating a staggering amount of data on a daily basis. In the course of regular operations, your company is probably collecting vast quantities of information while engaging with stakeholders, from customers and suppliers to employees and shareholders.

The number of risks associated with that new reality are vast and growing. Data misuse or unintended disclosure can bring erosion of customer trust, loss of business opportunities, and reputational harm. Further complicating matters, the concerns over the sheer amount of data being amassed coupled with the frequency of breaches are also prompting a rash of regulatory activity, as states and nations rush to address data privacy concerns through legislation.

BREACH FATIGUE

“For a while there was a little bit of breach fatigue, where people were quasi-numb to the headlines about the data elements out there in the wild that had been breached,” Myrna Soto, a board member at CMS Energy, Spirit Airlines and Popular Inc., told directors gathered for a panel discussion sponsored by the cybersecurity advisory firm Coalfire. “But what’s happening now is our legislators and regulators are starting to look at not only what corporations are obligated to report, but their obligations regarding managing data protection and data privacy. We’re seeing very aggressive regulatory movement.”

“It seems like every week we get another news blast that a new data privacy regulation has been proposed at the local, state or country level,” agreed David Forman, vice president of privacy & international assurance at Coalfire. “More than 25 states have already proposed or passed legislation around data privacy. Most of our clients are caught in a mode right now where there’s an evolving regulatory landscape and the rules are changing on them constantly, while they also have to meet the [data] needs of sales, marketing and other internal interested parties.”

In the absence of a federal standard, complying with the pockets of varying data protection and privacy requirements popping up across the U.S. will be challenging. However, there’s also an opportunity for companies to stand out from their peers by taking proactive steps toward handling more data responsibly, notes Forman. “It’s important for consumers generally to be able to look at a company and say, ‘Hey,

they’re doing things the right way. Whereas, if action is only happening when there’s a bad news cycle or an investigation by the FTC or DOJ, then that’s going to [generate] distrust toward that company and their products.”

Already, corporate leaders on privacy are emerging. Soto, who is also chief strategy and trust officer at Forcepoint, urged board members to take note of Apple’s privacy initiative to remove apps that track consumers data without their permission from its app store. “That’s important to boards because most companies have a digital presence, some type of app of their own, and we as board members should understand, what are we doing with that data?” she said. “Why are we tracking it? And probably most importantly, are we advising our consumers of what we’re doing—and making sure there is an opt in versus just an opt out? Those are brand-protection perspectives you may want to think about in the boardroom. How are we protecting the company’s brands from an unfortunate incident or deterioration of confidence?”

Directors should also be aware that data privacy protections call for consumers to be able to change their minds about the permissions they grant. “We have an obligation to make sure that if we collect data on preferences from a particular customer’s activities, the customer has the right to say, ‘I want you to forget about that,’” said Soto. “You can also put yourself in a liability situation if you don’t understand how a third-party processor of your customer data is accessing certain data elements. Those are some of the scenarios you need to think through and address when you look at data analytics.”

For many companies, the top challenges are collecting enough data to deliver a tailored experience without overstepping customers’ desired level of data privacy, managing that data responsibly and having the ability to adapt when that level changes. On the plus side, as privacy concerns continue to gain momentum, such diligent data privacy practices will pay off.

“As companies get comfortable saying, here are all the things we’re doing in security and privacy, you’ll see consumers will gravitate toward that,” said Forman. “This is a profound opportunity for reputation building going forward.” **CBM**

—Jennifer Pellet



David Forman, Vice President of Privacy & International Assurance, Coalfire

THE NEW RULES OF RISK

No one knows exactly what lies ahead—but you can still prepare for it. **BY C.J. PRINCE**



“

It's not, how do you assume a better fetal position so you can withstand the next outrage, but how can we dominate environments like this?"

—Gen. (Retired) Charles Jacoby

ONE THING IS CERTAIN coming out of 2020: The global pandemic and recession will be followed by new challenges in the years to come—and if the past year-plus has taught boards anything, it's that they have to find better ways to forecast those financial and non-financial risks and opportunities. As the world slowly returns to some semblance of normal, boards are engaging in some fundamental introspection about how they could have been better prepared, and how to best anticipate what might still lie ahead.

“The very first question on the minds of every board and every executive team is, how are we conceptualizing this ‘new normal’?” says Leo Tilman, author of *Financial Darwinism*. “There are so many moving parts, and one of the key questions is, what are the changes—in the market environment, in consumer behaviors, in the B2B landscape—that are permanent and which ones are transitory. A lot of conversations about strategy and big-picture pivotal decisions are based on the answer to this question.”

But given the many new risks facing companies, including the proliferation of cybercrime, the heightened focus on ESG and the reputational and brand risks in the era of cancel culture, boards must work with management to find opportunity in the uncertainty. “It's not, how do you assume a better fetal position so you can

withstand the next outrage, but how can we dominate environments like this?” says General (Ret.) Charles H. Jacoby Jr., Fifth Commander of United States Northern Command and the 22nd Commander of North American Aerospace Defense Command, who spoke recently at *CBM's* annual Board Risk Summit.

To do that, boards have to resist spending too much time focused on the past, says Evelyn Dilsaver, director with Tempur Sealy, Health Equity and Ortho Clinical Diagnostics, who recommends looking at the headlines of negative events happening to other companies “and really peeking around the corner to see what risks are not being covered, whether broadly through the company or within the committee structures.”

Jacoby, who, with Tilman, coauthored *Agility: How to Navigate the Unknown and Seize Opportunity in a World of Disruption*, offers a military lesson directors would do well to heed: “We're brought up to believe that the worst thing we can do is to be planning to fight the last war and not the next war.” He says the military does three things well—and which companies need to do better at—to forecast risk:

1. Intelligence. While information overload is certainly real, the data companies really need about clients, competitors and the market are not always readily available, which is why Jacoby and Tilman coined the phrase, “Fighting for risk intelligence,” says Tilman, “to emphasize that this is a very concerted, proactive process and you need to commit resources and orient everybody to that.”

2. Planning. Boards and executives realized the deficiencies of traditional corporate planning processes when they had to redo their strategic plans weekly between March and June of 2020. “They were literally redesigning and re-estimating their strategic plans, which told us that not only their baseline assumptions could have been wrong, but there was no contingency planning around it.”

3. Practice. Like tabletop exercises, war-game simulation looks at the reper-

cussions of a particular scenario to help quantify risk—but goes a step further, putting participants in role-playing positions and testing the robustness of their assumptions and the consequences of their decisions. A critical tool for military preparedness, war gaming works best when the goals are very clear from the outset. “One good way to look at this is where are there critical relationships between levels or between silos or between the lines of business where I need to make sure that we are linking arms with capability and have clarity in our strategic alignment and in how we are going to respond purposefully,” says Jacoby.

WHO OWNS THAT RISK?

One key way boards can improve their risk oversight is by ensuring that they not only have the appropriate risks on their radar, but also that the right committees or directors are responsible for monitoring them. For some companies, that means establishing a separate risk committee, says Agnes Bundy Scanlan, director with Truist Financial, NewTower Trust and AppFolio. “Obviously, it depends on the institution and their strategy and mission, but I do believe in a separate audit and risk committee.”

The two committees approach risk with very different lenses—one backward looking and the other forward, says Joseph Prochaska, Jr., director with Synovus Financial. “Audit committees also tend to focus on a set of rules: Are we in compliance with GAAP? Are we in compliance with Sarbanes-Oxley and the different control mechanisms? Whereas risk tends to be more freeform from the standpoint of, what should we be concerned about?”

The risk committee can also focus more on forward-looking opportunities and not just the dangers ahead. “So, that’s how do you use risk to your advantage?” says KPMG partner Jackie Daylor, who adds that if a board does have a risk committee, it needs to beware of thinking that all risk is owned by a single committee. “It’s so important to continue to play a team sport as you look at board structure and how the committees work together.”

For small and mid-cap companies, where the board is seven or eight direc-

tors, it may not be an option to carve out a separate risk committee, says Dilsaver. “So, audit just has to do both jobs.” She adds that nonfinancial risks are divided along ESG lines, with environmental discussed at the full board level, social risks monitored in the compensation committee and governance in nom/gov.

Those relatively small boards can also appoint one director to be the resident expert for one specific risk, says Dilsaver. “Cybersecurity, for example—the board needs to make sure [that director] has the resources to be able to talk about it intelligently within the board meeting because most of us did not grow up with that stuff. Even knowing the right questions to ask when you’re sitting in the boardroom is really important—and then hearing the answer and knowing it’s a legitimate answer.”

If the expertise doesn’t currently exist on the board—and often, even if it does—it might make sense to bring in outside experts to educate at the committee level, says Scanlan. “Then, they can help educate the rest of the board.”

RISK MANAGEMENT IN REAL TIME

While boards may be getting better at anticipating and reacting to crises, these dramatic events now play out in real-time, at warp speed and in full view of activist investors, online campaigns and citizen journalists, who are all too ready to call the company, and the board, out. Add to that the expectation that companies will take a vocal stand on political and social issues and things get even more challenging. “This is going to be the issue *du jour* of 2022,” says Richard Levick, a guru of crisis communications, who offers the following advice to boards:

1. Take a lesson from Delta. Ed Bastian, CEO of the Atlanta-based airline, made an initial statement praising aspects of Georgia’s new and very controversial voting rights legislation. But after he and the company were pilloried on social media, Bastian released a new statement, this time a forceful condemnation of the law. “In the second pronouncement, he was very Martin Luther King-ish in terms of his messaging,” says Levick, adding



Even knowing the right questions to ask when you’re sitting in the boardroom is really important.”

—Evelyn Dilsaver, Director, TempurSealy, Health Equity and Ortho Clinical Diagnostics

that the first response was likely initiated by public affairs or legal—which failed to accurately gauge how the wider public would receive it.

2. Understand perception is everything. If Delta had understood the way its response was being perceived, “if they had had a diversity officer involved, if they had had brand more heavily involved, I guarantee you, they would have looked at the Georgia legislation differently, at least in terms of their public pronouncements,” says Levick. “We have to blow up our silos. Silos have worked for 70 years—HR, GR, PR, legal, all separate—but that’s not how your critical audience looks at things. They see the interconnectivity of all this.”

3. Use your peace time wisely. When your company is not under attack, that’s when management and the board should be looking at crises happening to other companies and study what they’re doing. “You see American Airlines, you see Dell looking at what’s happening to Delta, and they’re saying, ‘How do we get ahead of this?’ That’s your laboratory.” **CBM**



BRIDGING THE DIGITIZATION & CYBERSECURITY DIVIDE

In pursuing the opportunities technological advances bring, boards must also navigate new vulnerabilities. **BY JENNIFER PELLET**

Across industries, how well companies fare over the next decade will depend largely on their ability to embrace transformative technology. Advances in areas like artificial intelligence, machine learning and cloud migration are driving the evolution of virtually every business model, as companies scramble to leverage the myriad capabilities they offer.

But the rewards of winning the digitization race—improvements in speed to market, customer experience and operating efficiencies—come with a caveat, noted Nazif Sharique, partner, technology and risk consulting at RSM US. “This uptick in the emergence of digital transformation can really elevate your risk profile in terms of cyber threats,” Sharique told directors gathered for a recent *Corporate Board Member* roundtable discussion hosted in partnership with RSM. “As your company becomes more technology based, there’s a need to calibrate heightened vulnerability into your digital landscape.”

For boards, the idea of assessing and addressing cybersecurity risks associated with technology during the transformation process represents a formidable challenge, agreed several directors participating in the discussion. “On the boards I serve on, the two areas are siloed,” said Cynthia Hostetler, a director at Vulcan Materials and Resideo Technology. “We talk about cyber when we talk about security, which includes physical security, not when we talk about AI.”

While the audit committee traditionally owns oversight of cyber-related risks, more and more boards are rethinking where digital transformation and IT-related risks fit into their committee charters. Amneal Pharmaceuticals, for example, created a new technology and risk committee charged with navigating oversight of the area. “The audit committee was covering such a broad definition of risk that the agenda was getting far too long,” explained Emily Peterson Alva, a director at Amneal. “So, in the past year, we created a committee that oversees what we think about as forward-looking and strategic risks, which include things



As your company becomes more technology based, there’s a need to calibrate heightened vulnerability into your digital landscape.”

—Nazif Sharique, Partner, RSM US



When you wake up and see that email or get that early morning phone call, you want to know exactly what the next 24 to 48 hours looks like.”

—Zachary Carroll, Partner, RSM US

like regulatory, security and other technology-related risks.”

Other directors, however, see a danger in relegating a strategic imperative like digital transformation to any one committee. At Regional Management, a risk management committee focuses on the company’s 10 most pressing risks, one of which is cybersecurity, while the full board engages on the company’s broader digital transformation imperative.

“We’re trying to help management define the company we want to be five years from now,” explained Carlos Palomares, a director at the company. “What do we want to be in terms of customer experience? How does digital help us achieve that transformation? How does digital help us compete with some of the new entrants into the field and create something sustainable?”

“Transformation is really something that should be discussed by the full board at every meeting,” agreed John Levy, a director at Washington Prime Group. “Even calling it digital transformation kind of characterizes it as something geeky, segregated into a corner. But transformation goes beyond digital integration; it’s about changing the nature of the business. These are huge massive changes, and if we don’t start seeing and treating them that way now, it will be too late.”

The board can help keep the big picture in focus by pressing management on transformation goals, added Ye Jane Li, a director at Knowles, who says her board holds “strategy days” committed to talking about long-term planning. “If we just do what ISS says, just focusing on quarter to quarter, we’ll do fine on paper, but we’re missing the point,” she said. “Every company is a technology company today. So, the challenge is making sure the company is still on top five years down the road. What’s the landscape? Why does the management team think we’ll be the winner in three to five years? And how do they get there?”

THE PEOPLE FACTOR

Risks related to digitization extend beyond cybersecurity, noted Levy, who pointed out that many companies may find their transformation efforts thwarted by a dearth of

technical talent. “Getting qualified, talented people is going to be a real problem for companies as we move further along. Will we be able to recruit or train to fill that need, or are we going to have a bottleneck where we all want to do something but there aren’t enough qualified people to help us do it?”

Companies that also face a lack of technical acumen in the boardroom should consider taking steps to help directors get and stay conversant with technological developments. Rather than rush out to recruit directors with a tech background, outside experts can help bridge technical gaps, said Jim Hunt, director at Brown & Brown.

“I’m not in favor of picking singularly focused board members,” he said. “Every one of us is probably getting asked about ESG experts on our board right now, but where does that stop? Board members need to look at things broadly. In an oversight capacity you have to think about the company, to be reading every day and not be afraid to ask penetrating questions. And, if you feel that you’re out of your depth, you go buy some expertise as a board.”

Doug Curling, a director at CoreLogic and Progressive, is comfortable with that approach. “With the companies I work with, it’s par for the course to have a presentation by an outside cyber expert, so we’re not solely relying on ourselves, not solely relying on management, on our customers or on our outside accountants,” he noted. “We’re bringing in specialists who come and talk to all of us about their assessment of how we’re doing and what we should be doing versus where we are today. We also track very carefully the security investment and the cyber investment because it’s an increasing percent of our operating dollars.”

Regular engagements with members of the IT team are also key. “You have to bring not only the CTO and the head of IT but also the people under them to make presentations on a regular basis to the board and the committees,” advised Levy, who also recommends informal engagements with technical talent. “Invite them to lunch or a board dinner because those less structured interactions are where you really get a sense of people and what they’re doing.”

VETTING THE CYBER SPEND

Deciding how much to spend on cybersecurity and how to deploy it is another area where boards, which well know that no amount of cybersecurity can entirely eliminate risk of a breach, may opt to seek input. Several directors reported relying on benchmarking their investment against industry peers. "It's difficult because the amount of money spent does not always equal the quality of the results when it comes to cybersecurity," said Li. "So, if we spend way more or way less than our peers, we want to hear why. Benchmarks are very important to us."

Alan Howard, a director at Movado Group, advocated devoting a significant amount of cybersecurity resources to workforce education. "The real risk is people clicking on an attachment or risks related to the new remote working environment," he said. "So, we look to make sure that people way down in the organization know that a small footfall could cause a large problem at the corporate level."

For Palomares, emphasis has shifted from prevention to recovery. "We now accept that fact that we're going to be infiltrated, no matter how much we do. So, we're spending an increasing amount of time on how we will respond after we're

penetrated. Making sure we know what we need to deploy is now part of the tabletop exercises that the boards I'm associated with require from management."

Bringing in an outside company for an objective evaluation can help boards vet a cybersecurity program for gaps. "Someone who knows the space well can poke holes, challenge assessments, help you get a holistic perspective and, at the end of the day, to form a comprehensive response plan," notes Zachary Carroll, partner, central financial services leader and practice leader at RSM US. "Because when you wake up and see that email or get that early morning phone call, you want to know exactly what the next 24 to 48 hours looks like."

If companies learned anything from coping with the pandemic, it was that preparation pays off. Efforts to build resiliency, the ability to adapt and thrive through setbacks, positioned companies to overcome an event no one foresaw last year, noted Levy. "The biggest takeaway from all the events of the past year is that we can do all the risk assessment we want, but no matter how careful we are, the world is going to change and we have to be agile enough to change with it." **CBM**



In the past year, we created a committee that oversees what we think about as forward-looking and strategic risks, which include things like regulatory, security and other technology-related risks."

—Emily Peterson Alva, Director, Amneal

ROUNDTABLE PARTICIPANTS

ZACHARY CARROLL

Partner, RSM US

DOUG CURLING

Board Member, CoreLogic,
Progressive

HILLIARD EURE

Board Member, MarineMax

JOHN HARRISON

Board Member, i3 Verticals

CYNTHIA HOSTETLER

Board Member, Vulcan Materials
Company, Resideo Technology

ALAN HOWARD

Board Member, Movado Group

JIM HUNT

Board Member, Brown & Brown

JOHN LEVY

Board Member, Washington
Prime Group

YE JANE LI

Board Member, Knowles Corporation,
Semtech and CTS

BRENDA NEWBERRY

Board Member, Spire

CARLOS PALOMARES

Board Member, Regional Management

EMILY PETERSON ALVA

Board Member, Amneal
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NAZIF SHARIQUE

Partner, RSM US

MARIBETH RAHE

Board Member, Consolidated
Communications, First Financial Bank

JOHN SCHMIEDER

Board Member, Mesa Labs

MYRNA SOTO

Board Member, CMS Energy, Spirit
Airlines, Popular

RISK WORK

Black Swan threats may be inescapable, says Gen. Stanley McChrystal, but your ability to move through them—and thrive—is very much in your hands. The trick is building a strong Risk Immune System. Here's how.

BY DAN BIGMAN

It started when a tourist flew home to Chicago from China. He was 52 and in decent health, but deep in his body a virus was quietly killing his respiratory system. Within days of his arrival in the U.S., this unknown illness was spreading among people he'd encountered. In just weeks, hospitals around the country were being overrun with patients experiencing chills, fevers, coughs—and dying.

But the worst was yet to come. The nation's medical supply chain failed. Lacking key protective gear, doctors and nurses contracted the still-unknown virus. Badly structured federal response systems and poor communication from Washington squandered any opportunity to track and contain the pandemic before it overwhelmed the country.

Just a few months later, this new virus had infected more than 100 million Americans and killed nearly 600,000 of them—far more than all the U.S. soldiers, sailors, Marines and airmen that died in combat during World War II.

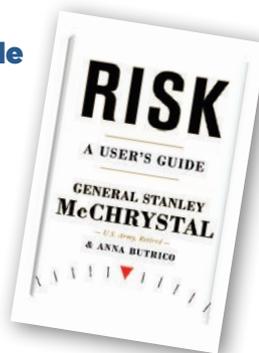
If you think you recall these events, you're wrong, writes Gen. Stanley McChrystal in the opening to his fascinating and useful new book *Risk: A User's Guide*. This isn't Covid-19. It's actually the outcome of a Department of Health and Human Services exercise called Crimson Contagion. Played out in 2019 to test the ability of the United States to react to the early stages of a serious pandemic, "its results were as alarming as they were conclusive," writes McChrystal. "Our nation was woefully underprepared."

For anyone who has lived through the last two horrible Covid years, the idea that the country had studied the potential for a viral pandemic and not heeded the warnings of what might happen is frustrating, and disappointing. For McChrystal, the retired four-star general who, most famously, ran all operations during the "surge" in Afghanistan after spending most of his professional career enmeshed in some of the riskiest situations imaginable, the outcome may be both of those—but it shouldn't be surprising.

It simply illustrates what happens when an organization—in this case, a nation—fails to strengthen the key systems, processes and structures required to remain resilient in the face of an increasingly unsettled world—and lacks the leadership required to maintain those systems. In the face of threats like Covid, or a million other potential risks to our businesses or our country, "we can blame outside threats all we want, but there is much we can do to prepare for them—often far more than we care to admit," says McChrystal.

LIVE EVENT / Risk: A Modern Leader's Guide

Gen. Stanley McChrystal will host an interactive online workshop based on his book *Risk: A User's Guide* on Thursday, February 3, 2022. Tying together his life's work exploring the essentials of leadership and risk management across centuries, he'll challenge you and your management team to build a stronger, more resilient organization—and run it more effectively. Join us: chiefexecutive.net/generalmcchrystal





That's the key idea in his new book. Rather than try to create foolproof plans for every imaginable scenario you might face, McChrystal lays out the case for building a hearty "Risk Immune System" comprised of 10 operational elements that, when maintained and improved, will make your organization more resilient than a dozen underground bunkers filled with dusty contingency binders. There's also a good chance it will make

your business run faster, smoother and with far-greater esprit de corps than ever before.

"This is a really good measure of how you can look at an organization," says McChrystal, who has served on the boards of JetBlue, Navistar and Deutsche Bank NA. "I think the board should be able to get enough information from management so they get a sense of the 10 Risk Control Factors. Are we healthy in

these 10? If something really goes badly, I am 99 percent of the time sure you're going to go back and find one or more of these badly lagging."

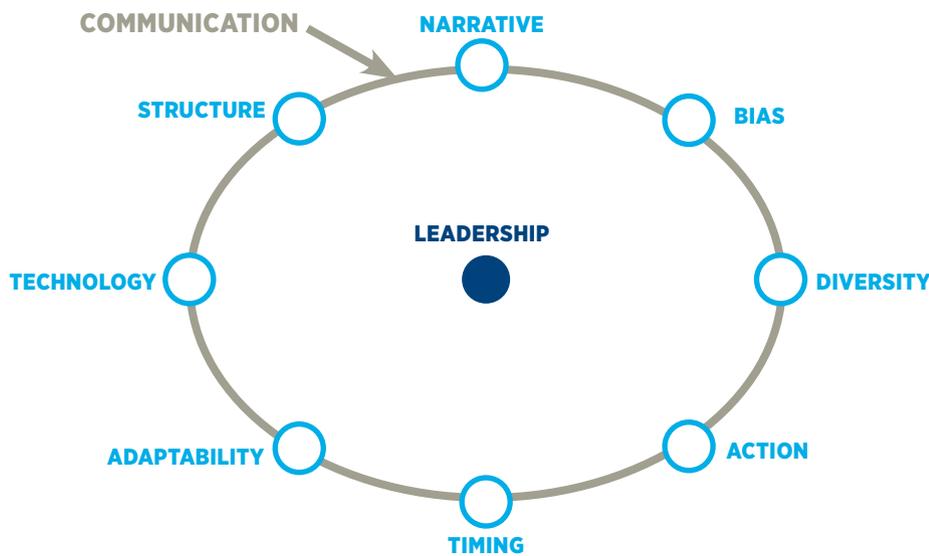
THE RISK IMMUNE SYSTEM

The key metaphor of the Risk Immune System came to McChrystal while studying HIV/AIDS with Dr. Kristina Talbert-Slagle, a Yale immunologist who saw parallels between the human immune system and counterinsurgency operations in the military. While most of us might recall this decades-long scourge as a deadly disease that killed tens of thousands, the reality is that people don't die of HIV/AIDS. They die of other illnesses that attack once HIV has destroyed their body's ability to fight infection.

Organizations have the same issue, McChrystal realized. Problems—whether societal in scope or simply the unexpected loss of your single best customer or some other nightmare scenario—are as inevitable and mundane as germs on your sink. What makes them dangerous—deadly even—is your inability to react effectively to the threat. Why? Problems with what he calls your Risk Control Factors, the 10 operational areas that comprise the Risk Immune System: Communication, Narrative, Structure, Technology, Diversity, Bias, Action, Timing, Adaptability and, at the heart of it all, Leadership.

"About 80 percent of what you do in a crisis is the same, whether it's a natural disaster, a cyber attack or a financial crisis," says McChrystal. "You have to communicate clearly. You have to have a solid narrative and align your organization on it. You have to overcome inertia and act. You need to act at the right time. You need to avoid blind spots with diversity and overcome your biases. You have to tie all that together with leadership. So, about 80 percent of what you do are basics, and then you add in those things that are unique to that particular threat, whether you're dealing with a flood or a cyber attack."

So what are the elements, and how do they work together? We asked McChrystal to help us understand the essentials of a healthy—or compromised—Risk Immune System.



The Risk Control Factors

Rather than try to build contingency plans for every potential eventuality, Gen. Stanley McChrystal prescribes building a strong Risk Immune System, where each of these Risk Control Factors—all of which are very much in our control—are strengthened and maintained.

COMMUNICATION. How we exchange information with others

NARRATIVE. How we tell others about who we are and what we do

STRUCTURE. How we design our organizations and processes

TECHNOLOGY. How we apply machinery, equipment, resources and know-how

DIVERSITY. How we leverage a range of perspectives and abilities

BIAS. How the assumptions we have about the world influence us

ACTION. How we overcome inertia or resistance to drive our response

TIMING. How when we act affects the effectiveness of our response

ADAPTABILITY. How we respond to changing risks and environments

LEADERSHIP. How we direct and inspire the overall Risk Immune System

COMMUNICATION

Central to everything is the ability to communicate—which requires four things: working physical infrastructure, a willingness to pass along information or engage in communication, a high-quality message that is accurate and not misleading and a respondent who is willing or able to listen and digest the message.

If any one of these areas is deficient in your organization, due to anything from broken technology to office politics, then you'll have a tough time in the face of any unexpected challenge. Because, McChrystal argues, whether you're in combat or business, everything is dependent on the ability to communicate effectively.

"There's no problem in communication that gets fixed and stays fixed," he says. "So the first thing you have to do is understand that there are all these bad communication habits and pitfalls. You've got to establish communications, you've got to put test communications through it, you have to exercise it, you've got to determine that it's working."

While running the U.S. Army's elite Ranger Regiment as a colonel, for example, McChrystal would test how well communication was functioning by putting out policies and then asking privates in the regiment to explain them.

"They'd go, 'Sir, why do we have to wear our underwear on our heads?' And I'd go, 'What are you talking about?' And they'd go, 'We were told.' You find out that by the time it got to them that it was just absurdly incorrect, and yet, they go, 'Okay. The boss said X.' So you have to constantly check that."

He suggests every leader find ways to analyze how well their organization is faring when it comes to the four key points of communication failure. "You have to have feedback loops that do that. You have to force people to understand that they are responsible for the flow of information, that if you have information, you are responsible to make sure other people get it. It's not their responsibility to ask for information that they don't know exists."

NARRATIVE

An often-overlooked part of building resilient teams is the story your organization

Running Through Risks

In *Risk: A User's Guide*, Gen. Stanley McChrystal lays out some exercises to strengthen and maintain the Risk Control Factors, including:

ASSUMPTIONS CHECK. While planning, get together and have all "stakeholders reflect on what they expect (not hope) will happen—and understand the impact if their assumptions prove untrue."

RISK REVIEW. Run annually, with quarterly reviews, run through all the risks that threaten the organization most often, including probabilities, consequences, indicators and potential mitigations.

RISK ALIGNMENT CHECK. Different teams examine a potential risk and plot the probability and consequences on an X/Y axis to develop a better understanding of how they're thinking about the issue, hopefully jumpstarting needed conversations across silos.

RED TEAMING. External players are brought in to take an outsider's look at vulnerabilities within the organization—and game out how they might be exploited.

PRE-MORTEM. Faced with a big decision or a potential risk, pull together a "focus group-like session" of stakeholders and ask them to speculate about what could go wrong.

tells about itself. "The narrative is extraordinarily powerful because it drives what we try to do, what we try to be, how we self-identify," says McChrystal. "It's got to do with inspiration and cohesion. If we have a narrative that we believe we are a band of brothers doing something honorable and bravely, we just perform differently."

A great example, says McChrystal, is the Marine Corps motto, *Semper Fidelis*—always faithful—an idea drummed into each Marine from the day they join up, giving them a shorthand for what's expected in that culture. Google had an equally potent motto—*Don't Be Evil*—at the core of its culture for years, but, says McChrystal, they ran into trouble when many in the organization felt the company's dealings with the Pentagon betrayed this ideal.

"It was perceived to be at odds with Google's stated values, and, therefore,



About 80 percent of what you do in a crisis is the same, whether it's a natural disaster, a cyber attack or a financial crisis."

A New Lens for Leadership?

McChrystal's approach to managing and mitigating risk through the 10 Risk Control Factors can serve as a framework for the job of being a leader at an organization—and, perhaps, what we should be seeking out in potential leaders. What should we be looking for? Here's what he had to say:

"If you have sort of a two-dimensional figure of a leader or a caricature of a leader, where they are tall and handsome with straight teeth and good posture, and all that kind of thing, that doesn't tell you anything. What you need to know is, can they understand the system? Can they understand the organization?"

"They've got to be smart enough to do it, and then they've got to go to school on that, on how the organization works, so they know what has to be put in place to make that effective. Then you've got to put them in places where they learn the skills. A number of different experiences across an organization is really powerful, because if you don't understand what it's like to receive information at this and when you're the person sending it up here, it's harder to do that. So we're looking for people who can do that.

"And then we're looking for people who have the ability to get people to work together. Sometimes it's to work with them, so they've got to treat people a certain way. But it's also to create an environment where you can get two other people talking to each other.

"It's almost like the old depiction of a diesel engine mechanic on a boat. They're all breezy, and they're chewing tobacco. They don't seem very smart. But they know exactly where to constantly adjust that diesel engine so that thing keeps working. I think that's sort of what leaders do now.

"There's still a little bit of inspiration. You've got to be an example. You've got to do all those things. But the real nuts and bolts is to get that thing to work, because if it works, anything is possible."

the emerging problem at hand. Structure really helps with that."

That means everyone has clarity about the key elements that help us understand our place and role in the organization: What's my job? Where do I go? Who's my boss? What are their expectations? How is success measured? What are the procedures we follow?

"One of the principles of counterterrorism is always go after key individuals in the enemy's network and take them out to try to disrupt their structure," says McChrystal. "We're vulnerable the same way."

Of course, the wrong structure can slow decision-making, create rigidity and thwart cooperation. And if it changes too quickly—watch out for restructuring for restructuring's sake—it can be "very destabilizing," says McChrystal.

Signs that your structure isn't working? Unclear roles and responsibilities, duplicated efforts, slow communication and very long chains of approval, ie: "your boss's boss's boss" must sign off on things, as the book puts it. Ask yourself this key question all the time: Does our structure make sense for what we're trying to do and for the environment in which we're operating?

TECHNOLOGY

Like many of the other Risk Control Factors, technology is a double-edged sword. McChrystal is a self-admitted early adapter, buying his own \$4,800 Radio Shack computer back in 1982 to help him better organize and run a platoon. But he's come to realize that every upside associated with technology in our organizations also creates a substantial chance to increase—rather than decrease—risk.

"For every advantage or strength it provides, it provides a corresponding weakness," he says. "If you have something that provides a perfect service to do this function, now you've got a weakness, because you probably no longer maintain the ability to do it without that technology. If that technology breaks or is attacked, then suddenly, you've got a vulnerability—that function is at risk."

He's not talking just about cybercrime. As a director at JetBlue, McChrystal learned how computer-driven scheduling could

people became cynical," says McChrystal. "They said, 'You said don't be evil, but you don't really believe that.' How many times do we see a gap between our narrative and then what we actually do?"

McChrystal counsels working deliberately and continually on honing the story you tell about yourselves to yourselves—and keeping an eye out for signs it is failing, such as cynicism, the "say-do gap" that hurt Google, muddled priorities and tensions that can undermine confidence. While the right narrative can

create a potent ethos to tackle challenges, "when our narrative is misaligned to our purpose, values or strategy," McChrystal writes, "We invite risk into our organization."

STRUCTURE

"Structure gives us predictability," says McChrystal. "It gives us a sense of stability. If you've got structure in an organization, when something is happening in crisis, you know where to go because the structure is clear...so you can focus on

go haywire, with system-wide failures cascading through the company after an unexpected snowstorm pushed crews and aircraft out of position. More recently, the failure of many manufacturers' supply chains over the past year came as a result of their deep reliance on just-in-time delivery. "We are the most connected society in history, and, therefore, we are now the most vulnerable," says McChrystal.

Do you fully understand where and how your organization incorporates technology? To what extent do you rely on automated processes? Who oversees them? Where is your technology vulnerable to malfunction, interruption or outside manipulation? And, increasingly, how do humans interact with all this—where have you substituted algorithms for human judgment?

"You have to do an assessment of every part of your organization where functions occur," he says. "How do we pay people? How do we account for people? And you've got to figure out, therefore, what's our weakness in that? Where can that go badly?" Doing so will not only help you understand your weaknesses and thus potentially mitigate risk, but it will also help you get a much deeper understanding of how your company actually functions—and how it might be improved.

DIVERSITY

In *Risk*, McChrystal makes a powerful—and pragmatic—case for building diversity into all levels of your organization. He absolutely subscribes to the idea that bringing in a more robust mix of race and gender is the morally right thing to do in our society, but there's a more practical reason for doing so: Mitigating the deadly risk of groupthink.

"Diversity is different experiences and perspectives and getting people who actually see the problem in a different way so that you cover the waterfront as effectively as you can," says McChrystal, "which means that first you've got to assemble those different perspectives, and then you've got to give voice to them. You can't just assemble them all in the room and if you've got too-big personalities, you do all the talk, and then the other people that are in the room don't feel empowered to say anything. You're not going to get diversity out of it. The key is you're



If you've got structure in an organization, when something is happening in crisis you know where to go."

trying to eliminate blind spots, you're trying to make sure that you don't get surprised where you don't need to be."

Building the kind of culture where lots of people feel accepted and empowered to speak up can be tricky. McChrystal learned a tip years ago from his boss at the Army's storied 82nd Airborne Division. He told McChrystal to disagree with him publicly—even if he didn't actually disagree with him. "He goes, 'I want you to do that because that's going to make it okay for other people to do that,'" recalls McChrystal. "And he was very intentional about that."

BIAS

Diversity also helps us see the filters though which we, and our organizations, see the world—many of which, psychologists will tell you, may simply be inescapable facets of human behavior. Bias is a hall of mirrors where we often see what we want to see, and, as McChrystal says, "buy what we want to buy."

"In Afghanistan, when I commanded, I requested additional forces from President Obama, got them, and we went forward," remembers McChrystal. "But part of that was based upon was an assessment that we could do certain things. One of those was improve the performance of the Government of Afghanistan. Now, we could improve security. We knew we could, and we did. We could do some economic things. But improving the performance, decreasing the corruption of the Government of

Afghanistan was more of a Hail Mary.

"I thought we could do it. When I look back now, I say, 'If I had been harder on myself, if people had been harder doubting that, it certainly was in question.' It's one of those things where I would have been hard put to convince people that it was 85 percent probability of going through it."

His takeaway from the experience: It's unlikely you'll be able to eliminate your—or your company's—biases. But you can and should be able to identify some of them before you act. Activities such as doing an "assumptions check" and "Red Teaming" can help (see sidebar, p. 35). But building more diversity and inviting a culture where speaking up is prized are essential tools for combating bias and the risk it poses.

ACTION

You'd think this would be an easy one for most CEOs—after all, who doesn't see themselves as a can-do, move-the-needle leader? McChrystal's experience in both the army and private industry has shown the opposite to be true. "Every CEO says they're an action person, and it's absolutely foolishness," he says. "The average one does not want to act at all, because there's personal risk in acting. If an organizational leader takes the organization in an uncharted direction and it goes badly, they're screwed."

This feeds into every organization's natural inclination toward maintaining the status quo. "There are always constituencies for the inertia," he says, which makes us vulnerable to all kinds of risks. "It makes us vulnerable for rationalizing that we are doing something, that we are addressing vulnerabilities or even addressing an emerging threat, when we, in fact, are not doing that."

Symptoms of inaction include slow reaction time to trends, missed chances, contradictory efforts among teams, falling behind competitors and analysis paralysis. Watch out for all of these, says McChrystal—but especially your own bias for inaction.

TIMING

You can do everything right but do it at the wrong time—and fail. Or you can do a lot of things wrong, but at exactly the right time—and

win. That's why, for McChrystal, it's essential to build in systems that help you make decisions and move at a time scale that increases—not decreases—chances for success.

Jeff Bezos is a master at this, says McChrystal. As CEO of Amazon, he would spend tons of time doing due diligence and deliberating on decisions that would decide the future of the company. But other kinds of decisions? Not so much. He'd push people deep within the organization make those decisions quickly, with very limited information—and zero input from the top. He was more afraid of standing still than getting minor things wrong.

"Bureaucratically, it's easier for leaders to wait until the tsunami has hit because then you get this groundswell, 'Hey, we gotta go do something,'" says McChrystal. "Well, of course we do. But how much cheaper would it have been if we'd done it before? And that's what leadership is about."

ADAPTABILITY

Simply put, writes McChrystal, adaptability determines "who survives and who doesn't." It leans on all the other Risk Control Factors and has similar flaws. "The problem with leaders here is that it is safer not to adapt, because you're doing something you're already doing and theoretically people have already approved that, or people before you have done this 1,000 times before. So, nobody's going to get fired for doing what their boss did when they were in their job."

Clues that your organization may be exacerbating risks by being inflexible include lagging behind competitors, being "frozen" by fears of failing, doubling down on approaches that have worked in the past even when circumstances change, an inability to innovate and a sense of surprise at what rivals bring to market.

Pay particular attention to any part of your systems that may restrict your ability to adapt to change, starting with an unceasing preoccupation with efficiency. "Maximum efficiency is usually very brittle," McChrystal says. "Adaptability means you've got the ability to respond to things, which usually means you've got to have some flexibility in the system. You've got to have the opportunity to adapt."



Adaptability means you've got the ability to respond to things, which usually means you've got to have some flexibility in the system. You've got to have the opportunity to adapt."

LEADERSHIP: THE ESSENTIAL INGREDIENT

In the early days of 2020, Boston Mayor Marty Walsh saw Covid arrive in America and, like most of us, was not too concerned. When an infected student arrived in Boston from Wuhan, China, he was quickly isolated. McChrystal, who helped the mayor's response team and tells the story in the book, reports that Walsh was hopeful Covid might be contained there.

When the virus flared in early March, Walsh knew he'd misjudged the situation. The president of the Boston Fed warned him that Covid might mean shuttering schools and businesses soon, as well as cancelling key public events like the Boston Marathon and St. Patrick's Day—political suicide in Boston. Others in the local scientific and medical community concurred.

Walsh and his team were as stunned as thousands of other public officials across the country, but what they did next was very different—and ultimately made a world of difference to the people of Boston and the surrounding area. The mayor listened, and then he acted—quickly.

"He put together this daily crisis response meeting," says McChrystal. "It was really magic."

On video screens run out of City Hall, Walsh and his chief of staff, Kathryn Burton, would bring together an eclectic gathering of stakeholders—not just the city government, but others, like bankers, hospital

administrators and private school leaders.

Each day, they'd figure out what needed to be accomplished over the next day or few days, and by whom. They'd then start each meeting by going around and finding out the status of each assignment. Day after day after day, doing the nuts-and-bolts work of keeping a city of 600,000 people operating and safe through one of the most disastrous episodes in U.S. history.

"Marty was masterful at keeping everybody focused and inspired on this," says McChrystal, who helped structure the setup. "So as a consequence, instead of a bunch of different organizations pulling in different directions, there was a sense that we're all solving this problem together, and we're all getting ground truth every day. It was really impressive. He was willing to make tough decisions, which people knew were politically dangerous. And so I give him extraordinarily high marks for it."

So far, Boston has fared far better than many similar-size metro areas in the country. Walsh was named U.S. Secretary of Labor by President Biden soon after his election.

Walsh's performance serves as a stark counterpoint to the lessons of *Crimson Contagion*—and also a reminder of how essential leaders and leadership are to making our organizations stronger and more resilient in the face of risk. It isn't about charisma or scrambling or pep talks in the face of disaster. It's about staying focused on the key processes that actually make organizations stronger. That's the big takeaway from McChrystal's work—as unsexy, perhaps, as it is vital.

"We tend to look for leaders to provide something few ever really could—salvation from the things that threaten us," McChrystal writes in *Risk*. "But the more constructive analysis would be to acknowledge that the real requirement in the people who lead us is not that status, but actual leadership, or the ability to effectively oversee the multidimensional Risk Control Factors—to turn the dials, so to speak—to enable the Risk Immune System to operate successfully." And help guide our people through whatever comes their way. **CBM**

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Compensation

ESG & INCENTIVE PLANS

What to think about when weighing incorporation of ESG metrics as a component of incentive pay.

RECENT YEARS HAVE SEEN a sharpening of focus on ESG, with key stakeholders growing increasingly vocal about the import of environmental, social and governance matters. Institutional investors and proxy advisors are pressing companies to enhance disclosure of ESG measures they view as linked to long-term performance, even as employees and customers call on the businesses they work for and buy from to step up on social issues like climate change. The Business Roundtable underscored this shift by revising its principles of corporate governance to embrace corporate stewardship, and regulators, too, are joining the fray, as evidenced by the SEC’s recent announcement of new requirements for disclosing material human capital metrics.

The events of 2020 have only served to fuel those conversations, with Covid-19 raising concerns around health and safety

practices and social injustice incidents bringing diversity practices front and center. The cumulative effect is a growing alignment of stakeholders around the need



“ON THE SURFACE, ESG MEASURES MAY SEEM SIMPLE TO INCLUDE, BUT THESE ARE COMPLICATED DECISIONS.”

—Erin Bass-Goldberg, FW Cook

for strong ESG practices and the question of what that means for compensation planning, says Erin Bass-Goldberg, managing director at FW Cook. “More and more companies are having the discussion, ‘Should we be including ESG in our incentive plans to underscore their importance, to reinforce our commitment to them and to hold our management teams accountable for making progress in ESG areas?’”

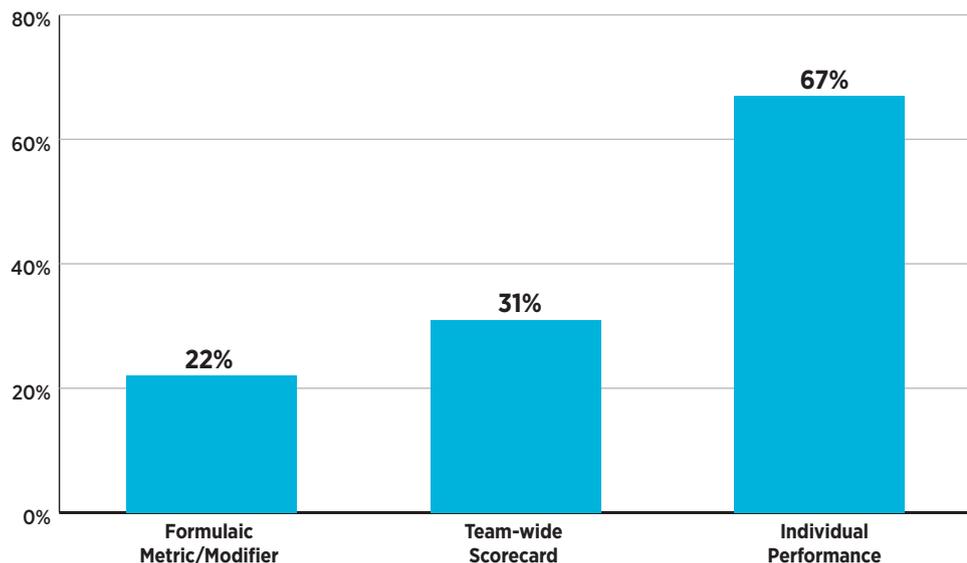
It’s a question that merits careful thought. Incorporating ESG metrics into incentive pay practices is a process rife with hurdles, from potential unintended consequences to challenges regarding goal setting and measurement, disclosure and proxy advisor reaction. Companies that move too quickly may set the bar too high—and risk setting themselves up to miss targets and earn stakeholder ire. “This is an area where we encourage companies

ESG Incentive Plan Stepping Stones

Where you are	What to think about	Example
Defining focus areas	Identifying ESG areas that are expected to contribute to long-term sustainable value creation	Diversity and inclusion
Setting goals or objectives	Evaluating whether the requisite processes/ infrastructure is in place to set outcome-based goals. If not, build out processes that feed into outcomes over time Setting outcome-based goals without the appropriate processes in place may contribute to poor decision-making	Diverse representation within talent pipeline and succession plan A recruiting plan to identify and slate diverse candidates Appropriate expatriate, developmental and training opportunities available to diverse talent throughout the organization
Considering soft launch	Including measurable goals, with discretion to evaluate results	Diversity goals incorporated into performance rating for merit increase (i.e., not directly tied to incentive outcomes), and/or Diversity goals incorporated into individual KPIs or corporate non-financial strategic scorecard (i.e., considered in determining incentive outcomes in non-formulaic way)
Incorporating into incentives as weighted component or modifier	Setting disclosable quantitative goals that directly and formulaically tie achievement to incentive outcome	10 percent of bonus payout tied to achievement of increasing diverse representation among VPs and above to 20 percent or more

How ESG Measures Are Used in Incentive Plans

(prevalence of types of measures among companies using ESG measures)



Note: Prevalence sums to greater than 100 percent because some companies incorporate ESG into incentive plans in more than one way (e.g., use one measure formulaically and another as part of an individual performance assessment)

to walk before they run,” says Bass-Goldberg. “On the surface, ESG measures may seem simple to include, but these are complicated decisions once you start looking at defining your top goals and figuring out how they’re measured.”

Still, many large companies have already embarked on the journey of adopting ESG measures in their pay practices. A recent FW Cook study, *Use of Environmental, Social, and Governance Measures in Incentive Plans*, looked at all U.S.-listed companies with market capitalizations in excess of \$25 billion and found that 56 percent used one or more ESG measures in their annual or long-term incentive plans. However, among those companies, only 22 percent incorporated the measures into formulaic components of their plans. “As far as we can tell, the others used the ESG measures as part of discretionary assessments of individual performance or possibly within a scorecard to measure the performance of the full team,” explains Bass-Goldberg, who coauthored a report on the findings. “Rather than disclose, ‘We moved our diverse representation from X percent to Y percent,’ they may say something like, ‘We improved diverse representation.’”

Size and industry play a large role in

where companies fall along the journey of incorporating ESG factors in incentive plans. Large companies in industries where a link between ESG initiatives and business strategy is well established are more likely to have quantifiable targets and transparent disclosure of performance against them. “These are the companies that have defined their ESG strategy, how ESG contributes to sustainable value creation and how their ESG objectives should be measured,” says Bass-Goldberg. “You can’t lead change by including ESG in your incentive plan. It needs to be supporting a strategy.”

At Verizon, for example, diversity and sustainability targets call for 50 percent of its U.S. workforce to be comprised of minority and female employees, at least \$5.2 billion of its overall supplier spending go toward minority- and female-owned firms and a carbon intensity reduction of least 10 percent. The company discloses the specific weighting for achieving these metrics (a combined 5 percent), an explanation for why these metrics are used and how it performed relative to those targets.

“The way Verizon has incorporated ESG into its incentive plans communicates that this has been a focal point,” explains Thomas Kohn, an FW Cook consultant, who says a surge in ESG-related disclosures is likely this

year, propelled partly by companies seeking to reward performance in a year when financial goals set in early 2020 have been rendered obsolete by the pandemic. “Where 2020 bonus plans are underwater because financial goals won’t hit threshold, companies may consider a variety of non-financial strategic factors, including ESG factors such as employee health and safety, to help them determine whether some level of payout is justified for the year.”

For some companies that incorporated ESG metrics in response to Covid-19, the metrics may be temporary—and possibly should be, given the challenges and potential pitfalls of incorporating ESG measures into incentive plan payouts too quickly. However, the events of 2020 also serve as reminders of the rationale driving companies to work toward addressing ESG issues on a lasting basis, says Kohn, citing the fallout of Covid-19 and incidents of social unrest as evidence that ESG factors can trigger financial and operational risk.

“I think we’ll definitely see a spike in disclosure of ESG measures in 2021, and it will be interesting to see how many companies keep those the following year,” says Bass-Goldberg, who anticipates momentum continuing to build as companies grow more sophisticated with evaluation of key ESG issues. “Over time, we expect more companies to begin incorporating ESG measures into incentive plans more formulaically with greater disclosure of targets and performance.”



Erin Bass-Goldberg, managing director at FW Cook, serves as independent advisor to compensation committees of both public and privately held companies.



Thomas Kohn, consultant at FW Cook, advises compensation committees on short- and long-term incentive plan design.

SUCCESSION AND THE C-SUITE

Used properly, retention grants for senior executives can be an effective transition tactic.

IT'S NO SECRET that leadership changeovers are where boards are most likely to have a critical, lasting impact on a company. While succession planning tends to focus on identifying and onboarding the new CEO, maintaining a stable, engaged and high-functioning team during the leadership handoff is just as crucial to a smooth, successful transfer of power. The surprise, unwanted exit of a key executive early in a new leader's tenure can disrupt what is, by nature, a precarious situation.

Yet, all too often, that's exactly what happens, as senior executives passed over for the top job or simply unsettled by the change, leave to seek other opportunities. Offering retention grants to leadership team executives, or cash and equity awards with delayed vesting, is one way that boards look to limit post-succession turnover in the C-Suite. Generally, they are effective—at least for a while, according to a recent study of 65 large-cap companies experiencing CEO turnover from 2010 to 2016 by FW Cook.

"The study confirmed the conventional wisdom that when you're giving people special equity grants, they're going to stick around longer," says Marco Pizzitola, a consultant at FW Cook. "But while retention grants do keep people around in this particular situation, they are very much a short-term solution, and the implications of that are important."

A TEMPORARY TIE

Among the companies in the FW Cook study, nearly 40 percent made succession-related retention grants to non-CEO named executive officers (NEOs). Of the executives receiving grants, just 8 percent departed within the first year. The number was almost double (15 percent) for those not receiving retention grants. While this difference was far less pronounced in the second year—10 percent and 13 percent, respectively—the disparity suggests post-succession retention grants are most effective at adding "glue to the seat" in

the first two years after CEO turnover.

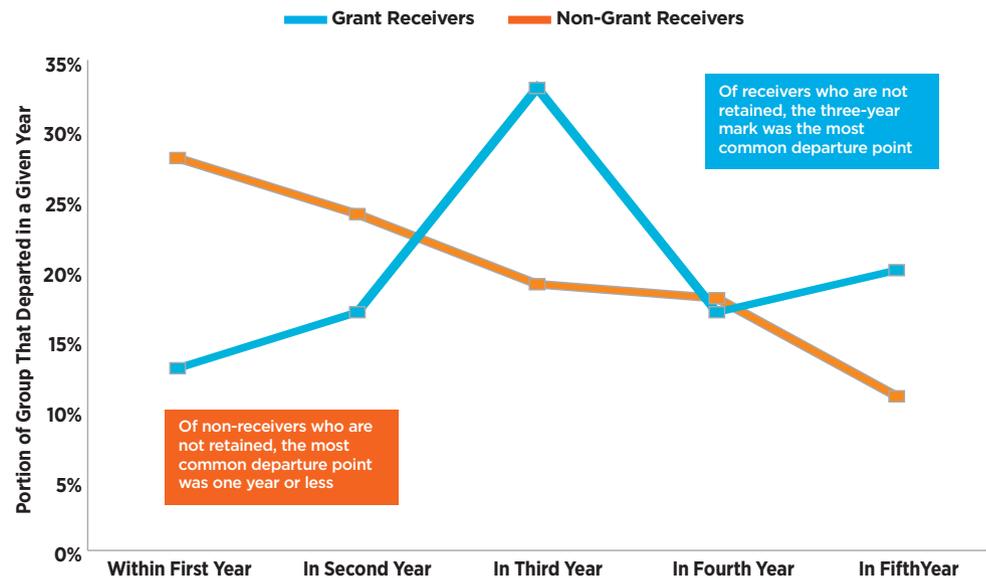
For boards, the message is clear: They have bought time, not long-term loyalty. "The takeaway there is that making these grants will give companies about two years of time to figure out what to do about this position," says Pizzitola. "That may mean making another grant, increasing compensation or giving that person more responsibility to keep them longer, or it may mean two years to focus on developing someone to replace

the departing executive or looking for someone they can recruit externally."

Among grant receivers, the most common departure point was in the third year after succession, which accounted for 33 percent of those who left within five years and 29 percent of all who eventually departed. In contrast, the most common departure point for non-receivers was within one year of CEO succession, which accounted for 28 percent of those who left

The Retention Grant Difference

Significantly more senior executives who receive grants stay on board for the critical two-year period following CEO turnover.



Grant Structures

The average (mean) size of a retention grant was \$3.3 million and, on average, grants vest over 3.6 years.

	25th Percentile	Median	75th Percentile
Grant Values (in millions)	\$1.1m	\$2.5m	\$4.1m
Vesting Schedule (in years)	3.0	3.0	4.1

Grant Size and Retention

The effectiveness of grants levels off after the \$2 million mark.

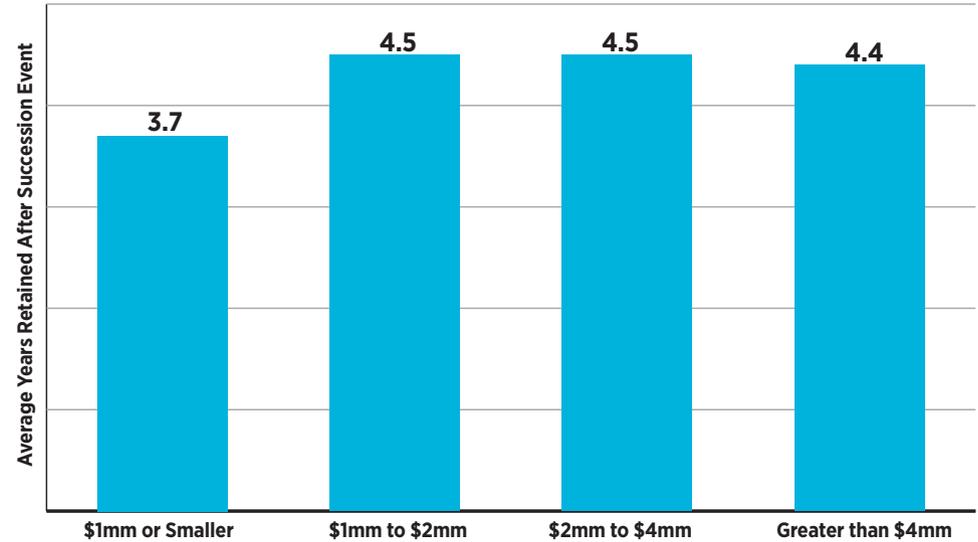
within the first five years, and 16 percent of all who eventually departed. “That’s meaningful because that first year or two, when C-Suite retention is most tenuous, tends to be the most critical,” says Cimi Silverberg, managing director at FW Cook. “That’s when it is most important to maintain stability in the leadership team, because a CEO succession, even if it’s well planned, can be pretty disruptive.”

The study results also suggest that companies that use retention grants may want to reconsider their vesting periods, which typically range between three and five years. “A vesting period on the shorter end of the range, with award size calibrated appropriately, may be optimal, given that the effectiveness seems to dwindle after three years,” notes Silverberg.

MEANING OVER MONEY

The study also looked for a correlation between the size of grants and the duration of retention. Among those receiving grants, the average (mean) size of a retention grant was \$3.3 million, and the 25th percentile, median and 75th percentile of awards had grant date fair values of \$1.1 million, \$2.5 million and \$4.1 million, respectively. Initially, the more valuable the grant, the stronger its ability to retain—but once the grants passed the \$2 million mark, their effectiveness in retaining executives showed a diminishing marginal return. In fact, the retention duration for executives receiving grants valued at between \$1 million and \$2 million was the same or higher as that of those receiving more than \$2 million. (See chart, above.)

This may reflect the fact that some executives find reporting to a newly minted CEO, in some cases one who was once a peer, untenable—or that they had ambitions for the role themselves. “Basically, the retention grant is enough to help these executives stick around for a certain amount of time, but after that, regardless of the size of the grant, their career aspirations take over,” says Silverberg,



who points out that for C-Suite executives who might have been in the running for the top job, the lure of a CEO role is likely to trump any potential payoff. “There’s almost no amount of money that can retain a non-CEO executive if they want and are offered the chance to be CEO somewhere else because the career development value of the CEO job is invaluable. So, even if the compensation level as CEO somewhere else isn’t materially higher than what they’re making, the opportunity to become CEO carries a significant value that a retention grant can’t offset.”

Absent interest in or opportunity for a CEO job, however, there are things companies can do in addition to retention grants—or instead of them—to help keep top talent after a CEO succession. “There are a lot of things that factor into what other retention strategies might be appropriate and effective,” says Pizzitola. Other retention strategies, such as expanding responsibilities or offering rotational positions that dovetail with an executive’s personal career goals, may also be appropriate and effective.

It’s also key for boards to recognize that, in some cases, retention grants may be appropriate even when the CEO succes-

sion comes about due to plans for a broad change in strategy or management overhaul. “There are times when, as part of the transition, the intent is to eventually replace some of the other executives,” he notes. “In those situations, there may still be value in making the retention grants anyway because then the company can make those decisions on its own schedule, on the CEO’s own timeline.”



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THOUGHT LEADERSHIP FROM FW COOK

EXCELLING AT ENGAGEMENT

A decade into Say on Pay, effective shareholder outreach is more critical than ever.

INCIDENTS OF SOCIAL UNREST,

climate-related natural disasters, a global pandemic—it's perhaps fitting that the events of 2020 gave companies plenty to talk about in a year that marks Say on Pay's 10th anniversary. As highlighted in "The Rise of Shareholder Outreach" (*Corporate Board Member*, Q2 2020), interest in more proactive engagement with proxy advisors and investors on compensation matters has been growing steadily over the past decade. The challenges of the past year only served to accelerate that evolution.

One reason is that while most companies refrained from modifying compensation plans during the throes of the pandemic, those that did so now feel compelled to explain their rationale, says James Park, a principal at FW Cook. "After Covid hit, some companies elected to modify their compensation programs, which kickstarted conversations about whether to bring investors into the loop and, if so, when," he explains. "Now, some companies are in a position to have to defend these pay actions, partic-

ularly those that fully recovered by year end. These companies may be judged with the unfair benefit of hindsight. They need to bring everyone back to what was going on in March 2020 and the factors that led to those decisions being made."

ENGAGING WITH INTENT

It's that type of situational engagement—compelled by the desire to explain extenuating circumstances—that most often prompts companies to consider outreach on compensation.

Companies aware that a compensation decision may be viewed negatively by investors can seek to preemptively address the issue by engaging with shareholders after the end of the fiscal year but prior to filing a proxy report. Often, however, it's negative vote recommendations from proxy firms or the reaction of a dissident activist investor during proxy season that trigger the need for engagement. This allows companies only a short window of time to conduct outreach before the annual meeting.

Given those time constraints, those

that see a potential need for engagement should be prepared to move quickly, notes Park. "Identify your biggest shareholders, review their voting history and proxy voting guidelines," he says, adding that directing communications to the right party is key. "Many large institutions have a stewardship team, separate and apart from the investment team, for discussions related to executive compensation and other proxy voting issues."

In the case of a negative vote recommendation, companies may also want to include proxy advisory firms in their engagement efforts. While overturning an "against" recommendation is unlikely unless there are significant factual errors to correct, Glass Lewis and ISS do communicate feedback from companies to their subscriber base, which provides context to investors.

SOLICITING MEETINGS

When requesting time with shareholders, companies should be prepared to make a strong case for getting an audience. "Not all investors have the bandwidth for direct engagement during the proxy season," says Park, who points out that proxy season is finite, and large institutions comb through thousands of shareholder proposals and engagement requests each year.

BlackRock, for example, recently reported that it held more than 3,000 engagements between July 1, 2019 and June 30, 2020 and votes at approximately 16,000 shareholder meetings in 85 markets each year. For the year ending December 31, 2020, Vanguard's Investment Stewardship team reported voting on more than 176,000 individual matters, engaging with 655 portfolio companies and meeting with thousands of executives and board members across the globe.

That increasing level of engagement on a widening spectrum of complex





“ONCE YOU GET IN THE ROOM, THEY MAY ASK QUESTIONS LIKE, ‘WHAT’S YOUR POLICY ON GENDER PAY EQUITY?’”

—James Park, Principal, FW Cook

topics means companies must make a compelling case to win an audience with investors. “It’s important to state your objective, introduce the team who will be attending and lay out a detailed agenda for what you want to cover,” says Austin Lee, a partner at FW Cook, who explains that investors increasingly gauge how serious an issuer is about engagement based on board member participation.

“Having a robust participant list, including independent directors and members of the compensation committee, adds credibility to the discussion, as they are ultimately responsible for approving executive compensation decisions,” adds Park. “Some investors will outright decline an invitation to engage if a board member doesn’t participate.”

PREPPING FOR THE CONVERSATION

Prior to the meeting, companies should review the investor’s proxy voting guidelines and be prepared to discuss their business objectives, governance framework and compensation philosophy. It’s also critical to prepare talking points to demonstrate how the pay program supports business strategy and long-term shareholder value creation.

The engagement team should also be equipped to engage on broader governance issues, notes Park, who says shareholders are using this opportunity to expand beyond compensation to delve into other areas of interest. “Once you get in the room, they may ask questions like, ‘What’s your policy on gender pay equity? What is your company doing to address climate change risks?’” he explains. “Large institutional investors have made it clear that long-term value creation is supported by good governance and sustainable business practices. Companies must be prepared to discuss their view on social and environ-

mental issues.”

During the discussion, it’s critical to avoid disclosure of any material non-public information that would have Regulation Fair Disclosure implications. If the engagement will benefit from discussing non-public information that hasn’t been communicated to shareholders, the company may want to file an 8-K with relevant engagement material that can be shared with all investors.

ASSESSING OUTREACH EFFORTS

During the outreach process, be sure to document who was solicited for engagement, which investors accepted the approach, whether it was successful at gaining support and any feedback about the pay program that it generated. In addition to informing internal discussion of whether any program changes are appropriate, that information can be used to help improve on future outreach efforts.

“You can’t please everyone. An evolving global investor base with conflicting views on corporate governance can present challenges for companies,” notes Park, who points out that companies may find themselves having to reconcile disparate perspectives. “So, evaluate what changes support the company’s long-term business strategy, or you may go through the entire process and decide there’s no need to change.”

Whatever the ultimate decision, it’s crucial for companies to follow up on engagements, acknowledging and

responding to what was heard. “That’s even more important if you choose not to make a suggested change,” says Lee. “You want to loop back sometime in the off-season and let them know, ‘Here’s why we didn’t go that route. And here’s why that decision aligns with our business strategy and the long-term interests of our shareholders.’”

Ideally, that conversation will be the start of an ongoing communication, enabling companies to build credibility with issuers over time. “Once you begin shareholder outreach, there’s a benefit to making a practice of reaching out to investors every year about the company’s business objectives and how the compensation program supports those objectives,” says Lee, who says regular shareholder outreach can lessen the probability of an investor having a knee-jerk reaction to an anomaly event or negative proxy advisor recommendation. “By demonstrating that you’re listening and responding to them, you’re building a level of trust.”



James Park is a principal at FW Cook with 20 years of experience assisting large complex organizations undergoing business transformation, facing challenged Say-on-Pay votes and conducting investor engagement.



Austin Lee, a principal at FW Cook, conducts market analysis on executive pay levels, designs performance-based annual and long-term incentive programs and evaluates the relationship between executive pay and company performance.

REEXAMINING HIRING PAY PRACTICES

As competition for talent intensifies, companies may need to rethink executive recruitment packages.

THE PAST 18 MONTHS brought changes to virtually every aspect of business—and hiring is no exception. Companies that grew comfortable with a remote work model during the pandemic are now able to draw from a wider pool of candidates. On the flip side, employees reticent about relocating suddenly find themselves far more marketable. At the same time, the pandemic-inspired hiatus on changing employers has faded as a sense of normalcy returns.

“It’s always been a national or even global job market, but for many people, that traditional barrier of relocation friction is now gone,” says Ken Sparling, managing director at FW Cook. “There’s just a lot more mobility in the market.”

Meanwhile, talent is scarce, particularly in technology, engineering and R&D roles. As a result, whether seeking a new CEO or hungry to hire high-performing talent with the skills and background



DUE TO SUBSTANTIAL WEALTH CREATION FROM THE MARKET’S REBOUND SINCE MARCH OF 2020... A LOT OF EXECUTIVE TALENT IS CURRENTLY SITTING ON SIGNIFICANT EQUITY VALUES.”

—Ken Sparling, FW Cook

required, companies should be prepared to provide competitive compensation packages.

FILLING THE BUCKETS

Generally, determining the appropriate ongoing pay for a given role is relatively straightforward, dictated by a market study and the company’s existing pay philosophy, says Sparling. “When you’re recruiting an experienced CEO or executive externally, the regular pay is typically positioned competitively against those of peer companies,” he notes. “It’s the two additional buckets—make-whole pay and inducement pay—that often require more careful consideration.”

Make-whole pay, which typically consists of the amount of cash bonuses due to be paid that fiscal year and/or unvested equity, compensates a new hire for funds he or she will sacrifice by leaving the company early. Inducement pay consists of

Hiring Offer Do’s and Don’ts

Offer Component	Do...	Don’t...
Annual Compensation	<ul style="list-style-type: none"> Align with the company’s current executive pay philosophy and structure Provide for compensation committee discretion to adjust compensation year-to-year 	<ul style="list-style-type: none"> Exceed competitive norms in the ongoing package Lock in a pay mix that is less performance-based than executives at similar level Include multiyear guaranteed salary increases or bonuses
Make-Whole Award	<ul style="list-style-type: none"> Replace like-for-like to extent possible, separating from regular annual compensation Provide vesting acceleration in a not-for-cause termination Include claw-back for a voluntary resignation 	<ul style="list-style-type: none"> Add the new hire into “in-flight” multiyear performance grants
Inducement Payment	<ul style="list-style-type: none"> Link to performance, particularly for larger CEO hiring packages 	<ul style="list-style-type: none"> Provide for full vesting acceleration in termination scenarios (different from a Make-Whole Award)

additional compensation meant to offset the risk of leaving a stable position for a new opportunity—and taking on the risks that go along with it.

Despite the clear rationale behind each component, the amount of total compensation in such a package can trigger shareholder ire. And this year, current market conditions are exacerbating that outcome, notes Sparling. “Due to substantial wealth creation from the market’s rebound since March of 2020 and SPAC and IPO activity over the past 18 months, a lot of executive talent is currently sitting on significant equity values,” he explains. “That’s raised the cost of bringing in experienced, qualified talent. We’re seeing the knock-on effects of that now as companies that made high-profile hires disclose those values in their proxies.”

CEOs or executives with lengthy track records of success often warrant large make-whole grants due to having earned substantial equity value at their prior company. In such cases, boards should be prepared to handle pushback from investors. “Some shareholders have aversion to seeing CEO compensation values that are double market or above a certain threshold amount,” explains Sparling. “So, if a hiring award takes pay disclosure above \$30 million, for example, many shareholders just won’t support it, even when the company has made the case that it was a one-time action to bring the person on board.”

COMMUNICATING COMP

Both the way that pay is structured and how compensation packages are disclosed can mitigate the risk of shareholder objections (See “Hiring Offer Do’s and Don’ts,” opposite). For example, boards may want to consider having a portion of make-whole and inducement awards vest over time. How each component of the pay package will be treated if the hire doesn’t work out should also be carefully weighed.



Companies should also avoid practices likely to trigger investor concern, such as multiyear salary increase guarantees or a severance package that exceeds two to three times salary and bonus.

It’s also critical to avoid a hiring package that will continue to be objectionable for multiple years running. “It’s important that on an ongoing basis the pay package is structured in such a way that it will not, by itself, continue to attract criticism,” says Sparling.

Finally, boards should be prepared to break down both the pay package’s provisions and the rationale behind it for investors. Proactively outlining the amount of regular pay versus one-time pay can offset knee-jerk reactions to the headline number.

“Make sure the different components of the hiring package are set forth clearly, especially when there’s a chance of attracting external criticism,” says Sparling,

who says a proactive approach to outreach may calm shareholder concerns.

“Companies should put themselves in the best possible position to get say-on-pay support for the actual hiring package or for the vote the year after the hire is made,” he says. “Then, even if that vote is negative, you will have set the framework for a rebound in future years and be able to get support going forward.”



Ken Sparling, managing director at FW Cook, consults with public and privately held companies on all aspects of executive and board compensation, including annual and long-term incentive programs, employment agreements and change-in-control arrangements.

PAY STRATEGIES FOR 2022 AND BEYOND

No other board decision receives more scrutiny than executive pay packages—and the events of the past year only accelerated that focus. In June, directors gathered at *Corporate Board Member's Compensation Committee Summit* to share perspectives on the most pressing executive pay and human capital management questions. Some takeaways.

BY JENNIFER PELLET



EXECUTIVE COMP AND INVESTOR EXPECTATIONS

Intangible assets comprise, on average, 52 percent of a company's market value, so it's only natural for stakeholders to seek more robust insight into how companies manage and invest in their workforce. The Council of Institutional Investors is pressing for enhanced Securities and Exchange Commission 10-K disclosure requirements that would facilitate greater consistency and comparability of human capital-related disclosures, explains Amy Borrus, executive director of the CII. In addition to supporting the requirement that public companies disclose their total number of employees, the CII seeks mandatory disclosure of the breakdown in the number of full-time, part-time and contingent workers, as well as employee turnover rates.

"Beyond that we would generally support the SEC encouraging issuers to voluntarily provide additional material human capital metrics, preferably using a generally accepted private sector investor-focused framework," says Borrus, who says consistency will help investors compare companies. "We are encouraged that the SEC's new chair, Gary Gensler, has put human capital management disclosure on the SEC's agenda."

CalPERS is also advocating on behalf of investors as part of the Human Capital Management Coalition, a cooperative effort among 35 institutional investors that collectively represent more than \$6 trillion in assets. Like the CII, the Coalition also seeks a head count broken down by type of worker, as well as three additional fundamentals: total cost of the workforce, turnover of management and diversity data.

SEARCHING FOR CLARITY

The latter should be an easy lift for companies that already collect workforce data. "A lot of times they already have this data available, and it's just a matter of disclosing it in a consistent and uniform way," explained Tamara Sells, associate investment manager at CalPERS, who notes that the pushback from companies stems from a lack of clarity about what to disclose and how to disclose it. "When you don't have consistent, universal standards, it's quite hard to know what exactly you should be reporting."

As momentum continues to build, panelists agreed, boards can expect further developments in disclosure expectations, including:

- Shareholder proposals requesting broader disclosures in areas like racial equity and pay gap audits or a diverse candidate search policy.
- A pandemic-fueled push for more information

around worker health and safety provisions.

- Proposed legislation mandating disclosure of diversity in executive suites and the boardroom.

Companies should also consider approaching the evolution of disclosure as an opportunity, notes Sells. "The SEC rulemaking on human capital left a lot of flexibility for company disclosures around human capital measures and objectives, but it didn't give any guidance or specificity as to how to do that," she points out. "So, companies should be asking themselves, 'What constitutes meaningful corporate action on human capital management for our particular business strategy over the long term? How can we take advantage of this current climate and turn this crisis into an opportunity for change for our company?'"



David Kokell, Head of Compensation Research, ISS



John Sinkular, Partner, Pay Governance

3 POST PROXY SEASON ACTION ITEMS

Fallout from the pandemic, market volatility and rising stakeholder interest in ESG issues brought an uptick in say-on-pay failures and compensation-related shareholder proposals during the 2021 proxy season. While the worst may be behind us, uncertainty continues to undermine efforts to align pay and performance. Panelists David Kokell, head of compensation research for ISS, and John Sinkular, partner at Pay Governance, highlighted three points of concern for boards and management teams.

Tying incentive pay to nonfinancial measures. Introducing ESG metrics and other strategic goals may help offset the uncertainty plaguing pay-performance alignment, noted Sinkular, who suggests considering incorporating nonfinancial goals as a minority weighting metric for incentive pay.

Disclosure of payments related to termination. A rise in severance payouts is prompting scrutiny among investors. "Our view is that severance payments are only appropriate for either involuntary or constructive termination scenarios," says Kokell. "If severance is going to be paid as an executive departs the company—and usually we're talking about multi-million-dollar cash amounts here—investors need assurances that those amounts were contractually entitled. Without fulsome disclosure in that regard, investors have no real way to analyze that."

More effective shareholder engagement. With 2021 marking the highest failure rate since the beginning of say-on-pay, ISS will be looking at how companies fare at hearing and addressing concerns. "One of the things that we look for is board participation," says Kokell, "including whether the comp committee participated in those conversations rather than having them relayed through senior management or investor relations teams."



Virginia Rhodes, Partner, Meridian Compensation Partners



Ani Huang, CEO, Center on Executive Compensation



Kate Tekker, Head of Global Total Rewards and HR Operations, Prudential Financial



Anthony Abbatiello, Leader, Global Leadership & Succession, Russell Reynolds Associates



Elizabeth Beshel Robinson, Board Member, Bank of New York Mellon and Russell Reynolds Associates

ESG AND INCENTIVE PAY

Already, 58 percent of companies include at least one ESG metric in their annual incentive plan, according to a recent study by Meridian. But rather than rush to follow suit, companies should consider following a four-step process, say panelists:

Start with the big picture. Step back and assess your organization’s readiness for including ESG metrics in your incentive plan, says Ani Huang, CEO of the Center on Executive Compensation. “Don’t just jump in feet first without taking a good look at the current situation at your company, what changes you think are reasonable to make and how that will play with the other goals stated in your comp plan.”

Sharpen your focus. Rank your priorities and decide where to start. “Part of the challenge is that ESG covers so many different areas,” says Virginia Rhodes, partner at Meridian Compensation Partners. “Ask your organization, ‘Which ESG metrics are most important for your business, and are they measurable for you?’ This,

again, requires data and analytics that many companies are still struggling to achieve.”

Find your short- versus long-term balance.

Prudential Financial chose to recognize inclusion and diversity as a long-term strategic goal by setting goals three years out rather than annually, explains Kate Tekker, head of global total rewards and HR operations. “We were afraid measuring annually might lead to quick decisions that might not be best for our long-term talent strategy,” she says. “Three years provided a thoughtful amount of time to make the right decisions and track our progress.”

Make it meaningful. If incentives are deemed too small or goals too insignificant, an attempt to tie ESG metrics to them could backfire by alienating outside stakeholders. “Activist investors and the media are really zeroing in on these disclosures, saying, ‘This company has a 5 percent metric on D&I; that’s hardly anything. What does that say about their commitment?’” says Huang. “You can actually have a worse consequence than not doing anything.”

CURATING CULTURE

Difficult to measure and even harder to change, culture is a thorny issue for boards. Panelists shared their views on getting a true read on how closely behaviors in the workplace align with corporate values.

ON ASSESSING CULTURE...

Elizabeth Beshel Robinson: It’s challenging as a board member to try to get at that truth [about culture]. The boards I’ve worked with that felt more successful have been ones where the management is self-critical and willing to come in and talk about where they see shortcomings and try to unearth the things that they see as problematic. In the last 15 months of the pandemic, where we haven’t been meeting in person and you haven’t been able to just have those informal check-ins, it’s been really challenging to break through the surveys, break through the metrics. I’m looking forward to getting back to board meetings in person for that reason.

ON WHAT TO ASK...

Anthony Abbatiello: There are two main things boards should be asking. The first is, what are

the absolute leadership behaviors we need to drive the strategy? There’s a disconnect between the strategy and the way work is getting done within the organization that is typically a leadership behavioral issue. It’s not values, it’s not mission statement or *raison d’etre*. It’s about understanding the specific traits and behaviors that underpin achieving strategic goals—growth, expansion of global markets, innovating new products and services.

The second is looking at the alignment, what we call cultural maturity. How well are those behaviors aligned between employees up through the leadership, and then across all the functions and geographies in the organization? When there is very little alignment between leaders and employees and very little alignment across the organization, we call that the danger zone on those behaviors. Because ultimately, we want to have leaders and employees believing in the same values that we value, or having the same beliefs, and we want to see that consistently across the organization. That alignment, that cultural maturity, those are the two most important things. **CBM**

THOUGHT LEADERSHIP PROVIDED BY MERIDIAN COMPENSATION PARTNERS

MARKET TRENDS IN CHANGE-IN-CONTROL SEVERANCE ARRANGEMENTS

By Jeff Keckley

WHEN WAS THE LAST TIME your company took a fresh look at the executive severance program? Severance arrangement reviews are often not an annual agenda topic for the compensation committee. However, shifting market trends in change-in-control (CIC) severance arrangements suggest a re-examination of current plans may be warranted.

Meridian recently published a Study of Executive Change-in-Control Arrangements, which provides insights on prevailing market practices and emerging trends in executive severance benefits in connection with a CIC event. The survey focused on CIC severance practices at 200 large U.S. public companies. As companies review severance plans and policies to assess whether their current structure continues to meet desired objectives, it is essential to understand how market practices have shifted in recent years.

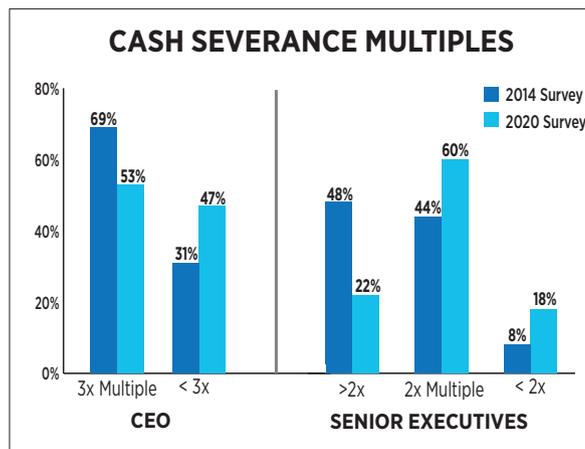
Evaluating CIC severance arrangements starts with understanding the purpose of the program and the fundamental plan objectives. Generally, the purpose of most CIC severance plans is to:

- Keep executives neutral to job loss while pursuing potential value-adding transactions;
- Retain key talent in the face of heightened uncertainty; and
- Maintain competitive benefits to attract and retain top talent.

Additional objectives may also consider consistency across plan participants, company protection by way of restrictive covenants and releases and ease of administration.

Forms of CIC Plans

CIC arrangements generally take one of two forms, as a severance plan that provides protection to a group of executives or as an individual employment/severance agreement. Although both forms are widely used, we've observed a recent and significant shift toward CIC severance plans. Companies are transitioning away from individual agreements for multiple reasons. Most notably, severance plans ensure uniformity of terms and provisions, enable adjustments across all covered executives and are far easier to administer and communicate.



CIC Cash Severance Benefits

Meridian's survey examines the structure of cash severance benefits and highlights design changes observed over the past several years. The basic structure of cash severance is unchanged. Most companies continue to provide these benefits to a select group of senior executives, structured as a multiple of salary and annual bonus. The majority of companies define bonus as "target," though definitions can vary, such as multiyear average or prior-year actual. All of these definitions have an important commonality—they are fixed, nondiscretionary amounts that a new owner cannot subjectively modify.

For cash severance, the more notable shift in the market is with the severance multiple. We have seen a material decline in the multiple used for CEOs and other senior executives' CIC severance. In Meridian's 2014 study, the CEO cash multiple was predominantly 3x salary and bonus, while senior executives' multiples were evenly split between 2x and 3x. Our recent study revealed a clear trend toward lower multiples, with nearly one-half of CEO cash multiples below 3x (47 percent) and a great majority of other senior executive multiples at or below 2x (78 percent).

Treatment of Equity Incentives

Regarding the treatment of existing equity incentives, the prevalent practice remains full vesting of all equity awards upon a qualified termination in connection with a CIC event (i.e., "double-trigger") or if the successor entity fails to assume or replace the award. Where we have identified an emerging

trend is with the definition of performance award payouts. Defining the payout based on "target" performance continues to be most common, but Meridian's survey found a significant increase in the number of companies defining payout as the greater of target or actual performance (27 percent). This definition enables participants to earn an above-target payout when superior performance is achieved prior to the CIC transaction, assuming performance can be measured mid-cycle.

Restrictive Covenants

One additional area where we have identified evolving market practice relates to the use of restrictive covenants. A majority of companies now include one or more restrictive covenants in CIC arrangements, such as a noncompete covenant. A fairly new concept gaining traction is to allocate a portion of the severance payment as "consideration" for the noncompete, lessening executives' excise tax exposure.

Excise tax gross-ups have been eliminated from nearly all company severance arrangements, and companies are looking for opportunities to minimize the likelihood of triggering the golden parachute excise tax. Internal Revenue Code section 280G specifically allows companies to exclude consideration for a noncompete from the excise tax calculation, providing a rare opportunity to shield a portion of the severance payments from adverse tax consequences.

Additional market prevalence statistics and insights are included in Meridian's Executive CIC Severance Arrangements survey, and we encourage companies to consider the changing market landscape when evaluating current severance arrangements. Meridian's full survey can be found on our website at meridiancp.com.



Jeff Keckley is a lead consultant at the executive compensation consulting firm Meridian Compensation Partners, LLC in Lake Forest, IL.

MERIDIAN
COMPENSATION PARTNERS, LLC

Note: Meridian's 2020 Study of Executive Change-in-Control Arrangements survey can be found at www.meridiancp.com.

DIRECTORS POINTS OF VIEW



“What I have seen time and time again is it is really hard to self-disrupt. It is really hard to disrupt a core business when it is contributing the bulk of your revenue and profits. But that is actually the time that you should start.”

—Patricia Russo, Director, General Motors, Merck & Co. and Arconic



“Don’t be too heads down. Move toward nontraditional candidates. They’re there. You just have to find them.”

—Peter van Oppen, Director, Impinj and Group Health Foundation



“I am not here to advocate that companies jump head first into criminal justice reform because it is difficult to engage in public debates on social issues. I do believe, however, that companies have the opportunity to drive change deeper to get at the root of the problems.”

—Gaurdie Banister, Director, Russell Reynolds Associates, Tyson Foods and Dow

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PREPPING FOR PROXY SEASON

Paused during the pandemic, ESG is back on boardroom agendas with a vengeance in 2021. Here's what directors should be thinking about on each branch of the acronym.

BY C.J. PRINCE

The topic of ESG, which had held the spotlight ever since Larry Fink's 2018 letter asking CEOs to clarify their company's purpose and long-term value, took a temporary backseat last year as companies struggled to keep the lights on during the global pandemic and economic freeze. In 2020, very little of directors' time in the boardroom was allotted to ESG, and just 27 percent said investors had raised the issue for discussion, according to *Corporate Board Member's* 2021 What Directors Think survey.

But with the vaccine rollout in full swing, hope abounds for a return to some sort of normalcy this year, and ESG is back in focus and very likely to be a key topic of interest during the 2021 proxy season. Recent quarterly earnings calls may have provided a preview of the larger role ESG will play: Twenty companies in the S&P 500 mentioned the acronym or sustainability on earnings conference calls between Oct. 1 and Dec. 31, compared with only six companies three years earlier, according to FactSet, a data provider. Globally, the term ESG was mentioned 205 times on investor calls during the fourth quarter of 2020.

And for the first time this year, investors have made clear that they are prepared to vote against directors who sit on boards that don't measure up on environmental, social and governance goals. "We are going to consider voting against this year if there is no racial or ethnic diversity," says Peter Reali, senior director with Nuveen, the investment management arm of TIAA. "We do believe the time is right to start taking action and holding companies accountable, especially if we haven't seen any movement—for example, [if] they put on three new directors in the past three years and everyone fits a similar profile as previous directors, that's going to flag for us a potential vote against."

Attorney Marc Gerber, who represents companies in proxy fights, says he believes that for most investors, 2021 will be "kind of a warning shot" as far as things like racial and ethnic diversity. "In other words, we'll highlight if you lack diversity or we'll note it, but we're not going to vote against the board in 2021—but we will start voting against in 2022."

The key this year is for boards to find that delicate balance between transparency and competitive savvy, offering investors enough of what they want without



**“The path to clarity
and transparency and
comparability is not
yet clear.”**

*—Jan Babiak, Director,
Walgreens Boots Alliance,
Bank of Montreal
and Euromoney
Institutional Investor*



“We need to know, how are we overseeing remote work?”

—Phyllis Campbell, Chair, Pacific Northwest Region, JPMorgan Chase; Director, Air Transport Service Group

putting their companies at a disadvantage compared with other players whose ESG data looks better—or whose data might also be less than stellar, but they’ve chosen not to disclose it.

Some companies have done materiality assessments to determine which issues are most critical to the company’s long-term value, while others are still sorting through the risks. To help boards prepare, *Corporate Board Member’s ESG Special Report* lays out the three branches of the oft-misunderstood acronym and what directors might expect from investors this spring.

THE ‘E’: GREEN GOALS

Ever since the furor over Volkswagen’s “diesel dupe” in 2015—which was in large part blamed on lax governance—boards have been well aware of the potential risks of failing to catch poor processes and controls around environmental issues. Until recently, some companies with relatively small carbon footprints—e.g., service firms, software providers—were thought to be exempt from serious scrutiny on the green front, but this year, investors are ratcheting up the pressure all around.

In his 2021 annual letter to shareholders, “[Larry Fink] absolutely painted the bullseye on climate change,” says Phyllis Campbell, chairman, Pacific Northwest JPMorgan Chase and director on the board of Air Transport Service Group. BlackRock followed that with a memo in February saying that directors of companies in which it invests must have “climate fluency” and must disclose their short-, medium- and long-term plans to reach net-zero carbon emissions by 2050. If a company does not voluntarily meet BlackRock’s new standards, the firm said it was prepared to support shareholder proposals that would force them to do it. Vanguard and State Street have issued similar challenges to companies to step up their ESG games.

“Those investors control somewhere upwards of 30 percent of companies’ stock collectively, so those are the Big Three [boards need] to pay a lot of attention to because other investors tend to follow their lead,” say Campbell. More than half of investors surveyed by EY said “climate risk and natural resource constraints” were among the biggest threats facing

companies over the next three to five years. To be successful in the future, those investors said companies would need to integrate climate and other sustainability risks into business strategy.

Doing that requires some thinking, however, because there is no one-size-fits-all answer, says Campbell, who until last year was a director on the board of Alaska Airlines, for whom emissions was a major issue. But nearly every company can find a way to relate to climate risk and ways to mitigate it, she says, pointing to Microsoft as an example of a software company that chose to set a big long-term goal—to be not only net-zero on carbon emissions by 2040 but net negative. “So, they’re looking at alternative sources of energy; they’re looking at their carbon footprint with their buildings; they’re looking at their vehicles’ standards around carbon emissions and employees who commute,” she says. “It may not be as big [for them] as for an airline, but there are definitely ways to benchmark and things companies can do within their own assets.”

As boards consider how the “E” risks apply, they may want to keep in mind the following:

Study the standards. The hodgepodge of sustainability standards has long been a challenge for both companies and the investors attempting to evaluate them—a world apart from financial reporting, which offers essentially two options, IFRS and U.S. GAAP. “Those two choices means you have comparable numbers, and you can’t just opt out,” says Jan Babiak, who sits on the boards of Walgreens Boots Alliance, Bank of Montreal and Euromoney Institutional Investor. “If a company didn’t want to disclose how they were accounting for revenue recognition, for example, they don’t have that choice because the auditors won’t sign off on it.”

There might be light at the end of that confusing tunnel. In the fall of 2020, five leading standards organizations—GRI, SASB, CDP, CDSB, IIRC—announced their intent to collaborate on a single standard, and, separately, the International Financial Reporting Standards (IFRS) Foundation released a proposal for developing a comprehensive standard. They face several key challenges, including materiality, which

Your ESG Roadmap

It's not enough to publish a corporate sustainability report; companies need to show they have a cohesive ESG strategy that is linked to purpose and woven into operations.

- 1. Take stock of your stakeholders:** Identify each stakeholder group, including employees, and determine which aspects of your business are most important to each.
- 2. Lead with purpose:** Now that you know what is important to stakeholders, define your purpose, set related goals and lead accordingly. Differing aspirations among stakeholders may make it difficult to gain acceptance on a set of measures. Be intentional with achievable goals.
- 3. Develop and report metrics:** Develop consistent and controlled policies for quantifying and reporting metrics.
 - Align metrics reported externally with those used by management in running the business.
 - Organize metrics in a systemic way while leveraging standards or frameworks.
 - Offer comparison figures to demonstrate consistency.
 - Determine the appropriate format and how frequently to report.
 - Implement controls over the preparation and reporting of metrics with the same rigor as controls over traditional financial reporting.
 - Provide context—the most relevant metrics consider the entity's industry and markets.
- 4. Encourage action:** Incentivize employees through their participation in setting the company's goals and by connecting aspects of compensation to achieving them.
- 5. Re-evaluate:** Changes in the social, economic or political environments can lead to changes in stakeholder views. Periodically assess whether the metrics continue to resonate with stakeholders.

Source: PwC's "ESG oversight: The Corporate Director's Guide," Nov. 2020

varies widely, and comparability of disclosures around multiple ESG issues. "I think we're kind of becoming 'woke'—if I can use that millennial language—to the fact that we need to have some accountability around this, but the path to clarity and transparency and comparability is not yet clear," says Babiak.

In the meantime, boards and management need to know which research firms—e.g., Sustainalytics, MSCI, Thomson Reuters, Bloomberg—their biggest investors subscribe to and should understand which data investors are most interested in and how much weight they give to absolute scores vs. underlying data. Boards also need to ensure information is being communicated effectively; if a comprehensive sustainability report is

published on the corporate website but is not picked up by data providers, it likely won't reach investors. "Some directors get frustrated because they say, 'We have all this stuff out there,' but if it's not put out there in a way that it's being captured by the investors, that's not helpful," says Reali, who adds that because of this, there will continue to be a push for ESG information to be provided in "financial-type documents," such as an 8-K.

S: SOCIAL SUBSTANCE

In the aftermath of a pandemic that shut down the economy, led to massive layoffs and highlighted the severity of income inequality—not to mention a year marked by extreme racial unrest following the death of George Floyd—all boards need to be familiar with "S" risks and must be prepared to show investors:

Progress on diversity. Around two-thirds of investors surveyed for EY's 2021 proxy season preview report said they planned to press for robust diversity disclosures for boards and the workforce. For the latter, most said they wanted diversity data aligned to the U.S. Equal Employment Opportunity Commission's EEO-1 Survey data, and many said they would look for a narrative about the company's human capital strategy and goals. Campbell notes that State Street highlighted ethnic diversity in the workforce. "That's the first time I've seen them be explicit about that."

But Jamie Smith, EY Americas Center for Board Matters investor outreach and corporate governance specialist, says investor firms do understand that it's a journey. "They have some of the same issues," she says. "They know the numbers aren't going to look good, but they want to see those numbers and see the plan for progress."

In her work with board members, Maria Moats, leader of PwC's Governance Insights Center, recommends that boards have a dashboard with "a manageable list" of key workforce diversity data they can follow, such as workforce composition, retention, promotion, pay equity. "So, it's at the level where you can ask questions like, why is there a leaky pipeline? Why is it that when you look at promotion rates between white males



“Definitely, telling your story is important.”

—*Courteney Keatinge, Senior Director, Glass Lewis*

and Hispanic females, one of them is going faster than the other—and what are you doing around that?” It’s sometimes an uncomfortable conversation, she adds, “but it’s okay to be uncomfortable as long as your questions are coming from a good place.”

A solid HCM strategy. For the past several years, investors have been asking to understand how a company’s human capital was part of its strategic long-term value consideration, but if anything, the pandemic trained a more intense spotlight on HCM, given the life-and-death impact on employees. This year, companies with front-line workers will be expected to show a continued focus on safety, and all companies will be scrutinized for the way they treated employees and managed the remote workforce during the economic shutdown.

Courteney Keatinge, senior director, ESG for Glass Lewis & Co., suggests companies in higher-skilled industries also pay attention to potential losses from the “she-cession,” as it’s being called. A disproportionate number of women have been leaving the workforce because they are more often the primary caregiver to children home from school and elderly parents who are at higher risk for Covid. “Companies have been spending a lot of time and energy and resources to develop women and promote them within the organization, so they could be losing a lot of investment on these women they’ve been developing if they’re not more flexible right now and don’t manage the needs of those employees,” she says. “This is hopefully a temporary situation that in theory will resolve itself at some point. So, you don’t want to lose long-term investment over what is hopefully a short-term situation.”

Healthy culture. Reali says he will be looking for signs in the narrative of a healthy culture. “I will be the first to admit that that presents some challenges from a systemization standpoint, because you can’t press a button and say, tell me all the companies that do a good job in that.” But the board makeup, board evaluation and diversity in the executive ranks and the pipeline will offer hints as to whether the company is practicing inclusion, he adds.

Given the shift to remote work, culture is even harder to monitor, says Campbell, which makes it even more of a critical board issue. “We need to know, how are we overseeing remote work? How is management bringing people together who aren’t in the day-to-day workplace environment?”

THE ‘G’: GOOD GOVERNANCE

According to *CBM’s* 2021 What Directors Think survey, fielded in partnership with the Diligent Institute, 43 percent of directors called their success measuring progress on “G” initiatives “highly successful” compared with just 18 percent and 17 percent for “E” and “S” respectively. That may be because delivering good governance is something boards have been doing for decades. But even so, several topics under the “G” heading could use a second look in advance of proxy season:

Board diversity. Like workforce diversity, stakeholders want to see progress on diversifying the board. They’ll want to know, for example, what policies exist to ensure the nom/gov committee looks at women and racial minorities when appointing new directors, says Keatinge. Disclosure and narrative will be key. If a board lacks diversity, “they could say nothing and not be violating any norms or laws,” she says. “However, it really does kind of demonstrate the seriousness with which they are approaching this issue. If they have engaged four recruiting firms and are implementing the ‘Rooney Rule’ and doing all this stuff to ensure that they have a woman on their board in the next two years, that’s an instance where we probably would not recommend against any directors on the board. So definitely, telling your story is important.”

Board refreshment and composition will also be in the spotlight, particularly given ISS’s policy update, which shifted from recommending against term-limit shareholder proposals to considering them on a case-by-case basis. “There will be a stronger focus on really wanting to understand how board expertise aligns with strategy and the current challenges companies are facing,” says Smith, who has heard investors question the relevance of long-tenured directors. “The burden is

Just starting? Don't try to boil the ocean.

When Alaska Airlines was trying to make oversight of ESG more structured, the company selected three metrics in each major category to monitor. “Don’t pick the 10 things that management’s looking at but ask, what are the most material to our moving the dial and to institutional investors,” says Phyllis Campbell. “So, they chose waste and carbon emissions.”

For the ‘S,’ given Alaska Air Group’s strong culture of employee engagement and customer satisfaction, the board started with metrics along engagement, which was tied to employee surveys and other data sources. The culture climate issues were overseen by the audit committee, while the employment data was overseen by compensation and leadership development, Campell says.

“So, just pick two or three that are material, tied to your long-term strategic plan as well as your culture, and monitor those. Over time you might adjust them and change them, but you’ve got to start somewhere. Getting the board and management both to agree on what those metrics are is probably a good starting point. And then at least you have a baseline of something you’ve been following over time and something that you can actually benchmark in terms of change.”

on the board to make that case. Looking at the challenges—digital transformation, changing stakeholder demands, the focus on human capital’s role in driving value, the role of diversity and growing sustainability risks—looking across this horizon, how do directors around the table have the skills to be resilient and create long-term value?”

Whistleblower allegations. Audit and risk committees should dig into the quality of the company’s process for receiving complaints and how they’re handled, says Moats. “Look at your process with management, how can we enhance this? Does this allow for people to freely submit their complaints and reinvestigate?” In light of the riots and attack on the U.S. Capitol in January, boards also are being encouraged to increase oversight around political activity, political donations and lobbying. “That’s always been out there, but it’s mainstream now.”

Compensation. Following the year of Covid-19, investors will be looking at how compensation of top executives, including the CEO, align with broader human capital

decisions, such as pay cuts, furloughs and layoffs. “There were a lot of announcements last year about executives foregoing bonuses and whatnot,” says Reali. “Then you saw a little bit of making up for that with bonuses [at the end of the year], so we’re just going to be looking to make sure that pay continues to be aligned with performance overall.”

Stakeholders may also be looking at how companies are tying their diversity goals into executive compensation. A recent FW Cook study on the use of ESG in incentives plans found that 56 percent of U.S.-listed companies with market capitalizations in excess of \$25 billion used one or more ESG measure in their annual or long-term incentive plan. However, the majority of those used discretionary rather than formulaic methods of applying those metrics, indicating that identifying quantifiable goals is still an issue for many companies. “The challenge is how do you translate goals that may be more difficult to measure and translate that into something concrete that you can put into a compensation plan and motivate people to achieve that,” says Gerber.

Reali says he is less concerned with tying pay to DE&I metrics. “We’re not trying to micromanage that,” he says. But if a board has decided to do that, he hopes to see more granularity around the metrics, what exactly is being incentivized and what they disclose. In other words, no window dressing. “What we really want to do is get at the root cause of systemic underrepresentation. How will this solve those issues?”

Moats stresses that when in doubt, boards should err on the side of transparency because that will build maximum trust with stakeholders and attract investors. And while she hears directors fretting over what a new administration and new SEC chair will mean from a regulatory perspective, she reminds directors not to be too caught up in that. “This is a time in history that we have not seen before, when stakeholders are demanding more of leadership and of companies. We are the most trusted institutions. So, what are stakeholders demanding? What is your purpose? What is your strategy? Why the E, the S and the G? Start with that—that’s your real story.” **CBM**



ON THE AGENDA

Perhaps the hottest topic in modern business is the role of ESG in corporate America. From CEOs to institutional investors to Washington regulators, everyone has an opinion. Too often lost in this conversation: the voices of corporate board members. To find out how boards are integrating matters of ESG into their overall risk and strategy oversight, *Corporate Board Member* partnered with EY's Center for Board Matters to survey 381 public company directors on their perspectives, practices and forecasts for ESG. Here are our key findings.

BY MELANIE C. NOLEN

Today, most Fortune 500 companies—and many smaller ones—have grown accustomed to issuing sustainability reports communicating the company's mission, community involvement, diversity measures, environmental performance and other ESG initiatives. But while this may have been sufficient five years ago, today's investors are demanding more: more transparency, more metrics, more reporting and more standardization.

There's no doubt: boards and leadership teams are feeling mounting stakeholder pressure to act and report on an increasingly wide-ranging list of issues. In a recent survey conducted by *Corporate Board Member* and EY's Center for Board Matters, some directors reported feeling that the demands can, at times, be unreasonable.

Pet insurer Trupanion experienced that pressure firsthand when a proxy advisory firm expressed concerns that director Rob-in Ferracone found surprising for a financial services company. "ISS came along and said, 'You are high risk from an environmental perspective,'" she recounts. "What it came down to is we were only high risk because we hadn't reported heavily on it, and we hadn't filled out the ISS survey and the ISS scorecards."

THE NEED FOR NUANCE

While acknowledging that investment firms need data to accomplish their research and benchmarking, directors point out that requests don't always fit the business or can be tricky to meet. "The questions they ask are very detailed, and it's hard to get the data around your carbon footprint, for example," explains Ferracone, who serves on the company's compensation committee, adding that the company is nonetheless "working in earnest to incorporate ESG into what it does."

But often, directors we talked to say these issues warrant a deeper conversation than the one analysts and investors seeking benchmarking data are able—or willing—to have. "They've got 150 companies' earnings calls they're doing in three weeks, so it's a quick hit," says Mike Gianoni, president, CEO and executive director at Blackbaud and

chairman of the board at Teradata, adding that it's with the savviest of investors that companies can discuss the value-add of ESG. "It's the longer conversations outside of those [earnings] calls that try to get into the 'who is the company'; that's a whole different thing," he says.

Frank Brandenburg, who is chairing KEMET's board through the company's integration with acquirer Yageo Corporation, says he understands why some directors push back on ESG demands from investors. "I feel the same way," he says. "I don't want to be lectured and forced into doing something or have shareholder pressure or social pressure to tell me what to do, yet they've never really participated or sat in the chairs that we sit in. I understand that you can go overboard to the point where you're doing things that are just for appearance purposes and not for real profits."

Ideally, ESG should be integrated into every company's strategy, adds Brandenburg, who notes that identifying and executing on what that means for each particular business can be challenging. "Employee morale is an extremely important part of your profitability," he says. "A lot of companies say employees are our most important asset, yet they don't necessarily behave that way."

Understanding what investors want to see in the context of their respective businesses is part of the challenge, say directors. When asked to rate their understanding of their shareholders' ESG expectations, directors rated the "G" a 4.1 out of 5 (on a scale where 1 = low understanding and 5 = great understanding)—but the "S" and the "E" a mere 3.4/5.

The issue, as many survey participants pointed out, is that "which aspects of ESG are important is very specific to each company," says Ferracone. And shareholder priorities also range widely.

SEEKING STANDARDS

Meanwhile, ESG reporting guidelines are coming from all quarters, from SASB and GRI frameworks to Nasdaq's global ESG reporting guide for public and private

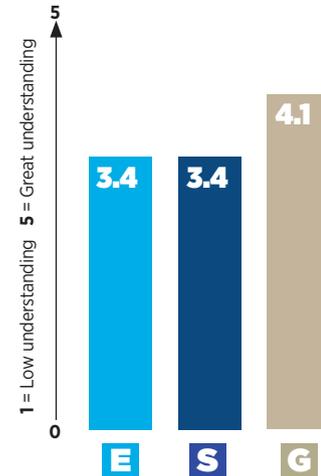
companies and California's Climate-Related Risk Disclosure Advisory Group.

"The hard part," Gianoni says, "is there are no standards. It's not like SEC reporting or accounting standards. There's no body of work that creates any standard of good, and it's different by company. For example, the environmental side is pretty darn easy for a cloud software company like mine, but it's pretty darn difficult if you're a manufacturer building in 40 countries; you got a whole scope of environmental [issues]. It's quite different."

The lack of standards is an issue for the investor community as well. "A lot of what we hear from investors is that the disclosure is so fragmented and company-specific that they can't compare it or benchmark it," says

DO YOU KNOW WHAT YOUR SHAREHOLDERS EXPECT?

"On a 1-5 scale, please rate your understanding of your company's shareholders' expectations as they relate to ESG matters."



HOW DO YOU TELL YOUR ESG STORY?

"If your company currently reports ESG information externally, which framework(s) or metrics do you use?"

Company-Specific Metrics/Frameworks

51%

Sustainability Accounting Standards Board

36%

Global Reporting Initiative

21%

Not Sure

19%

Task Force on Climate-related Financial Disclosures

11%

Climate Disclosure Project

9%

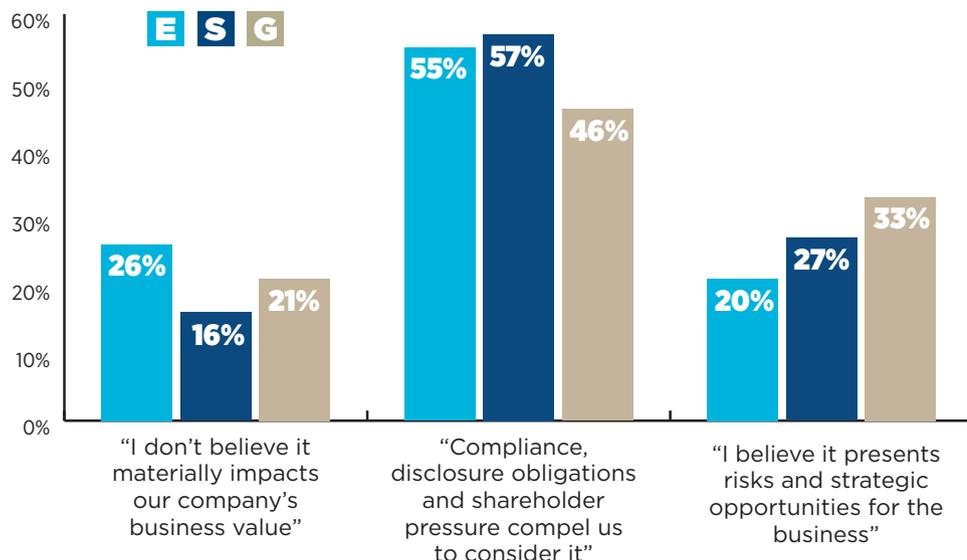
Other

5%

* Respondents were asked to select all that apply.

WHY DO YOU FOCUS ON ESG?

“Which of the following best describes your view of ESG matters?”



“I think the objective is to, every year, always get better in all of the categories.”

— Mike Gianoni,
Chairman, Teradata

Stephen Klemash, leader of EY Americas Center for Board Matters and a partner in this research. “That’s part of why they’re pushing for companies to use these frameworks and potentially pushing regulators to do rulemaking, to have something standardized so that they can do performance analysis, benchmarking and have a uniform set of data.”

Ideally, investors want companies to use external frameworks as a base and add company-specific data points to tell their unique story, he explains. “Investors want standardized data as a baseline to make it easier to benchmark and compare and want to see companies supplement that with company-specific reporting as helpful to understand the business, the strategy, the overall risk management and the business context of what people are doing,” Klemash says.

Some directors, however, argue that the topic of ESG is too broad and complex for standardization. “How do you have a standard for the ‘S’ side of that?” asks Gianoni. “I think the objective is to, every year, always get better in all of the categories. Our company is half male, half female, so our big focus on diversity is

all of the underrepresented groups. And for gender diversity, are we helping our female associates get higher and higher in our chart? If in the next three years, we go from 50 percent female to 70 percent, but we do not improve the total percentage of the other underrepresented groups, I think we failed. Everyone starts from a different place, so to have those standards, it’s really tough to do.”

While most directors say their companies would “do the right thing” regardless of requirements, the majority of those surveyed say they are only considering ESG issues in response to compliance, disclosure obligations and shareholder pressure. Twenty-six percent of directors don’t believe environmental initiatives materially impact the company, while only 20 percent of directors participating in the survey say they view the “E” aspect of ESG as an area that presents risks and opportunities for the business.

Despite the skepticism, directors report being relatively confident of their grasp of material environmental issues. Just 5 percent of those surveyed reported lacking confidence in their understanding of what the “E” component means for their business, and even fewer feel ill-equipped in their knowledge of the “S” (4 percent) and “G” (1 percent) components.

Directors have long reported feeling confident about their understanding of the G component of ESG, but the survey data shows half (49 percent) of them also say they have an “excellent” understanding of their company’s specific risks and opportunities when it comes to the “S”, and most particularly with respect to workforce diversity, equity and inclusion.

BEING INTENTIONAL

Of course, every industry is impacted by these issues to varying degrees. But while the “E” may be more material for heavy carbon emitters than for a professional services firm, for instance, Kathy Misunas, a seasoned board director and advisor to various businesses, argues that it’s still worth examining in the current climate. “Even a consultancy has the ability to look at how their people travel or if they’re traveling, for instance, on an airline that has stated that it is going to be carbon free by 2030. Every company has some

opportunity to have an effect.”

Larry Bickle, a retired public company CEO who is now a director at hydrocarbon exploring company SM Energy, points out that companies that produce products containing petrochemicals, from phones, cosmetics and clothing to carpets, food preservatives and medical devices, can push for more ESG in their operations. “I was on the board of Tucson Electric company for 15 years, and I’m proud to say that during the time that I was there, we went from 2,400 megawatts in coal down to 400 megawatts in coal. We replaced it with natural gas, and that made a huge drop in our environmental footprint. Switching from coal to natural gas is a huge improvement in CO₂ emissions for generating essential electricity.”

Brandenberg advises companies to be intentional about understanding what ESG means to their companies and translating that to goal-setting. “Some companies consume tremendous energy; some don’t, so energy conservation may not be the issue at hand to them, but figure out among those topics what would be important to your company, and then just start talking about it and do some internal measurements, set some goals,” he says. “The trap is people will follow those measurements just for the sake of measurements, but that doesn’t tell them anything, they don’t set goals. So, if they’re going to measure something, they have to have a goal in mind as to what they would like to achieve, something that is relevant to their profit or the health of their company.”

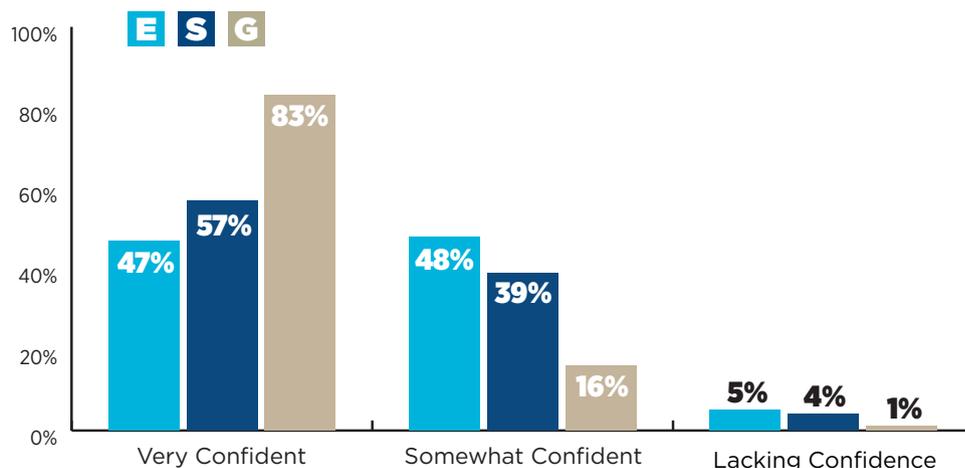
Ferracone agrees that establishing a baseline is crucial. “From where are we starting?” she asks. “What does our company do now? Where are the gaps in pay, representation, inclusion or promotions or other areas in which the treatment isn’t even? So, it’s an internal measure, and the question is, ‘How do we improve?’”

MEASURE TO MATTER

For Christopher Franklin, CEO and chairman of Essential Utilities, a Pennsylvania-based utility company that operates in 10 states under the Aqua and Peoples brands, success begins with setting clear objectives and establishing metrics. “It’s like any other objective that we set for ourselves in business. If you measure it, you’re going to improve it. So, if we’re

WHAT’S YOUR ESG IQ?

“How confident are you in your personal understanding of the material ESG issues facing your company?”



going to make improvements in some of the areas like diversity in our suppliers, diversity in our employment, environmental measures, we’re only going to do those by setting targets and then achieving them.”

While the full board must be involved in the ESG conversation to ensure that everyone understands the materiality of the issue and that the board has the right skillset to address ESG moving forward, committees play an important role, according to Klemash. “Nom/gov committees may want to dive into how it all impacts the governance of the organization and how they’re communicating it in the proxy,” he says. “The audit committee may want to look into the type of assurance or attestation they will need when reporting on that data. The comp committee may be looking at whether there’s value in tying executives’ goals in compensation to ESG and communicating the why—and most importantly the why not.”

Overall, he advises taking a step back to assess where the company is today and where it intends to go in the future, and to think about the ways to broadly communicate these assessments and decisions, whether it’s under a regulatory standard, an earnings call discussion or an impromptu request by a pool of investors. “It’s no different

GAUGING YOUR ESG RISK LEVEL

“How would you rate your understanding of company-specific risks and opportunities related to the following ESG topics?”

	EXCELLENT	ADEQUATE	NEEDS IMPROVEMENT	NOT A RELEVANT ISSUE FOR THE COMPANY
Stakeholder views on core governance practices (e.g., voting structure, director election practices)	61%	32%	5%	2%
Stakeholder views on board composition and refreshment	54%	39%	6%	2%
Other workforce issues beyond DEI (e.g., workforce stability, health & safety, training & development, labor relations)	43%	48%	8%	1%
Workforce diversity, equity and inclusion (DEI)	49%	37%	12%	2%
Other environmental issues (e.g., natural resource management, recycling, circular economy)	25%	52%	17%	7%
Climate risk / energy transition	30%	47%	15%	9%

WHERE CLIMATE CONSIDERATIONS COME INTO PLAY

“Do climate and energy transition considerations inform any of the following at your company?”

	YES	NO	UNSURE
Overall strategy	61%	34%	5%
ERM process	57%	28%	15%
Capital allocation process	50%	43%	7%
Executive pay program	26%	67%	7%

than total shareholder returns on a stock,” he says.

ESG AND PAY

As pressure to be more proactive on ESG issues mounts, some boards are pondering tying ESG metrics to compensation. Ferracone, who’s also the CEO of Farient Advisors, a compensation, performance and governance advisory firm, has seen boards land on both sides of the ESG incentive debate.

“I have one client who said, ‘You know what? We do a lot of things. We take DEI, as well as all kinds of ESG things, very seriously,’” she says. “And they’re thinking that if they were to put these types of measures into their incentive system, it would actually narrow the focus of people.... Others say, ‘ESG is not going to get the attention it needs unless we actually put it into our incentive system.’ It becomes a judgment call, but I think one of the things that’s become more standard is that comp committees and companies feel like they need to at least look at the subject. So, even if they decide not to put stakeholder incentive measures into the incentive system, they’ve at least looked at it, considered it, understand the pros and cons of it, and they move on with that knowledge. I’m seeing a lot more people taking it seriously.”

To Gianoni, the lack of ESG standards across industries makes incentivizing ESG impossible. “You can tie executive comp to so many things. But ESG is not standardized or regulated, so it can be so broad that it could be very subjective and not objective. That’s what I worry about when you start to tie compensation to things like that.”

In his eyes, it’s about building the right culture. “The ‘E’, the ‘S’ and the ‘G’ are all linked together as one thing. They’re different categories, but they do the same thing, which is building a competitive, financially viable company. If you have a really good culture, you can win at business. It’s just connected,” Gianoni says. “Having a good culture means you also have diversity and inclusion. It means you have to do the ‘S’ in ESG. You have to do all of that. If you don’t do that, you will not have a good culture in today’s and the go-forward world. And I believe most board members would agree on that.” **CBM**

CHANGES ARE COMING TO BOARD OVERSIGHT OF ESG, HCM AND DEI. IS YOUR BOARD READY?

From climate change to workplace diversity, there are many important topics on which boards are increasingly providing oversight. With new and evolving issues, here's what boards should know about stakeholder expectations and how to provide effective oversight. By Laura Wanlass

OVER THE PAST DECADE, institutional investors, shareholder activists and the SEC have asked for increased transparency from companies about how they manage environmental, social and governance (ESG) risks. In the past 18 months, the far-reaching impacts of the pandemic and growing social demands have accelerated board oversight of ESG material risk factors, with a particular focus on diversity, equity and inclusion (DEI) and human capital management (HCM) risks.

Looking ahead to the 2022 proxy season, ISS, Glass Lewis and numerous institutional investors have announced an increased focus on ESG risk factors, including enhanced board diversity, disclosure of people-related risks and how companies are addressing diversity and inclusion in their workforce. Failure to respond to these types of demands can have a direct impact on companies' bottom line and relationship with investors. Additionally, we expect the SEC to announce later this year new rules around more robust disclosures on board diversity, board oversight and climate-related risks.

So, how should companies and their boards systematically identify, prioritize, mitigate and oversee evolving material ESG issues? The first step is to ensure relevant parties are speaking the same language, which can be a challenge with multiple acronyms that have overlapping meaning.

If you picture ESG materiality risk factors as an umbrella term, HCM and DEI are initiatives that fall under it. While these terms overlap to some degree, stakeholders expect boards to be savvy about how they individually address each of these risk categories without lumping them into one general category.

Once a company has a good understanding of how these terms apply to their oversight activities, they must stay current on changes to stakeholder viewpoints, particularly changes to investor and proxy advisory policies.

How Stakeholder Expectations Are Changing

Evolving investor and proxy advisory firm voting guidelines will pressure boards to provide

Defining ESG, HCM and DEI



oversight of certain material ESG risk factors, including DEI and HCM. The list below highlights some key changes in sentiment by investors.

- ISS: Beginning in 2022, the firm will recommend votes against the chair of the nominating committee or other relevant directors at companies where no racially or ethnically diverse directors have been publicly identified (determined on a case-by-case basis).
- Glass Lewis: Beginning in 2022, the firm will generally recommend voting against the nominating committee chair of a board that has fewer than two female directors.
- BlackRock: The firm expects companies to identify and report on material ESG risks and opportunities and provide board oversight of HCM and DEI; it will consider voting against the reelection of directors where a board has not adequately demonstrated how material issues are identified, managed and overseen.
- Vanguard: While the firm has no minimum diversity requirements, a lack of diversity disclosures is the biggest risk for a vote against a board or support of a shareholder proposal for increased disclosures.
- Fidelity Investments: The firm will consider voting against boards that are not made up of at least 30 percent women in 2022.

With evolving viewpoints and regulation, companies must sort through all this information to properly prioritize actions and policies and provide sufficient information to the board for accountability purposes. To do so, consider

benchmarking peer practices and disclosures, assessing regulatory requirements, and analyzing the policies and values of key stakeholders.

There are certain communication and organizational considerations that must also continually be evaluated by management and the board, including:

- Developing a compelling narrative that is consistent across internal and external communication channels
- Ensuring proper oversight and coordination between management and the board
- Reporting risks and opportunities that are material to the company and the broader industry in an effective manner
- Providing ongoing board education on material and evolving ESG topics

Every company is at a different phase in their ESG journey. Aon's corporate governance and ESG advisors use data, analytics and experience working with all types of organizations to prioritize ESG actions and communications and drive functional accountability in navigating this process. Contact us to learn how we can help.



Laura Wanlass is partner, corporate governance & ESG practice leader at AON.



EXCELLENCE IN ESG

Even as environmental, social and governance issues become a focal point for stakeholders, boards are grappling with a lack of industry standards and uncertainty around shareholder expectations. Some lessons and strategies gleaned from CBM's recent ESG Board Forum.

BY C.J. PRINCE



Elad Roisman,
Commissioner, Securities
and Exchange Commission

NAVIGATING BIDEN'S AGENDA

Early on, President Joe Biden made his climate agenda clear by announcing that the country would rejoin the Paris Climate Accord and cancel the Keystone XL Pipeline, dismantling two of the more than 100 environmental actions taken by the Trump administration. That's left many companies and boards unsure of how new disclosure requirements might impact them.

SEC Commissioner Elad Roisman, who was appointed by President Trump, spoke about the new line item disclosure requirements in the areas of ESG, and recommended ways the SEC might tailor rules to mitigate costs:

1. Scale disclosure for public issuers. The cost of obtaining and presenting new disclosures will be proportionately greatest for smaller companies that have scarce resources. It will similarly be high for less mature companies trying to develop and refine their business models. Scaling the new disclosure requirements could lighten that burden. "We have taken that approach with many of our existing required disclosures," said Roisman, adding that new requirements should be limited to public companies.

2. Allow some flexibility in presenting information. "We'll need to be reasonable in our expectations of what companies can disclose and how they can disclose it," said Roisman. "I worry that for most 'E'

information, companies will have to go to outside vendors to evaluate and obtain it and that our regulations will inflate the demand and cost for such data."

3. Consider a safe harbor. Roisman advocates something similar to what is available for companies' forward-looking statements. "We'd be asking companies to tell us what they know as best as they can discern it. I worry we will chill that effort if we do not provide them some space to provide that disclosure."

4. Disclosures could be furnished rather than filed. Filing with the SEC could put companies in legal and regulatory crosshairs. "To the extent that the argument for additional SEC required 'E' and 'S' disclosures is that investors want the information and benefit from uniformity SEC required disclosures would provide, those benefits can be realized without imposing the level of liability that filing with the SEC presents," said Roisman.

5. Extend implementation time. Companies will look to the SEC and to peer companies for guidance about what level of detail and scope of information meets requirements—and that may take a while. "I hope that we can be patient in how we choose to implement this new regime."

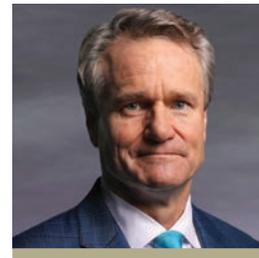
GETTING TO CONVERGENCE ON ESG

Boards face an alphabet soup of metrics complicating efforts to report on ESG issues. But standards will need to converge if companies are to satisfy stakeholders. “Investors are asking for these metrics so they can compare companies... Employees want to know about what their employers are doing, and customers also want to know ESG standards,” said Bank of America CEO Brian Moynihan. “It’s not a discussion of ‘Should we do it?’ but more ‘How should we do it?’”

To drive convergence, the World Economic Forum’s International Business Council released Stakeholder Capitalism Metrics—a set of 21 universal, comparable disclosures focused on people, planet, prosperity and principles of governance. “If you just close your eyes, you say, ‘Oh God, it’s

another set of metrics,’” said Moynihan, chair of the council. “But if people look at them, they’ll see they incorporate the best of those out there.”

While many companies that have signed on thus far are large organizations, progress on ESG metrics is becoming critical for companies of all sizes. “When I talk to midsize companies, I say, ‘This is hard, and it will take time and effort and money, but you’ll have the expertise of people like ourselves to give you the why-fors and why-nots,’” Moynihan said. “You can do it because you’ll have to do it, frankly. If you’re a cleaning company, a call center, a supplier, we can’t buy from you unless you agree to do these things across these metrics, because we have an agreement among ourselves that we’re going to deliver on these metrics.”



Brian Moynihan,
CEO, Bank of America

INVESTORS WEIGH IN ON THE EXXON VOTE

When ExxonMobil lost three board seats to little-known activist hedge fund Engine No. 1 this past spring, it demonstrated what even a tiny investor could do to pressure boards and management to get climate religion. In a session moderated by Katie Martin, partner and board chair for Wilson Sonsini Goodrich & Rosati, institutional investors shared whether they supported Engine No. 1’s director nominees and what the take-home lesson is for public company boards in general.

Peter Reali: We have been engaging with Exxon for years and expressing concerns around not just climate risks, but overall company performance. In this case, we supported all four of Engine No. 1’s nominees, and that was done entirely for investment reasons, full stop. And what does this mean [in the big picture]? This means that for companies that aren’t taking the ESG factors that are important to them into account, we are willing to use the power of the proxy, the accountability mechanism we have, to effect change at the company.

John Hoepfner: We supported the four nominees from Engine No. 1, and we were quite early in our public expression that this was the right decision for the company, again, for financial reasons, with a big climate tilt. This is a big deal in terms of broader investment stewardship relations with companies. This is not just a director vote—this

was an activist who took an aggressive position to change the structure of the board. What does that really mean looking forward? That means if you’re a sustained laggard by the investment community’s consensus, things may change fast. You become a risk, a target. That’s brand new. We have never seen an ESG activist win majority slate in the U.S. That’s a big sea change.

Kristin Drake: We’ve always said, if you want to really push change, it needs to be votes on directors, or through a proxy contest. It was interesting to see Exxon—it was clear that shareholders wanted to see a change. Just generally, in terms of addressing E&S concerns, votes on directors are much more effective. And in terms of identifying companies that we want to target, we did a climate letter campaign toward the end of last year that was focused on companies in industries where climate change is likely to be material and where board oversight of climate risk is not disclosed. And we’ll also look at [whether] what the company has said is material. If the company is in an industry where SASB says, ‘Hey, this risk is likely material,’ and the company doesn’t identify it as material, then we dive into why. Is there something different about this company, about their strategy, their operations that makes it reasonable that this issue isn’t considered material? So, it’s very case by case, and we do come at it from a board perspective in our voting and in our engagement and in what we look for disclosure-wise.



Peter Reali, Managing
Director, Head of Engage-
ment, Responsible Investing,
Nuveen, a TIAA Company



John Hoepfner, Head of US
Stewardship and Sustain-
able Investments, Legal &
General Investment Man-
agement, LGIM America



Kristin Drake, Head of
Investment Stewardship,
Dimensional Fund Advisors



Ana Dutra, Director, CME Group, Eletrobras, Harvest Health & Recreation, First Internet Bank



Alejandro Wolff, Director, Albermarle, JETSmart, Frontier Group

ALLOCATING OVERSIGHT

Given how many oversight issues fall under the ESG umbrella, it's no easy task for boards to figure out which ones are material, how best to monitor them, and how to keep the board's ESG IQ high enough to ensure no risks fall through the cracks. Paul DeNicola, principal of PwC's Governance Insights Center, posed those questions to two veteran directors: Ana Dutra, who sits on the boards of CME Group, Eletrobras, Harvest Health & Recreation and First Internet Bank; and Alejandro Wolff, a director with Albermarle, JetSmart Holdings and Frontier Group Holdings. Excerpts of the discussion follow.

How do you allocate responsibility for ESG oversight? Is it at the committee level or board level?

Ana Dutra: There is no one size fits all, but if we look historically, the components of ESG—sustainability, environmental issues, D&I, CEO compensation—have all lived in different committees on the board. So what I'm seeing is, let those topics live where they live and then create an ESG report at the end of the day [for the full board]. Establishing a separate ESG committee would likely create more confusion than help, because you would have overlap of issues.

Also, I've always been a fan of separating risk and audit, and now it's even more important. Audit is the rearview mirror, but if you look at cybersecurity issues, geopolitical issues, social justice issues, you are making a plan to mitigate the risk [in the future].

Alejandro Wolff: We have a very similar approach. The board as a whole has oversight responsibility and principal responsibility for aligning sustainability and ESG issues to corporate strategy. So, having these committees feed into that board structure and oversight is important, and it happens naturally through the reports that the committees present each meeting. We also have a formal session when the board will look at ESG and sustainability as a whole to ensure that it's tied to corporate strategy long term.

I would add that, if you haven't done much in the past [on ESG], there might be an argument to establish a sustainability committee or an ESG committee to get things started and highlight just how important this is and the attention that the board

and management ought to be paying to this range of issues.

What ESG expertise do you have or need to have on the board?

Dutra: ESG can really encompass everything. So, [you need to] distill that and understand where you have expertise and where you don't, because on one hand, I agree that the entire board needs to understand ESG and where the company stands. On the other hand, you can only have so many experts on different issues. So for example, in the CME Group, which is the largest futures exchange in the world, we're highly dependent on making sure that we are top-notch, world-class in cybersecurity. So, that's an expertise we need on the board. And quite frankly, it's proxy season, so understand where the proxy advisory firms are narrowing down, and that you need to have the type of expertise to respond.

Wolff: I would highlight one point, which is that you really do need this expertise within management. No matter how much expertise you bring onto the board, you don't want the board to have more of the expertise than management does.

What is the context in which you are discussing ESG? Who is doing the presentations?

Wolff: We have ESG issues built into our charter checklists, so each committee is dealing with an aspect of it that is appropriate to its role on a quarterly basis and reporting to the full board each meeting. The full board gets a presentation from management once a year formally. And then issues that come up over the course of the year—for example, human capital and social issues during Covid—are dealt with on an ad hoc basis.

Dutra: With regard to who's doing the presentations, I've seen more and more exposure for the chief compliance officer on the board, and particularly the risk committee. And again, that's a strategic decision the board and the company have to make if they are going to be more on the side of checking the boxes on compliance or if they are going to be on the cutting edge of all ESG issues and be more proactive. Also, the chief information security officer—a role that we didn't even have 15 years ago—is getting higher exposure as well. **CBM**

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Digital Transformation

DISRUPTING DISRUPTION

The pandemic impacted many companies' business models and digital transformation roadmaps. Objectives shifted, new risks emerged and consumer interest in engaging through technology spiked. In a survey of 188 public company directors, *Corporate Board Member* and RSM sought to find out where companies were heading and how they were surmounting some of the roadblocks 2020 threw in their way. Here are the key takeaways.

BY MELANIE C. NOLEN

In a world of constant change, the way customers interact with companies is evolving dramatically—and there's no doubt that those changes are driving digital transformation. To succeed in the decade ahead, companies must not only understand how consumers interact with their brands across new technology channels but also how they want to interact with them in the future. Customer loyalty is a thing of the past in most sectors, and companies must now rethink the customer experience and develop a digital transformation strategy to match.

According to our survey, board members are fully aware that digital transformation is critical to their company's future success: Half ranked it a 10 out of 10, on our 10-point scale, with 10 being most critical. Overall, 69 percent of directors participating in our survey said digital transformation was very important to their company, rating it either a 10 or 9 out of 10. No one ranked it below a 4 out of 10

(and only 1 ranked it a 4), a clear sign of consensus.

That is a significant change from just two years ago. Only 6 percent of participants say the issue has not evolved in their board discussions over the past two years. The great majority (85 percent) say the issue is now either part of the overarching strategy discussions or that it continues to accelerate at a significant pace.

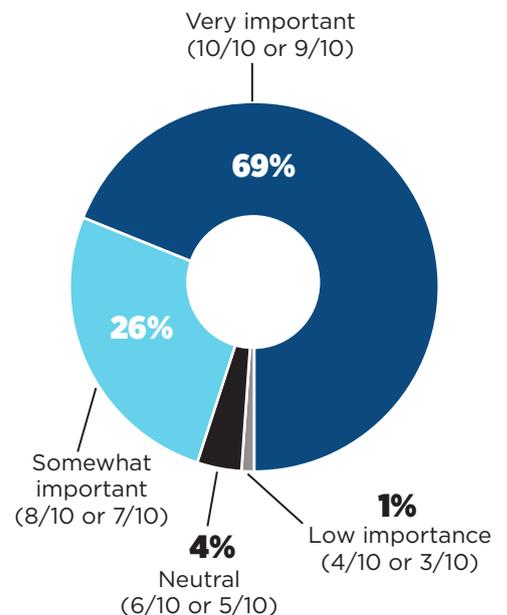
THE TRANSFORMATION IMPERATIVE

When asked why, fully three-quarters of directors say the Covid pandemic is the main reason for this accelerated pace of transformation—a crisis that altered business models and impacted digital transformation roadmaps.

"Companies were backed into a corner by the crisis in a way," says Bill Kracunas, principal at RSM US LLP, who partnered with *CBM* on the study. "If you didn't have an ecommerce platform, if your customers

HOW MUCH IT MATTERS

What is the importance of digital transformation in your company's success?



couldn't buy from you directly, you were in panic mode. And a lot of companies started thinking, 'we gotta figure that out.'"

He says the Covid pandemic has made companies realize that on the one hand, they had to react—and fast—and on the other that they were able to move much faster than they ever thought possible before.

Werner Geissler, director at Phillip Morris International and The Goodyear Tire & Rubber Company, says the key driver of digital transformation for his company has been the need to become much more consumer-centric and deal with the impact of social media on consumers being better informed; having higher expectations regarding the entire product experience; requiring tailored messaging; being valued as an important value creator for the company—"and not accepting unexplained compromises or deficits on consumer service."

Taking this approach allows companies to better understand that digital transformation is not an IT project but rather an enterprise-wide transformation that requires an in-depth look at structures, systems, capabilities and activities. "It has ramifications on the entire E2E supply chain, which in turn has implications on working capital and cash flow management," he says. "And it has consequences on people and culture systems from building the needed skills through internal training or external sourcing, driving the right culture, installing appropriate performance evaluation systems and synchronizing compensation systems."

George Corbin, director at Edgewise, former chief digital officer at Mars and former SVP of digital at Marriott, agrees that digital transformation is about something much bigger than technology. He says companies need to approach digitization from three angles—strategy, operating model and leadership—by identifying the true demand disruptors for a product in general rather than who the direct competitors are; understanding that the entire traditional operating model has to change rather than modernizing just a few processes; and ensuring the company has a growth-focused leadership team rather than just leaders who know how to run a business well. "And that includes who's on the board itself," he says. "Technology is just a bit player in all of this."

Our survey data shows that companies are, indeed, beginning to understand the true value of digital and what that really means in the big picture. Only five years ago, the primary aspiration for digital was an internal focus on building efficiencies, reducing costs and improving processes. Today, the spotlight is on the customer and changing perception of the offering by modernizing the brand with new capabilities. In the next five years, directors say they expect digital to push businesses even further, breaking into new markets and redefining the very essence of their company.

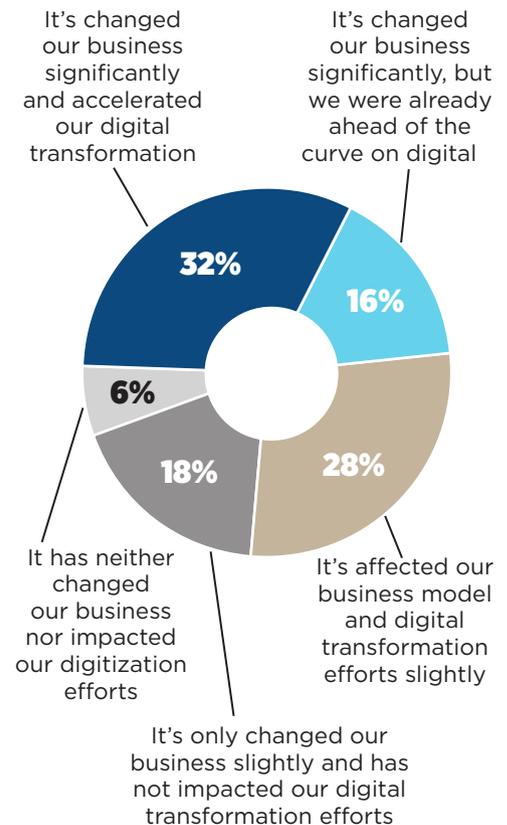
DIGITAL ASPIRATIONS

Kracunas describes the progression from automating the accounts payable process, for instance, to transforming the product into a smart product to building the capabilities to go global or break into new markets as a natural curve that demonstrates the vast power of digital transformation and the growing awareness that the customer is at the very center of it all.

"Digital is an enabler," says Dr. Latham Ramchand, director at Insperty and executive vice chancellor and provost at the University of Missouri, who says her company has taken a proactive step toward considering those aspects so that digital transformation becomes a little more than

THE COVID EFFECT

How has the pandemic impacted your business model and digital transformation roadmap, if at all?



WHERE IT'S GOING

How has the issue of digital transformation evolved in your discussions in the boardroom over the past two years?

They have been increasingly integrated into our overarching strategy talks but at a regular pace

49%

They have accelerated significantly

34%

They have been part of our discussions but mainly at a committee level

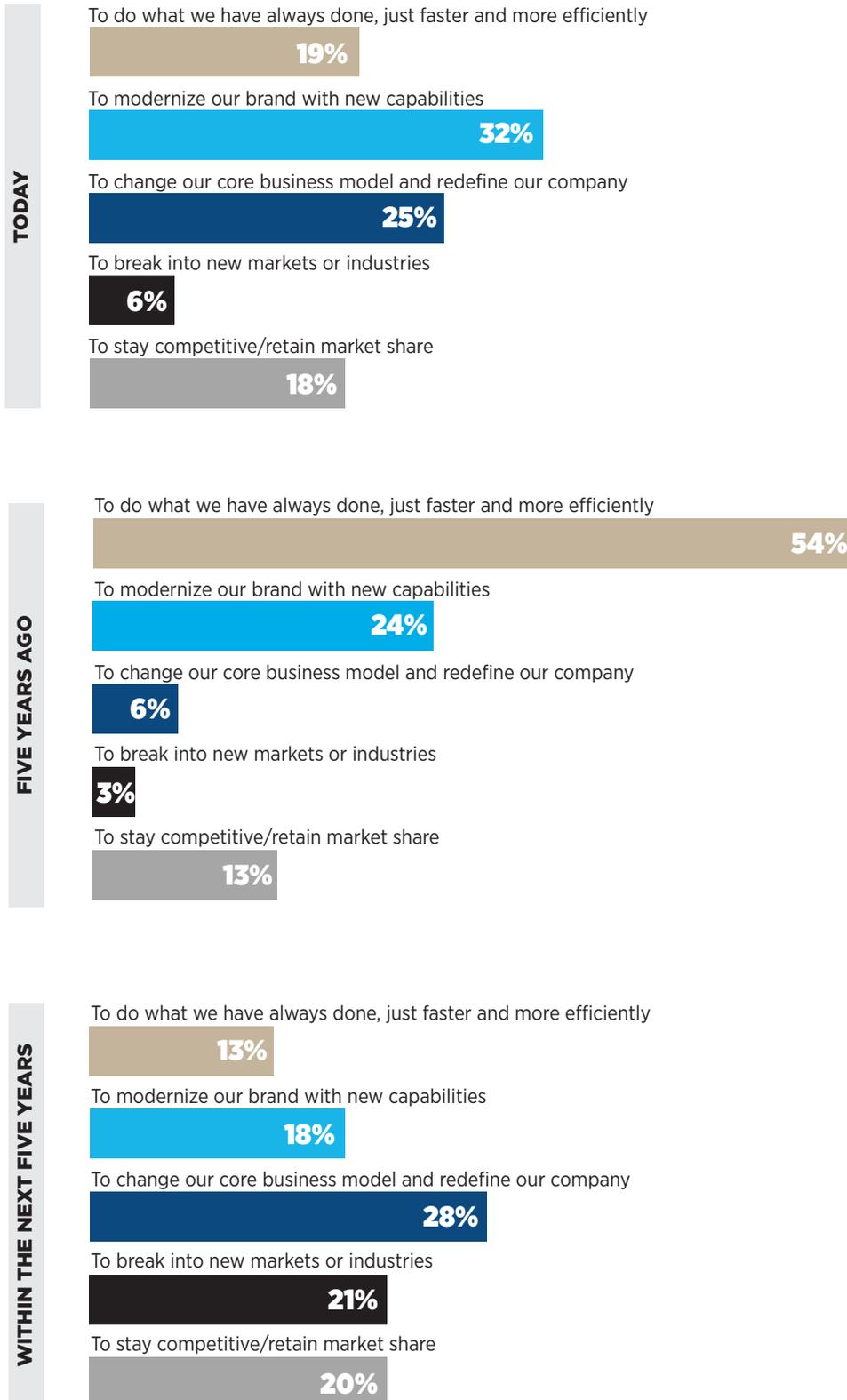
10%

They have not evolved further than where they were two years ago

6%

GROWTH GOALS

Which of the following best describes your company's primary aspiration for digital outcomes?



just a technical reality or a function. "It becomes more a part of the customer experience that can then differentiate what you offer."

Overall, 84 percent of directors say they are hoping digital technologies will help their companies improve the customer experience. While that is a significant proportion, it is followed very closely by cost effectiveness (74 percent) and growth (71 percent), which Kracunas says should be viewed as benefits of digitization rather than objectives.

"It's easy to cut costs," he says, "but it's a lot harder to gain market share and make sure your customers remain loyal, and that's where you want to focus your time." He says companies need to learn to focus outward. "It takes a new type of thinking to think about your customers' journey and what they are going through, how they are buying your product, what they are experiencing."

With 30-plus years in the retail industry, Tara Abraham, director at Peoples Bancorp and chair of privately owned manufacturer Accel, considers herself a retailer at heart. She says companies need to use data analytics to better understand their customers' future wants and get there before they do. "It's about continuous improvement and never settling and seeing what else is out there," she says. "Your customer isn't asking for it yet. Because if your customer is asking for it, you're too late."

THE DATA DILEMMAS

The majority of board members agree that the harnessing of technology should be customer-driven, with 70 percent listing data analytics as most important to their company's future success. While that is promising news, Abraham cautions that companies need to pay close attention to how they treat the data they collect. "The privacy of customer data is paramount," she says. "It's that level of trust. It's the reputational risk. As soon as you learn that you lose that reputation, you've pretty much lost all the confidence of your clients, and they will go somewhere else because everyone has so many options out there right now."

In addition to privacy and security, companies also need the ability to make sense of the data and understand why

they're collecting it. "I would suspect that most companies focus on the 'what' analytics—what's going on in terms of sales, costs, service, etc. However, the real value is being created by the 'why' analytics, such as understanding why the what's are what the what's are, because they enable you to address underlying root causes and to drive factors that deliver good what's," Geissler says, adding that he believes "the ultimate use of data analytics would be to manage the 'how'—how one can lift a company or a team onto a higher level of performance by simulating different what-if scenarios of interdependent variables before the final plan gets implemented."

Ramchand says that while her board company views analytics as merely a tool to better serve the customer, companies may find answers to questions that they hadn't considered in the data collection process. "I think that really depends on having good leadership that continues to ask questions," she says. "At the end of the day, all these are tools, and our goal is something bigger."

Data collection and analysis alone is not a strategy, agrees Corbin. "I've seen a lot of effort go into data cleansing and data standardization and a whole bunch of stuff; sometimes it was investing millions where it didn't necessarily need to be spent," he says. "But data is not the same as insight. What are the insights we need to drive the business?" The potential is in determining the big problems the company needs to solve, and then applying data and insights against that.

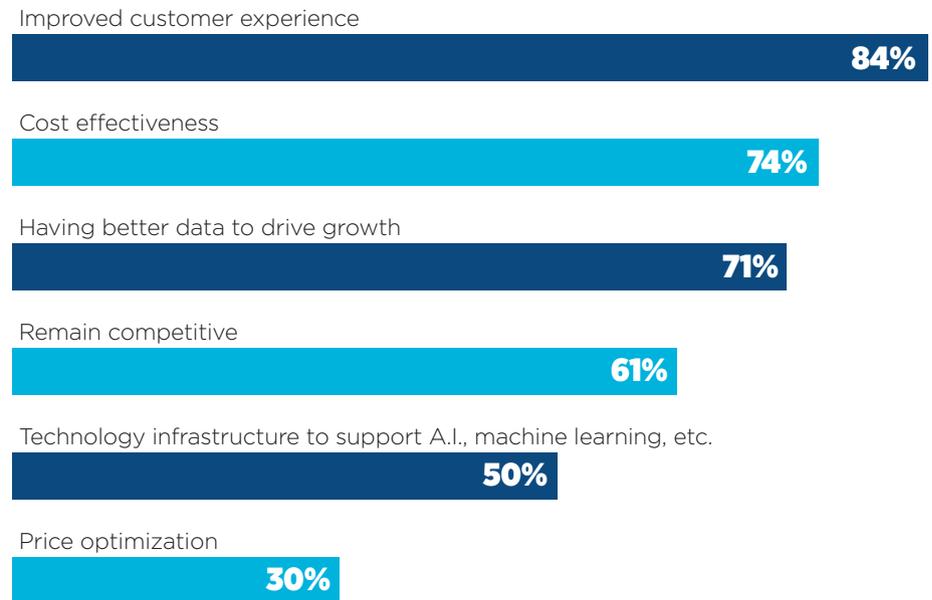
CLOSING THE GAP ON DIGITAL

Breakthrough technologies are emerging at a faster pace than predicted, and the Covid-19 crisis has further accelerated that pace. Today, most companies are left playing catch-up to the digital leaders—60 percent of directors say their company is still behind.

"Technology solutions evolve so rapidly, and it is natural for organizations to feel behind to some extent," says Kracunas. "However, customers are drawn to solutions and companies that simplify their buying experience. Without a perspective of what's available—and perhaps more importantly, what's coming—companies face a challenging and more costly journey to play catch up."

TOP OBJECTIVES

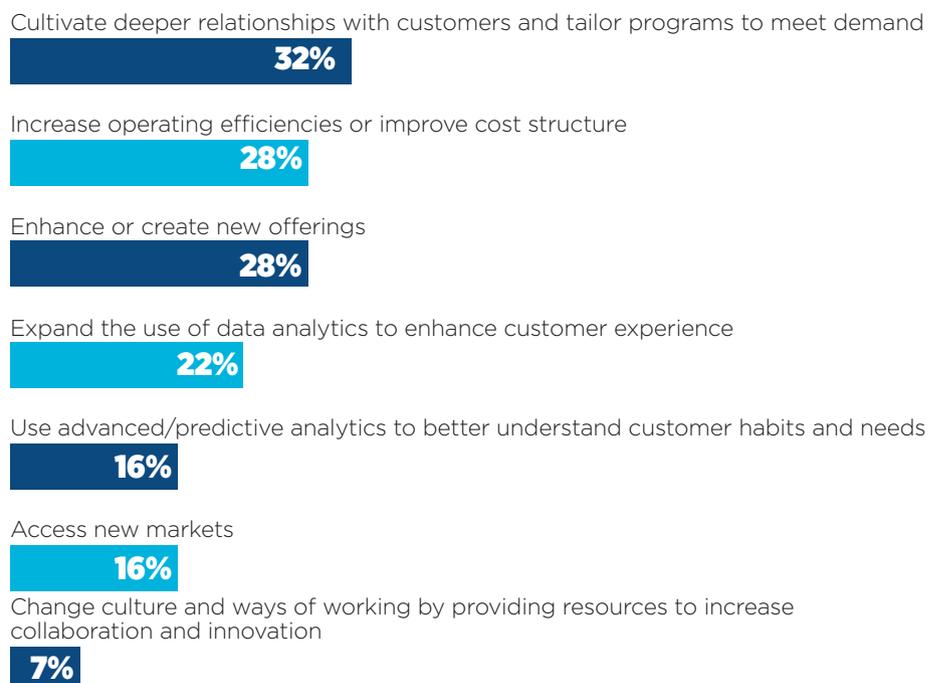
Which of the following business objectives are you trying to address with digital technologies?



*Respondents were asked to select all that apply.

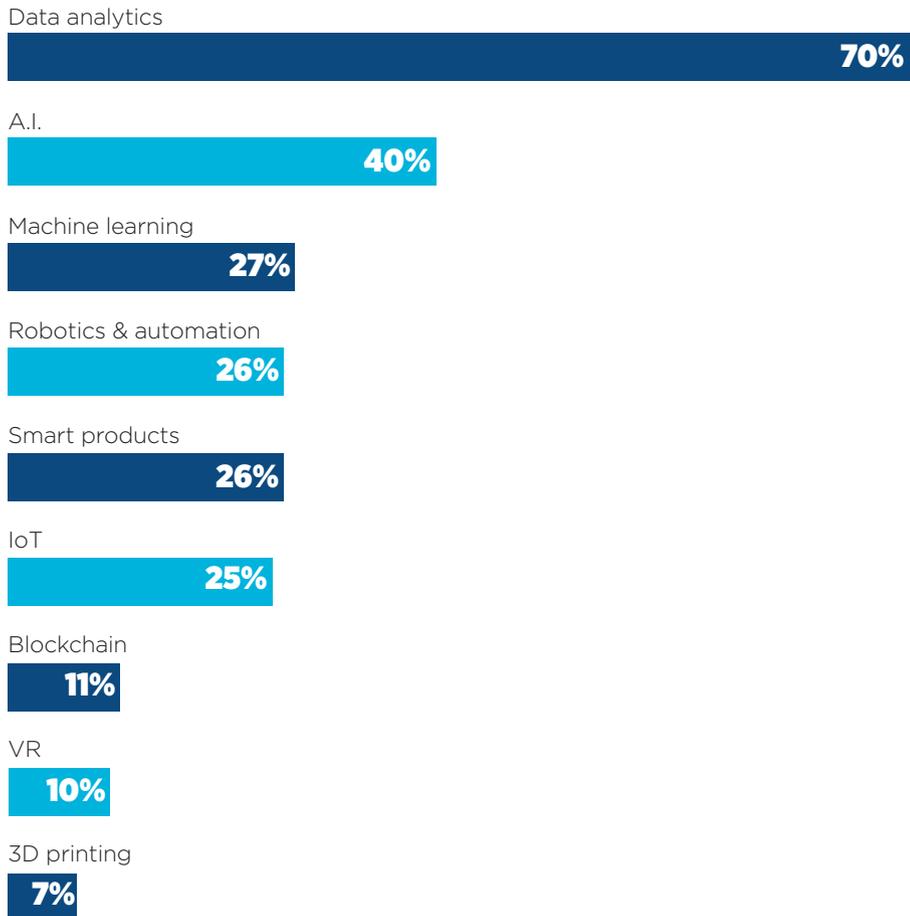
WHY WE CARE

Reason for pursuing digital transformation



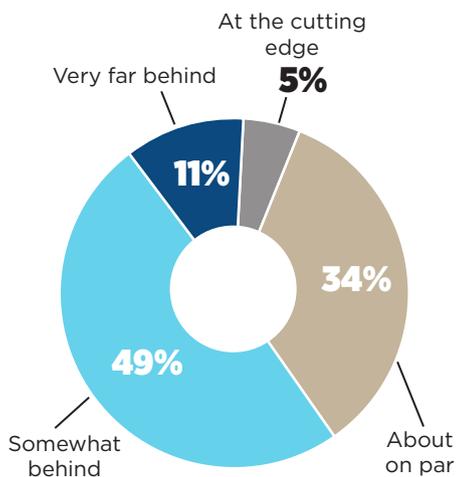
WHAT MATTERS MOST

Technologies directors said were “extremely important” to future success:



WHERE WE STAND

How would you rate your organization’s progress toward digital transformation relative to the companies you would consider to be digital leaders?



At the same time, companies shouldn’t rush to adopt a new technology just because there’s hype around it. Ramchand believes it may be too early to assess the true value of technological innovation on individual companies and across sectors, and that good leadership teams should be able to discern the hype from the value. “If you look at how companies are valued, at what’s happening on Wall Street, and you see the tech companies’ valuations relative to the bricks-and-mortar companies’ valuations, it’s clear that the market is placing a huge bet,” she says. “And it may not even be a bet because some of these are a little more mature companies—but there’s clearly a difference between that sector versus other sectors now.”

The question is whether the expectations of the capabilities of emerging technologies are warranted or based on assumptions of potential that may not ever be realized. “There is a little bit of

[the latter], I think, happening; the market is giving us that valuation,” says Ramchand. “And some may respond to those signals and say, ‘Okay, I don’t want to be left behind.’ But all I can say is, it’s definitely a trend to watch out for, and good leadership should be able to step in and feel comfortable saying, ‘No, I’m not going to do this just because that’s what everyone else is doing. I need to make sure I’m still serving my customer right.’”

Directors are walking a challenging line in this area, with 34 percent of those surveyed saying they do not feel confident about their own understanding of their companies’ strategic customer insights, including the customer experience, and 24 percent saying the same of their company’s possible innovation inflection points—only 15 percent report feeling “very confident” in either of these aspects.

SOLVING FOR KNOWLEDGE GAPS

Awareness of your customers’ pain points is the starting point to understanding your innovation inflection points, says Corbin. “We went from Gillette and Edgewell basically dominating the shaving industry to, for instance, seeing Gillette go from 70 percent market share to 50 percent market share because of these insurgent brands, like Harry’s, The Dollar Shave Club and others coming in—and not because they had a better product, but because they solved the customer’s problem better for the customer at the time.”

Newcomers succeeded by successfully analyzing customer friction points and tackling them better than the incumbents did. “It wasn’t the speed of the blade, because Gillette has 2,600 patents on blades alone. You’re not going to make a lot of incursion there,” he says. “But what they tackled are these other friction points, ‘Do I have to go to the store? Can I just get it delivered to my doorstep? Can I just schedule that? Can I just pay this amount per month for that privilege? Yes, to all of those things. And that’s where companies tend to get blinded by doing what they’ve always done.’”

Ramchand says her research background prompts her to ask questions about anything she doesn’t fully grasp. “The more questions we can ask of the management, the more effective we can be as directors, because clearly there’s so

much out there that's hard for us to grasp all at one shot," she says. "I just emailed someone and said, 'Are we doing this because it's required, or are we doing this out of best practice?' And the response has been we're not required to do this, we're doing it. That's good information. That tells me something about the leadership of the company."

Seeking different schools of thoughts on any given matter to challenge group-think is a primary board responsibility. "Of course, you always hope that management has a sharper perspective on the future than you, as the board, do, but you can't always bank on it, so it's always good to have a board that brings in outside perspectives and is open to provocation," Corbin says. "There are folks out there who are actually quite good at stirring the pot, who have literally written books on this, talked about the disruption threat and how incumbents get disrupted and how to prepare yourself... If you're not feeling challenged and are a bit terrified of the future, then you're not bringing in the right perspective."

LEARNING OPPORTUNITIES

For the board at Peoples Bancorp, it's all about continuing education—which has been strongly recommended by CEO Chuck Sulerzyski. "He is a huge proponent of continuing education for the board of directors," Abraham says. "It's expected that we are doing continuous education in all aspects. Chuck will consistently bring in an expert in some areas to talk about what's going on in the economy or market space or what the trends are in technology and where they see the shifts in consumer spending... it really helps the board be able to analyze where there could be possible threats or possible shifts and how we would have to pivot so rapidly."

Directors have a responsibility to seek out the knowledge they need to be effective while resisting the urge to let that newfound skillset lead them to overstep their role, she adds. "Our job as the board of directors is oversight. We're not supposed to be in the weeds. It's also our job as a director of a board to take that initiative to get that education, to get that knowledge transfer, to take the time and do research on what's going on in the industry that you sit on that board, and if you're not taking the time to do that, then you're not

“The more questions we can ask of the management, the more effective we can be as directors, because clearly there is so much out there that’s hard for us to grasp all at once shot.”

—Dr. Latham Ramchand, Director, Insperty

WHAT DO YOU KNOW?

Percentage of directors “very confident” in their understanding of the following:

Megatrends facing your organization and industry

37%

New and emerging competitors

22%

Possible shifts in your organization’s operating model resulting from external or internal risk drivers

20%

The wide-ranging strategic opportunities and impacts that are possible for your organization

20%

Potential technology shifts that could disrupt your organization and industry

18%

Strategic insight about customers at a granular level, including customer experience

15%

Your organization’s possible innovation inflection points

15%

invested and you're not committed to the success of the company on whose board you're sitting."

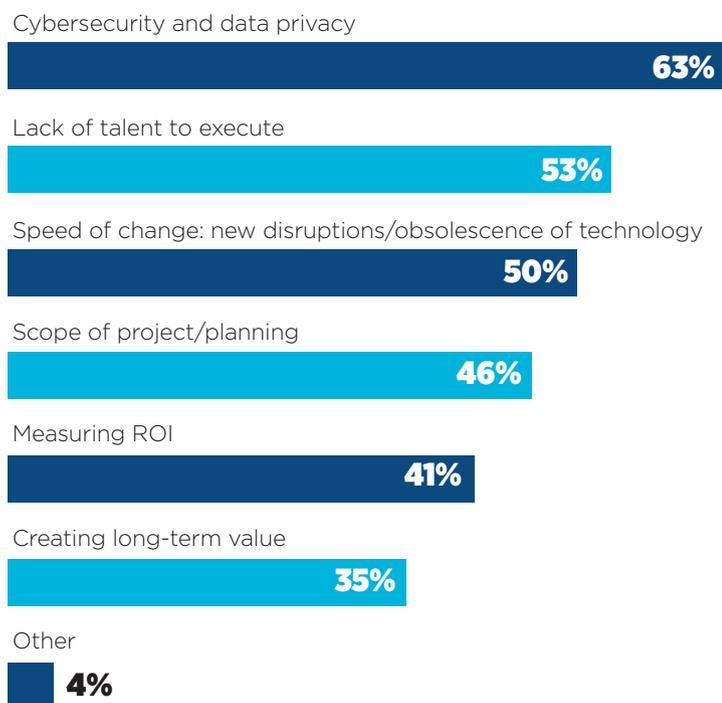
At Skyline Champion, board chair Timothy Bernlohr addressed the gap by seeking out and onboarding digitally savvy directors, including CEOs of tech companies. "I got cutting-edge industry leaders who have never served on public boards to do an assessment of many of our attributes and our deficiencies, and work with us in the strategic-planning process, along with the big-name consultants working with them and thereby customizing our own

“Everybody’s consumed with the day-to-day job, but you’ve got to delegate the present and tackle the future. And sometimes you need these catalysts to help do with that.”

—George Corbin, Director, Edgewell

WHERE TROUBLE LIES

Which of the following do you perceive as risks associated with operationalizing digital transformation?



**Respondents were asked to select all that apply.*

digital strategy,” explains Bernlohr, who is also a director at WestRock, Atlas Air Worldwide and International Seaways.

While some directors express concern that placing too much emphasis on the “tech-savviness” skillset can run its course once the digital strategy has been developed and executed, Bernlohr disagrees: “Digitally savvy directors who are CEOs and CFOs of large, publicly traded tech companies are no different than CEOs of old economy,” he says. “They all have investors to answer to, they all have quarterly conference calls, and they all understand the pressures of running a

business. They, in my opinion, are undiscernible from other types of directors that you might get in an ‘old’ industry. They can see around corners that perhaps older directors like myself can’t see, and not just in technical matters. They have a workforce, generally, that is younger; they have a workforce that is more professional; they have a workforce that is more millennial; they have a workforce that has those same skills and attributes that we’re trying to hire to complete our digital transformation out in the heartland. So, I think they’ve got excellent skills that don’t run dry after a project is completed.”

Some directors find war games to be quite effective in thinking through disruption. Corbin suggests dividing the board and leadership into groups and giving each a mandate, such as, “We want you to take 50 percent share of our industry in the next three years. What are you going to do?”

“This group of executives came into the room that day, nervous about a competitor and about this other sort of intermediary that was in our industry, and they left that room terrified of Google and this other third party,” he says. “When you get a bunch of executives competing with each other, magic happens because the first table stands up, puffs out their chest like, ‘We’ve got this,’ and by the end of it, their jaws are on the table.”

For Abraham, the area directors should prioritize if they do not feel confident about or are behind in their digital transformation is “investment in technology to mitigate risks and to make sure that your reputation is secured, that the data is secure. Because even if you can’t afford a chief information technology officer, chief information security officer, you can outsource that. But if you don’t have the systems and the technology already installed, then no one can implement them,” she says. “So, if you don’t have that investment in technology that is paramount to protecting your data and your security, then you don’t have the ability to expand your business offerings or take care of your clients.”

THE HURDLES AHEAD

Cybersecurity and data privacy ranked as the most recognized risks associated with operationalizing digital transformation,

“We’ve done a lot of work defining what the talent looks like and what our needs are to digitally transform, but finding the right talent to implement robotics automation, ERP, MRP systems is difficult...”

—Timothy Bernlohr, Chairman, Skyline Champion

BIGGEST HURDLES

Top 3 barriers to operationalizing digital transformation

Talent: Recruiting, retaining, upskilling



Technical: Integration, implementation



Financial: Cost of digital investments, access to capital, etc.



Source for all charts: RSM and Corporate Board Member

according to 63 percent of directors in our survey, and talent as the main barrier, with 57 percent of the votes. For Abraham, security ranks as a top priority: “You have to make sure that the data is so highly secured and guarded, that you have the seven-layer firewall and that you’re constantly upgrading your technology so it’s not antiquated because, quite frankly, 12 months from now, we’re on to the next,” she says.

Kracunas agrees that companies need to think about these risks from the very beginning and not as an afterthought. “There is an inherent level of risk involved in any technology investment, and you need to address those challenges and develop a plan upfront before a solution goes live,” he says. “Implementing new tools and applications is important for long-term success, but if risks are ignored and become an ongoing issue, they can continue to compound and the true value of the investment may never be realized. Ultimately, getting the most out of your digital solutions starts with the insight and talent you have access to.”

In some cases, the challenges are regional. “At Skyline Champion, we’ve done a lot of work defining what the talent looks like and what our needs are to digitally transform, but finding the right talent to implement robotics automation, ERP, MRP systems, is difficult, particularly where the predominance of the manufacturing base exists,” Bernlohr says. “People who are recent computer science or logistics, science graduates many times want to work on either coast and don’t necessarily want to work in the heartland, where they’re predominantly manufacturing jobs that are digitally transforming as we speak. So, it’s an issue finding people to go to certain locations and work on robotics when there are other opportunities in perhaps more favorable locations, at least in their opinion.”

For many companies, the talent challenge is more complicated, entailing understanding what the company will do with the skillsets it’s so intent on acquiring. “What I have seen in some other groups in the move to digital is that it’s that shiny object out there,” Ramchand says. “How do I get a cloud engineer or how do I get a software engineer? In my role, I see this a lot. And then people are like, ‘Okay, what do you really want them to do? And it’s not clear what they want them to do. All they’ve heard is these fancy terms out there.’”

“If your strategy is murky, if you’re unclear on what the real outcome is of your digital transformation, it’s easy to go in the wrong direction with the type of talent you hire,” agrees Corbin. “You’ve got to get clear about the destination, and from there it cascades into, here’s the type of people you’re going to need. Now, the challenge for everybody is hiring them. Data scientists are expensive. So, you then have to look at, is there a combination of insource versus outsource that you can use? Can you contract out on some of these resources? Yes, it’s likely that could cost you more, but it also gives you more versatility for peaks and valleys in demand... Look at flexible staffing models for them, building the team in time, as folks contract with you, you can convert them to full-time. It gives you a sort of dating period together and create the best offer you can to bring them in.” **CBM**

LESSONS FROM YOUR FUTURE

Technology is reshaping everything about business—and the revolution is accelerating. Insights for directors about the wild ride that lies ahead of us.

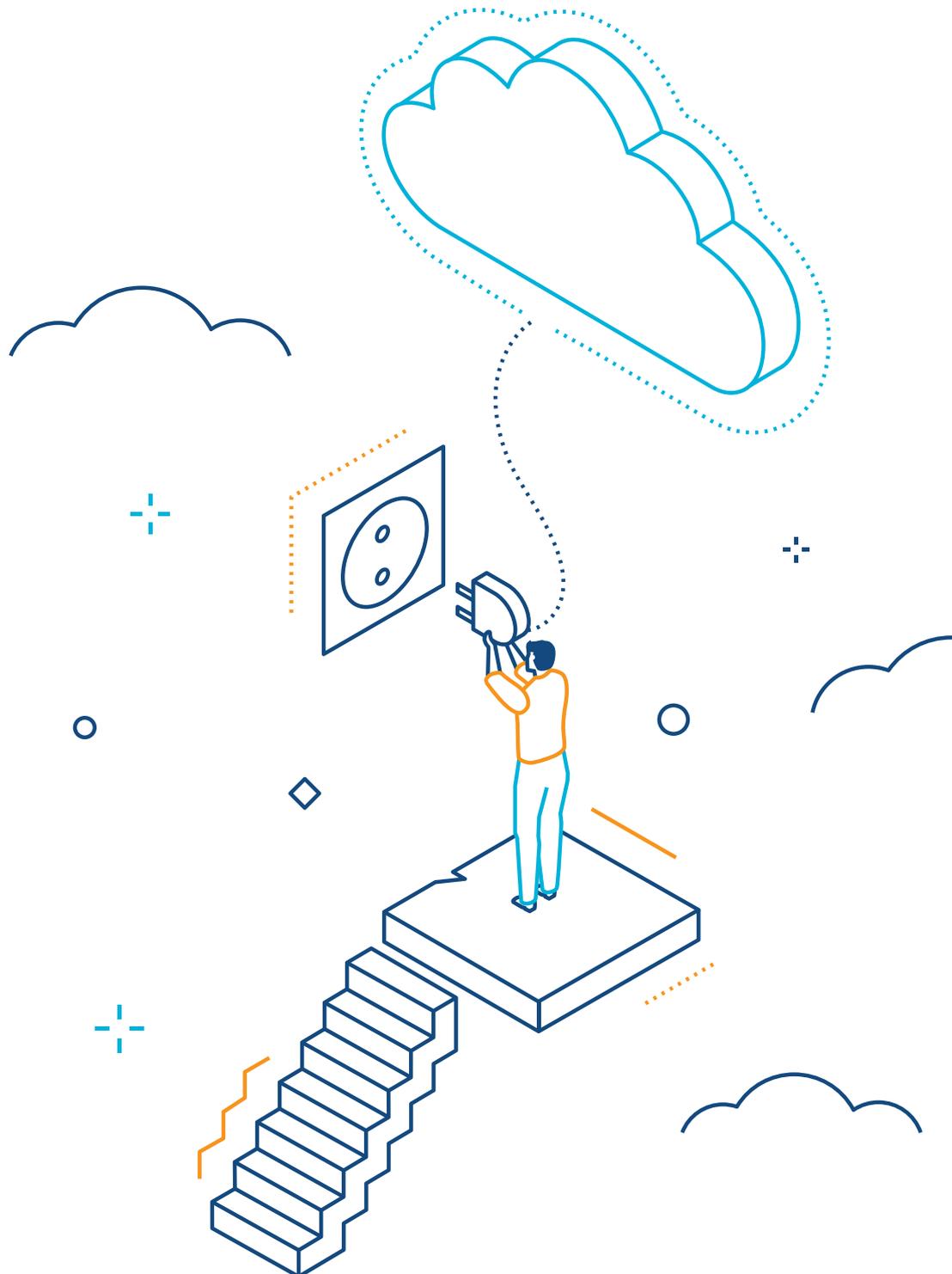
BY JENNIFER PELLET

Last year brought waves of change not seen in more than a decade—many of which accelerated digital transformation strategies from years to months, underscoring the importance of tech agility. While the need for a focus on digital transformation was well-established long before the pandemic, the crisis was a revelation for traditional companies, which discovered just how quickly change is actually possible.

Tech rollouts that had been plodding along on a trajectory of modest milestones were successfully fast-tracked, moving more quickly and with less resistance than anyone thought possible.

Digital companies, too, felt the pandemic's impact. Demand from legacy company customers spiked, bringing the welcome, but challenging prospect of managing even more rapidly accelerating growth.

In February, directors gathered virtually to hear insights from experts and the experiences of their peers on designing the right technology strategy for a post-pandemic future. Takeaways from *Corporate Board Member's Disruptive Tech Summit* follow.



WHAT A DISRUPTOR DOES DIFFERENTLY

Explosive growth isn't magic, but it is hard. Lessons from DocuSign.

When former Frontier Communications CEO Maggie Wilderotter joined DocuSign's board just before it went public in 2018, she saw a company poised for rapid growth. DocuSign's solution for obtaining signatures on legal documents remotely brought convenience and efficiency to what was often an arduous process for businesses of all sizes. "So, the total addressable market for the company was huge," says Wilderotter, who also serves on the boards of Costco Wholesale Corporation, Hewlett Packard Enterprise and Cadence Design Systems.

Then came Covid-19, which sent demand skyrocketing as lockdowns began sweeping the globe. "Companies started looking at digital transformation not from a cost management perspective anymore, but from a competitive advantage perspective—and that's really been a huge catalyst for a lot of DocuSign's growth," Wilderotter explains.

THE BOARD ADVANTAGE

For CEO Dan Springer, Wilderotter's presence on DocuSign's board throughout has been invaluable. Having steered Frontier during the company's climb from a regional player to the Fortune 500 ranks, she was able to guide management toward focusing on a long-term outlook. "One of the most important things she's done for me as a partner here was helping me to see the company not as we are today, or even in the coming year, but multiple years out," Springer says. "We're growing so fast that it's easy to focus on just next year versus really thinking through the challenge of having people with the leadership experience for the company we were becoming—a very large public software company."

Getting the right people—both on the management team and on the board—was a big part of the puzzle. "Maggie and I pretty much transformed our 12-person, all-white-male board into a nine-person board that is about one-third women and one-third people of color," explained Springer. "As with the management team, it wasn't that we were trying to get rid of people, it was about the leadership capability and experience we needed for the future."

By the time Covid-19 hit, the company had devoted time to identifying opportunities and developing a long-term plan. When demand for e-signatures spiked, DocuSign was able to consult its customer-centric playbook and move swiftly to respond. "That made it easy to adjust," says Springer. "We wanted to be a customer success company, so we knew that we needed to mobilize all of our resources toward doing that."

LESSONS FOR LEGACY COMPANIES

DocuSign benefits from the mindset that characterizes so many tech-centric companies aggressively and urgently pursuing ways of making processes digital. However, Springer sees the company as grappling with many of the challenges shared by more established legacy companies. "It's about talent, culture, discipline," he says. "It's about knowing what you're good at and should be doing, who you are versus not. It's about customer focus and priorities, and it's also about continuous improvement, trying to look around those corners, but staying the course on the things that you are best at and making sure that you shore that up as you focus and move into other areas. Young companies are just like young kids. You fall down, you scrape your knee every once in a while, but you heal fast. With bigger companies, it's harder, but the fundamentals of success are basically the same in the long run."

Those fundamentals extend to governance. Regardless of size, every company can benefit from a board that pushes for discipline and helps management find ways to identify and focus on rational, long-term solutions. Often, says Wilderotter, that may entail pushing for access to direct input from employees and customers.

For example, DocuSign's board looks beyond metrics like customer retention rates for ways to monitor the company's success at staying true to core goals like product innovation and delivering customer success. "We look at the voice of the customer as we hear it from the management team, but we believe that you have to trust, but verify," says Wilderotter, who cites the board's request that a panel of customers attend its strategy retreat as an example. "Customers, both new to the company and existing longer-term customers, gave the board feedback on what they like, what they'd like to see change, what works for them and where they think opportunities are. It was very enlightening for us as a board to really hear from the voice of the customer, because they had some great insights that we had not really discussed with the management team."

"Remember that sometimes you've got to push your CEO, even though your CEO doesn't want to do what you're asking them to do. I do think that as a board, you should have that voice of the customer in the boardroom every once in a while, because that verification or those insights are nuggets that really can make a difference in terms of success."



Maggie Wilderotter,
Director, DocuSign, Costco
Wholesale Corporation,
Hewlett Packard Enter-
prise and Cadence Design
Systems



Dan Springer, CEO,
DocuSign



Shohini Ghose, Professor of Physics and Computer Science, Wilfrid Laurier University

QUANTUM COMPUTING IS STRANGE, CONFUSING AND THE FUTURE

Hard to grasp, tougher to explain, this ‘spooky’ technology will transform computation, communication—and just maybe business itself.

WHAT IS IT?

“Quantum physics essentially is a description of all of the interactions between electrons and photons and other microscopic particles at that very individual quantum level,” says Shohini Ghose. Quantum computing uses the principles of quantum theory to move beyond the traditional off/on binary computing model that encodes information, or bits, only in values of one or zero. Instead of bits, quantum computing uses “qubits” that, rather than as a precise value, exist in “superposition” or on along fluid spectrum as a combination of zero and one, with some probability of being zero and some probability of being one.

Coupled with another property—entanglement, or when two or more particles in a quantum state are mutually dependent—superposition enables quantum computers to more rapidly identify optimal solutions for certain problems.

Still confused? You’re not alone. Microsoft CEO Bill Gates copped to being stymied by the prospect of conceptualizing quantum computing, likening it to decoding hieroglyphics. Fortunately, you don’t need to understand exactly how quantum computing works to get up to speed on what it means for business.



WHY IT MATTERS

“One of the reasons that quantum computing is so exciting is that it may help us to break through some of the constraints [of traditional computers] and access much, much more computing power,” says Ghose, who posits that over the long term almost every aspect of our lives today could, in principle, be impacted by this quantum revolution. “There are many, many applications.” Here are just a few:

An Optimization Advantage. “Any task involving sorting through large amounts of data or maximizing the efficiency of a process turns out to be a good fit for quantum computers, which will be able to more rapidly explore enormous sets of possibilities. They will be capable of analyzing traffic routes, schedules or delivery supply lines or, when we’re talking about financial data, huge amounts of transactions” to identify optimal answers to complex business problems exponentially faster than today’s computers.”

Unbreakable Encryption. “Anyone who tries to hack an encrypted message encoded using these properties of quantum particles won’t be able to precisely copy the message and read it, because of quantum uncertainty. They would have to break the laws of quantum physics to hack the key... on the flip side, quantum computing poses a threat to our current forms of encryption, which will be vulnerable to attack.”

Teleporting Communication: “This isn’t *Star Trek*-style teleportation where people disappear in one location and reappear somewhere else. We can’t do that. However, we can talk about teleporting quantum information, meaning the information on one particle disappears at one end and, because of entanglement with another particle at some faraway location, can be reconstructed at the other end. This kind of communication is a fascinating and powerful future possibility, not only for communication but also for computing protocols when computers are connected in some kind of a cloud network.”

‘A GREAT OPPORTUNITY TO REVISIT ALMOST EVERYTHING’

Disruptive tech plus Covid creates entirely new ways to serve consumer demand—and own the markets of tomorrow.

ON HOW CUSTOMER STRATEGY CONVERSATIONS CHANGED IN 2020.

Sarah Hofstetter: “This has been a great opportunity to revisit almost everything because if you were dropped on planet Earth in March 2019, how you’d go to market would be one way, whereas if you were dropped on planet Earth in March 2020, you’d rebuild the company completely differently. You don’t need to have a global pandemic to be able to ask those questions of yourself.”

Bill Kracunas: “One of the things I’ve noticed is that customers will sacrifice quality for convenience. As much as I like my Smartwater, they don’t have it on Amazon, so I’ll buy whatever they’ve got just because it’s easy. It used to be quality, value, convenience. I think it’s quality, value, convenience and experience, actually. There’s a new adjective in there.”

Scott Letier: “But when you’re talking about the convenience over experience over quality, some of that has to do with the nature of the product and whether it’s something you identify with, your favorite jeans, or something you’re going to open and consume quickly. And with Amazon, the quick ability to get something delivered and also the flexibility they have in return policy gives you that comfort that if it doesn’t taste right, they’ll take it back. That is very important and has been important for years for some of the most loved brands, like Nordstrom and Costco.”

ON ACCESS TO CUSTOMER DATA.

Sarah Hofstetter: “Boards in particular, can suffer from analysis paralysis. ‘I’ve looked at this piece of data. Now let me ask for the next one, and the next one and the next one.’ And you lose sight of things like what is the new customer experience? In certain cases with boards, it’s up to management to educate the board on what data is important against the KPIs that they’ve agreed to. In the end, the board’s job is to ask questions along the way.”

Leiter: “As a board, it depends on whether we’re able to collect the data, react to that data, actually, more importantly, turn that data into

usable and actionable information. Hopefully, we will be able to interpret that, ask the right questions and create some value for the management team. Sometimes they’re right in the middle of the fight and they need somebody to take a step back and, hopefully, provide some perspective. We can bring some of that value to them by saying, “We’ve seen this over here. How are you going to react to this situation when it hits you?”

ON SPEEDING RESPONSIVENESS.

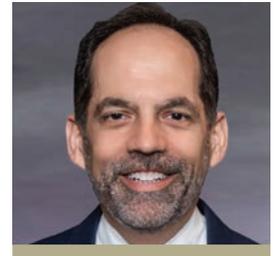
Hofstetter: “Let’s talk about looking at signals in social media to help us understand where flavor profiles are going or how consumers are sharing information. What are ways to be able to get that and act on it faster, whether you’re a legacy company or one built in the digital age? When Kraft saw that there were a lot of parents giving their kids mac and cheese for breakfast during the pandemic, they came up with a special line of breakfast mac and cheese. Literally, it’s just a repack, not even a full re-platforming. It was purely direct to consumer. They had the research and were able to pivot on a dime.”

Letier: “There’s a need to consume and react quickly to unstructured data. You can’t just depend on it all coming up through the ranks from the standard sources. Things have changed, right? And being able to react to that and to put a product out on the fly has become not very expensive. The ability to try something, to touch the two wires to the battery terminal to see if it has a charge, is quick and easy these days, depending on the complexity of the product. You can change macaroni and cheese a lot faster than you can change the iPhone 12.”

Kracunas: “These decisions are data-driven today. You should be looking for people to make strategic decisions based on data and experimentation and creativity, but then measuring it. It’s all about being data-driven to understand what the ask is, what we need to do, and then is it working? Should we do more or less? Kill it? The data-driven decision is becoming more and more important.”



Sarah Hofstetter, Board Member, Campbell Soup Company; President of Profitero



Scott Letier, Board Member, Conduent, Xerox and MV Transportation



Bill Kracunas, Principal, Management Consulting, RSM US LLP

'A WHOLE RAFT OF OPPORTUNITIES'

Six strategic technologies will reshape every business in the 2020s.



Steve Brown, Author, *The Innovation Ultimatum*

Entire industries have already been reshaped by new capabilities brought by emerging technologies, many of which are being combined in interesting ways to solve business problems. Companies founded on digitization continue to challenge legacy competitors, forcing a race to understand the opportunities as they arise and develop digital strategies to embrace them.

The gap between companies that get this—have a digital-first attitude—and those that don't is widening, says Steve Brown, former chief evangelist of Intel and author of *The Innovation Ultimatum*. "We are now moving into the spatial computing era, connecting the digital world and the physical world ever more intimately," he says. "This brings a whole new raft of capabilities that together enable you as business leaders, supported by your organizations, to solve problems in ways that you have never been able to solve them before."

As technology continues to knit the digital and physical worlds ever more closely together, says Brown, CEOs must be mindful of six rapidly evolving technologies:

SENSORS AND THE INTERNET OF THINGS. Data collected by sensors in everything from light bulbs and tires to complex machinery already inform actions. That's only the beginning, notes Brown, who points to a Starbucks franchise's creative use of Wifi. Hotspots in each store monitor traffic in real time by counting of the number of phones and using the data to control the music system. Low traffic calls for chill music that encourages sitting and relaxing,

while higher traffic triggers faster tempos to get people in and out faster. Says Brown, "Your task as leaders is to stop thinking about technology as purely giving you productivity and efficiency gains, but, 'How do I use technology to be able to be more creative, intuitive and make better decisions?'"

AUTONOMOUS MACHINES AND ROBOTICS. While self-driving cars command a lot of attention in the autonomous technology area, the opportunities are endless, from blended teams of humans and machines working together to new services and ways of reaching customers. "There are companies building autonomous mobile stores—summon the store from your smartphone and it moves to you and opens up so you can buy what you want," says Brown. "That should have you thinking, 'How can I use technology to bring services to clients?'"

ARTIFICIAL INTELLIGENCE. A.I. is the technology that enables the digital world to understand a lot of what is happening in the physical world machine vision. "A.I. has the ability to see the world in more detail than we as humans can, to find important patterns in data and to, through machine learning, use that ability to solve problems and improve decision-making," says Brown.

A.I., for example, is assisting film studios in Hollywood to sort through scripts and identify those with the most box office potential. It's also being employed by engineers and architects to optimize designs. "A.I. takes that design and riffs on it, creating hundreds or even thousands of variants and

A.I. AND THE ORGANIZATIONAL LEARNING ADVANTAGE



Mark Weber, Strategy & Operations Lead, MIT-IBM Watson A.I. Lab

The percentage of companies able to achieve a significant financial benefit with A.I. languishes at a dismal 20 percent, according to data from 3,000 companies in a study by MIT Sloan School of Management, says Mark Weber, strategy and operations lead at MIT-IBM Watson A.I. Lab. However, that number jumps to 73 percent among companies that invest in organizational learning. For companies, the takeaway is that there is value in helping people at all levels of the organization understand A.I. and what it will mean for the organization through a robust program of A.I. strategy workshops, strategy seminars and director briefings.

A.I. Progress Report



putting them through simulations, then coming back to say, ‘If you tweak the design this way, it will cost 6 cents less, or if you design it that way, it will have 22 percent more tensile strength,’” says Brown. “If you’re not thinking about how you can use A.I. to boost your decision-making from the boardroom on down, then you’re probably missing an opportunity.”

5G AND SATELLITE. Between the 5G network rolling out in major cities around the world and the broad connectivity coming online via satellite networks, “everyone and everything will be connected by the end of the decade,” says Brown. “That opens up a whole raft of opportunities for every business.”

BLOCKCHAIN. Designed to keep track of currency transactions, the security provided by blockchain technology can help companies track the movement of goods through supply chains. “A way of recording things in the physical world, digitally timestamping them, gives business a whole new way of bringing transparency to supply chains,” says Brown. “Tokenizing assets gives us a better understanding of where the things we buy come from, how they were made, how much energy and other resources were used to make them.”

AUGMENTED REALITY. A huge leap up from virtual reality, augmented reality will overlay the physical and virtual worlds—an advance with practical business applications in virtually every industry. Geographically dispersed workers who feel as if they share the same space as their coworkers will be able to collaborate more effectively. In the next few years workers learning to operate or repair equipment may be able to “put on a pair of magic glasses” for step-by-step, real-time guidance as they tackle the task.

Ultimately, the real potential of all of these six technologies comes by combining them. “Think about these as new colors in your palette to be combined in creative and interesting ways,” says Brown. “It’s a strategic weapon to help you get ahead of your competitors. Investing in these technologies can allow you to create new products and services, build new channels, reach new markets, elevate your employees, streamline your operation and maybe create new business models and revenue streams. You can do some amazing things with this stuff.”

‘YOU’VE GOT TO GIVE YOUR PEOPLE PERMISSION’

If the pandemic made one thing clear, Cars.com CEO Alex Vetter says, it is the importance of leveraging tech to build a connected organization.

For a company that relies on online sales, there’s nothing quite like seeing your user volume drop to “virtually zero” overnight, says Alex Vetter, CEO of Cars.com, which operates front-end websites for 5,000 car dealers. That’s what the company saw happening with the announcement of shelter-at-home orders. “By the third city, we were staring at a situation where all of our user growth would potentially go to zero,” he recounts. But it wasn’t long before the company started to see user growth start to tick back up—and within a month, cities like Seattle were higher in traffic than they had been pre-pandemic. While the national picture was dire, it turned out people still needed to go places—and they didn’t want to do it by plane or mass transit.

When states forbade local dealerships from staying open, Cars, swung into action with an aggressive customer petition campaign for the sale and service of cars by technology. With its entire workforce shunted from their offices into working remotely, the company still managed to rally, says Vetter, who credits these traits for Cars’ resiliency:

A SPIRIT OF PERPETUAL LEARNING. “If you’re not keeping your company sharp in trying and testing new things, you’re actually going to get old. We don’t ask everybody to justify every trial or every test. You’ve got to give people permission to know that they’re going to go down some roads that aren’t going to lead you anywhere—that will enable you to find some on-ramps that will accelerate your growth.”

INTERVIEWING FOR COLLABORATORS. “In addition to growth minded people willing to try new things, we interview for collaborators, people who had demonstrated teamwork. That’s the new organizational workforce mentality. I don’t want soloists. I need team players because that’s how share points are won.”

EMPOWERMENT. “We encourage people to decide and do rather than seek approval, [especially during Covid]. We really wanted to unlock even our most junior front-line people to talk to customers and make split-second decisions about what to do. We wanted them to know that we had their backs.”

INFORMATION FLOW. “In a crisis you need to break down the formality and just get information out quickly. We also sent an edict to have fewer meetings. We didn’t want the standard cadence of getting together weekly—so, we shortened everybody’s expectations to doing quick huddle check-ins and then letting people get back to work.”

EMPATHY. “We were all dealing with a lot of personal challenges and uncertainty with our families. Being empathetic as a company about what our employees and our customers were going through was the prevailing characteristic that I think we demonstrated in customer actions and the way that we took care of our employees that kept us linked together as a team.” **CBM**

DIRECTORS POINTS OF VIEW



“Culture is hard work, and there’s no way to sugarcoat it. But you can architect a culture, and you can change a culture over several years. It is not an overnight process. There are no quick fixes; there’s no two-minute fast-food kind of appetite here. I believe the board’s most important responsibility is to clearly identify what kind of culture you want and then how you are going to achieve it.”

—Brad Oates, **Compensation Committee Chair, CIT**



“Activists are everywhere, and I’ve had a couple on boards that I’ve been on. And it’s interesting, activists have a point of view. You always learn something from the interactions.”

—Ellen Kullman, **Director, Amgen, Dell Technologies, Goldman Sachs**



“As with everything else, when you are absorbing all the sorts of impacts and the changes for risk management, those same inputs also allow you to look at your strategy and say, ‘There are opportunities.’”

—Claudia Fan Munce, **Director, Best Buy**

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THE DEAL DILEMMA

Pressure is building to snag value while the getting is good. But mergers and acquisitions are always tricky—and boards have a whole host of new issues to consider.

BY RUSS BANHAM



In this period of record M&A values and volumes and ample capital, board members at public companies and private equity firms may feel pressured to greenlight acquisitions, despite accelerated (and shallow) due diligence into the target company's strategic fit. Public companies are awash in capital from record stock prices, and there's enough dry powder for private equity

firms to spend like there's no tomorrow. Why worry?

But like anything too good to be true, today's M&A dealmaking may look foolhardy in no time. Over the past 50 years, 60 percent of the more than 1,000 M&A transactions with values ranging from \$5 billion to \$150 billion eventually bombed, according to a July report by Aoris Investment Management. Meanwhile, the scope of due diligence has never been wider.

"We're in an age where a target's digital readiness, ESG factors, new work paradigms and DE&I agenda can turn what looks like a great deal into a so-so deal or, frankly, a big mess," said Thomas Smale, board member at LTV Fund, a large U.S.

investment fund focused primarily on SaaS and software investments.

Financial factors like stock market volatility, supply chain disruption and inflation uncertainties also must be in scope, but board members are used to asking questions to senior management about the economic climate. "That's nothing new, but what is new is all these other due diligence concerns," said Smale, whose day job is CEO of M&A advisory firm FE International.

Other board members are equally concerned about a blind rush to the altar, a "let's make a deal now before the good times pass" mentality. "There's a lot of cash out there, but that doesn't mean you go out and spend money like a drunken sailor," said Anna Catalano, a board member at multiple companies, including Appvion, Kraton, HollyFrontier—and Willis Towers Watson, who saw their proposed merger with Aon recently derailed by antitrust concerns (see "Passing Biden's Muster," p. 34). "So much has changed in the last year and a half—ESG, ransomware incidents, how we work and the tools we use. We're in uncharted waters where the usual M&A due diligence isn't enough."

These potential hazards certainly haven't constricted the surge in dealmaking, which at press time remained on a record-breaking tear. The first half of 2021 saw more than \$2.8 trillion in global

"There's a lot of cash out there, but that doesn't mean you go out and spend money like a drunken sailor."

*—Anna Catalano,
Board Member,
Willis Towers Watson,
Appvion, Kraton
and HollyFrontier*



“Digital readiness, ESG factors, new work paradigms and DE&I agenda can turn what looks like a great deal into a so-so deal.”

—Thomas Smale, Board Member, LTV Fund

Passing Biden’s Muster

Willis Towers Watson’s long-planned \$30 billion merger with Aon, an even larger insurance broker, would have created the world’s largest insurance broker, surpassing behemoth Marsh.

But their plans came undone thanks to an antitrust lawsuit filed by the U.S. Justice Department in June asserting that the merged entity would reduce competition, “consolidating the industry’s Big Three (brokers) into a Big Two.” In late July, the big brokers called off their merger. (Anna Catalano, who sits on WTW’s board, declined to comment on the decision.)

The message from Washington appears to be: *Big is fine, but too big is bad.* It’s not a new message, per se, with the SEC under President Trump blocking or threatening to thwart big deals in several industry sectors. However, two weeks before the Justice Department’s lawsuit, President Biden sent a signal by signing an executive order “to combat the excessive concentration of industry, the abuses of market power and the harmful effects of monopoly.”

For boards, the hard part is understanding what constitutes “excessive.” “The new administration and its new people have no track record of [antitrust]

mergers and acquisitions, of which \$1.3 trillion was recorded in the U.S., according to Refinitiv. Deals exceeding \$10 billion also were common, among them Discovery’s \$43.3 billion acquisition of Warner Media and Dell Technologies’ \$52.2 billion spin-off of VMware. And the year is far from over. Nevertheless, not all deals got the green light from regulators, as evidenced by the derailed merger of giant insurance brokers Willis Towers Watson and Aon.

With the economy roaring and interest rates holding steady in midsummer, even rising concern over the fast-spreading Delta coronavirus variant didn’t pause the dealmaking fervor. Going forward, more than three-quarters (76 percent) of CEOs participating in PwC’s midyear M&A survey expect that global economic growth will improve further in the next 12 months, virtually guaranteeing a nonstop parade of M&A deals

enforcement or viewpoints to ‘read’ their actions and guidance,” said Stephen Kasnet, board chairman at Granite Point Mortgage Trust.

Minus this understanding, Thomas Smale, board member at LTV Fund, advises reviewing three major antitrust laws—the Sherman Act, the Clayton Act and the Federal Trade Commission Act. “While most board members aren’t actively sitting around thinking about how they can restrict competition or engage in price-fixing, they might be inadvertently violating the law—despite their good intentions,” he said.

Smale recommends consulting an attorney experienced in both M&A litigation matters and antitrust laws to review the terms and conditions of the contract.

Certainly, the SEC’s thumbs-down on the WTW-Aon merger is instructive. Board members should beware transactions involving peer competitors that unfurl a red flag, as the many months involved in closing the deal will consume substantial financial resources.

As Kasnet put it, “No one wants a surprise, so I expect that many positive combinations may be delayed until the picture is clear.” —R.B.

tumbling into board members’ laps.

“I’ve been doing this for 20 years, and it is easily the hottest M&A market I’ve ever seen—bar none,” said Cathy Bedrick, financial due diligence service network leader at KPMG US. “That ‘hotness’ should make every board member pause, however. The deals are coming in so quickly, and competitors are moving just as fast to snap them up, and there isn’t the usual luxury to tick every box in the due diligence.”

Miss a few ticks and public company board members can end up at the other end of a shareholder lawsuit. “Boards have a fiduciary obligation to challenge management to ensure the metrics of the target company strategically align with the deal thesis,” said Trevear Thomas, national managing principal and M&A offerings leader at Deloitte.

The problem is offering constructive criticism on such newer risks as the target company’s ESG factors, DE&I initiative, cybersecurity and the state of its digital transformation progress. Accurate and thorough metrics on these risks take time for management to collect, review and provide to the board. Nevertheless, as Thomas said, “To drive M&A success and minimize disruption, board members have a clear responsibility to ask for and evaluate this information.”

A GRIP ON ESG AND DE&I

If awards were given out for the business acronym of the year, ESG—for environment, social and (corporate) governance—would win in a landslide. Investor demand is aggressive for public companies to provide accurate disclosures of their ESG practices as they pertain to business and operations, employee engagement, health and safety, and corporate responsibility.

For more than a decade, large institutional investors like BlackRock and State Street have sounded the call, but many businesses and their boards listened without taking concrete actions. After a global pandemic, myriad #MeToo scandals and a recent heat dome boiling shellfish in the shallow waters of the Pacific Northwest, customers, partners and the public at large have joined investors in pressing companies to demonstrate ESG commitment. Apparently, so has the U.S. government: U.S. Securities and Exchange Commission Chair Gary Gensler is mulling the implementation of climate-related and human capital ESG disclosure rules.

For now, boards must cope with the lack of an agreed-upon global standard and framework that companies can use to describe and disclose their ESG data. More than a dozen different ESG frameworks and standards exist, including the Global Reporting Initiative (GRI), Carbon Disclosure Project (CDP), Sustainability Accounting Standards Board (SASB) and the International Integrated Reporting Council (IIRC). Confusion reigns.

"I'm having a tough time as the board chairman of two financial services companies trying to figure out how to measure

derneath them, and they're not 100 percent sure which ESG standard will prevail. Consequently, we're being asked [as the M&A advisor] if enough due diligence is being done to satisfy investors, customers, communities and other constituents."

To provide clarity to board members on the subject, KPMG, Deloitte and other Big Four firms offer a range of ESG assurance services. "We look at the target company to compare and contrast its ESG maturity with the buying entity," said Thomas. If the level of ESG is immature but the buyer decides to pursue the transaction anyway, Deloitte will

meritocracy and providing opportunities to all people."

She is far from alone in this view. "Given everything that has occurred, there's no question that anyone who seriously questions the value of a diverse and inclusive workforce, partnering organizations and customers is out of touch with reality," said Duncan Smithson, senior director, HR Mergers & Acquisitions at Willis Towers Watson.

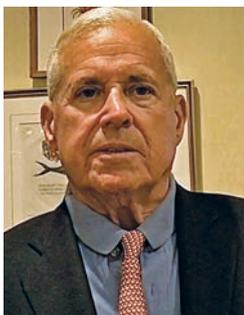
Smithson specializes in the people-related risks inherent in M&A due diligence. "Our hard survey data and similar surveys by other firms strongly suggest that more diverse and inclusive companies and boards perform better," he said. "The challenge for the board is knowing the right questions to ask management. Otherwise, it's difficult to get beyond [management's] platitudes that the target's DE&I program or its ESG factors are fine or are things we can take care of down the line."

To avoid a box-ticking exercise, Smithson recommends that board members talk about DE&I and ESG in ways that make senior management realize they're not about to leave these serious subjects to a post-deal cleanup. "Inevitably, only the board has the clout to ask the big question—"With all that's going on with ESG and DE&I, should we even be doing this deal?" he said. "That usually gets their attention."

He further recommends that board members ask senior management to illuminate the issues giving them any pause whatsoever about the target's DE&I practices. "If this is the case, I'd then ask if the purchase agreement [with the target company] has been restructured to include the target's representations and warranties with regard to these issues," he said.

Representations within an M&A purchase agreement ensure what the seller (and buyer) attests is true is in fact true, whereas a warranty is the promise of an indemnity if the assertion turns out to be false post-transaction. "For example, if the seller represents that it has not had any issues over employment discrimination, but it later is revealed that it had systematically resisted hiring and promoting people of color or LGBTQ individuals, that can easily blow up into a scandal post-transaction, reducing the value of the merger or acquisition," Smithson said.

Insurance brokers can arrange the purchase of representations and warranty



"We're used to doing environmental due diligence. But, like other boards, we're grappling with the rest of ESG."

—Stephen Kasnet, Chairman, Granite Point Mortgage Trust and Two Harbors Investment

ESG," acknowledged Stephen Kasnet, chairman of Granite Point Mortgage Trust and Two Harbors Investment. "The primary reason we do M&A is a strategic fit, where we believe both businesses will come out better together than remaining separate. Since we do a fair amount of real estate transactions, we're used to doing environmental due diligence. But, like other boards, we're grappling with the rest of ESG."

At least these boards are trying. "Many board members stick their heads in the sand," said Catalano. "But after the Exxon Mobil annual meeting in late May, when long-standing directors were unseated by a small activist group for not moving quickly enough to address climate change, ESG is getting serious attention. Board members know they must critique the target acquisition's ESG factors. The last thing anyone wants is buying a company that damages value and drags you down."

Bedrick agreed that boards have awakened to the ESG risks of the companies they serve and the businesses they buy. "ESG is the number one thing boards are talking about now, particularly our multinational clients in Europe that are moving faster to require ESG disclosures and reporting," she said. "The ground is moving so quickly un-

provide "remedial actions" to smooth the integration process.

Down the line, hopes are high for a converged global ESG reporting standard. Recently, the International Financial Reporting Standards (IFRS) Foundation proposed the development of an International Sustainability Standards Board. Until an agreed-upon ESG standard is forthcoming, board members are the last line of defense to ward off an M&A train wreck.

INCOMPATIBLE CULTURES

M&A due diligence has long tried to account for possible cultural incompatibilities—behavioral norms and values of two companies that fail to converge. This mismatch in strategy, operations and management is blamed for the failure of many mergers and acquisitions. A target company's workforce diversity also must figure into the post-deal culture fit.

"DE&I is drawing increased scrutiny from employees, investors and communities," Catalano said. "In an M&A context, it's important for boards to understand how the potential merged or acquired entity manages DE&I. Understanding how the company hires, retains and promotes its workforce tells you how much value it places on building a

insurance to address the indemnity costs. “Buyers and sellers generally are loath to tie up capital in an escrow account to provide the indemnity,” said Smithson. “The insurance eliminates this issue, to allow the buyer and seller to proceed with a smoother and faster deal.”

DIGITAL AND CYBER READINESS

Another crucial due diligence consideration is a target company’s technological depth and breadth—its level of digital transformation and cybersecurity.

“It’s crucial for an acquirer to carefully evaluate the target’s digital readiness—the

state of its digital transformation,” said Bedrick. “If the target has unique digital capabilities helping it manage its business in different and successful ways, that’s an attractive opportunity for a buyer wanting those capabilities.” Alternatively, if this is not the case and the target’s digital and cyber security readiness are lagging, she said, “you’d certainly want to know that before moving forward.”

Nearly half (47 percent) of CEOs are struggling with digitalization, feeling they are simply “out of their depth” or are just “hanging in there,” according to a May 2021 survey by *CBM’s* sister publication

Chief Executive, conducted in partnership with Amazon Web Services. Nevertheless, 70 percent of CEOs say their organization is in “full swing” with various stages of digital initiatives. The challenge is determining which stage a target company has reached. Failure to heed this risk can be time-consuming and costly. An acquirer can end up with legacy applications that fail to easily integrate with its own digital assets, resulting in an expensive “lift and shift” migration.

Another concern is the security of the target company’s IT network and systems, especially following a recent spree in high-profile ransomware attacks drawing multimillion-dollar ransom payments. CNA Financial, one of the largest insurers in the U.S., recently paid a record \$40 million ransom in Bitcoin to hackers. JBS, the world’s largest supplier of meat, paid \$11 million in Bitcoin to cybercrime gang REvil to decrypt its locked-up systems. And as stressed-out drivers along the Eastern Seaboard will not soon forget, Colonial Pipeline paid cybercrime gang DarkSide a \$4.4 million ransom in Bitcoin to decrypt its systems and resume pipeline deliveries.

The federal government recently elevated ransomware as a “critical priority,” with FBI Director Christopher Wray telling *The Wall Street Journal* the agency is investigating 100 different ransomware types. “If boards aren’t asking questions about the due diligence into the target company’s cyber-risk readiness, they may come to regret it during the integration,” said Thomas. “When integrating the target’s potentially antiquated and unpatched systems and IT assets, the acquirer’s enterprise network can unknowingly be exposed to a possible cyber incident like a ransomware attack.”

Finally, the target company’s remote and flexible work arrangements are another due diligence consideration, given that more than 36 million Americans may be working remotely by 2025, according to a study by Upwork—an 87 percent increase over pre-pandemic levels. “The ways we work are now an essential question board directors have to ask about,” said Catalano. “If they don’t, they’re still playing around with old models and yesteryear’s knowledge.” **CBM**

Russ Banham is a Pulitzer-nominated financial journalist and best-selling author.

Doing the New Due Diligence

As in past acquisition binges, the fear of missing out can compel unwise transactions. The pace of dealmaking in 2021 may be creating that type of frenzy. As of June, global mergers and acquisitions in 2021 totaled a record \$2.4 trillion, up 158 percent from the same period last year, according to a report by Refinitiv Deals Intelligence. As the velocity of deals increases and a good portion of dealmaking remains in a virtual and remote setting, M&A due diligence is becoming “shorter, faster and with less lead time,” said Dan Hawkins, CEO at board advisory firm Summit Leadership Partners. “If any due diligence on the [target’s] management team takes place, it is often an hour of time with each person and is surface at best.”

It’s easy to trip when you run too fast and can’t see the ground below. Today’s accelerated dealmaking environment is occurring on such terrain, the M&A advisors and experts contend. Nevertheless, the board can suggest ways to finish the deal and finish it well.

For example, Thomas Smale, board member at LTV Fund, recommends spreading the due diligence across functions. “Every function, like operations, HR, IT, supply chain and so on, should be tasked to spend some time with their counterpart at the target company,” he said. “To assess the flexibility of work, the HR leader at the acquirer can discuss the subject with the HR leader at the target.

To determine the levels of digital readiness and cybersecurity, the CISOs, CIOs and/or chief data officers at both companies can get together and converse.”

It’s a solid idea, one that boards should

Global mergers and acquisitions in 2021 totaled a record \$2.4 trillion, up 158 percent from the same period last year.

promote to safeguard that nothing is swept under the rug, including the newer issues dominating modern due diligence. “The board’s most important task in an M&A transaction is making sure the deal is a clear strategic fit,” said Smale. “To do that, members need to know everything that just might stand in the way of achieving the strategy.”

Kasnet has a similar opinion. “It used to be that growing for the sake of getting bigger was a reason to acquire or merge; that’s no longer something board members should be comfortable with, not anymore,” he said. “Bigger is better when it comes to income, not necessarily size. Anything that can affect future income needs to be on the board agenda.”

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HUMAN CAPITAL

The CHRO-Board Partnership

WHO'S MINDING THE TALENT GAP?

At a time when human capital is the most important issue facing business, a new survey suggests HR chiefs and directors aren't necessarily on the same page. **BY C.J. PRINCE**

WITH THE TALENT WAR intensifying and companies looking for ways to cope with what's come to be known as the "Great Resignation," boards are understandably preoccupied with the risks related to talent and skills shortages. A new SEC rule requiring companies to expand their human capital management disclosures in their 10-Ks has only added to the focus. Increasingly, directors are changing charters to add human capital oversight to their comp committees and are looking for a lot more data about talent from management.

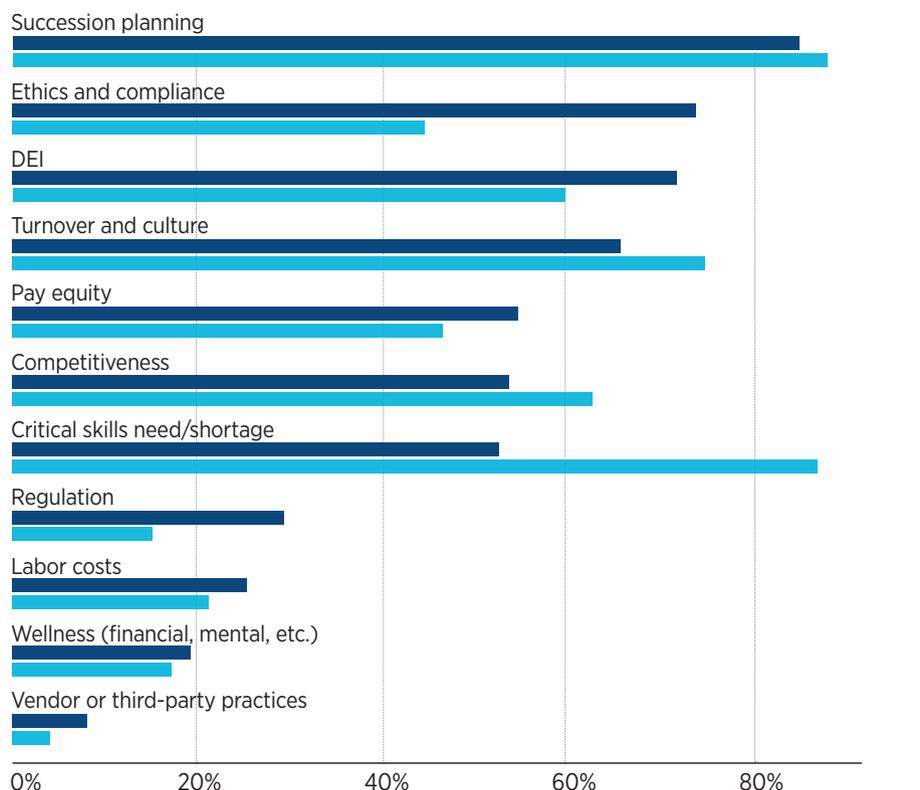
Yet, when it comes to many of the most essential people issues facing companies right now, new research from *Corporate Board Member*, done in partnership with the Society for Human Resource Management (SHRM), finds a potentially worrisome gap between the expectations of directors and CHROs.

Our survey found 86 percent of directors, for example, rating information around the company's "critical skills need/shortage" as a must-have, while only 52 percent of CHROs said the same. Meanwhile, almost three-quarters of CHROs prioritized "ethics and compliance" as a top board concern compared with just 44 percent of directors, and CHROs

ESSENTIAL ELEMENTS

"Which of the following human capital elements are essential for a board to address in the exercise of its duties?"

■ CHRO ■ DIRECTOR



Source for all charts: SHRM and Chief Executive Group

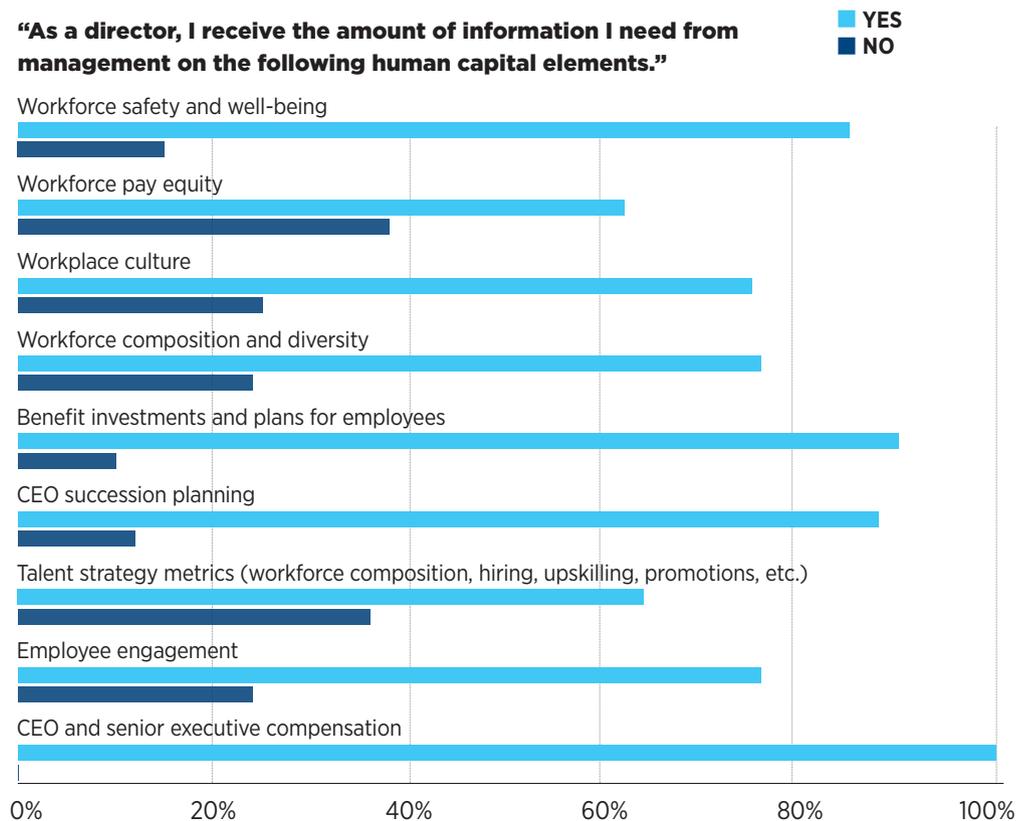
chose “regulation” as an essential human capital element twice as often as directors. As you’d expect, the two groups agreed on succession planning as a top priority.

“There may be a disconnect between boards recognizing culture and human capital management as part of their purview” and HR viewing the board as having a consulting role rather than having direct oversight, says Maryann Bruce, board member at Amalgamated Bank. “You want management and the board to be on the same page. If we’re not, board members won’t feel like they’re getting what they need, and HR is going to feel like you’re in the weeds, you’re micromanaging. So you’ll have misunderstandings.”

Susan Skerritt, who sits on several boards, including Tanger Outlets, VEREIT, Community Bank System and Falcon Group, agrees. While the CHRO might view talent strategy as primarily the responsibility of management, “from the board’s perspective, the board has a fundamental responsibility to identify and mitigate risk, and people—and the behaviors and actions of people—can be a very significant risk.”

KNOWLEDGE QUOTIENT

“As a director, I receive the amount of information I need from management on the following human capital elements.”

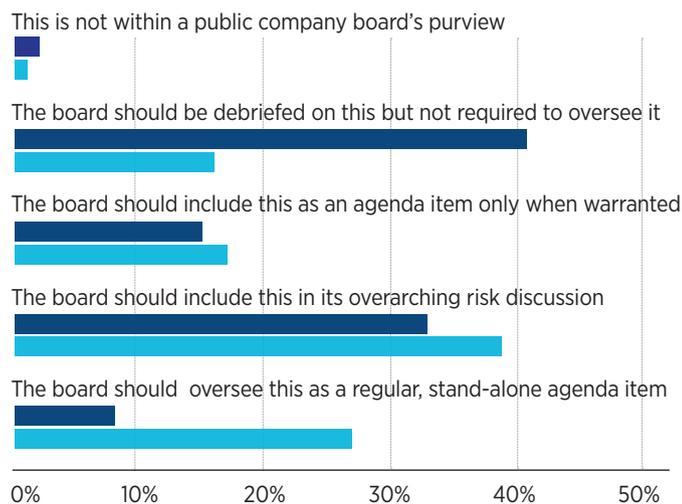


THE BOARD’S ROLE

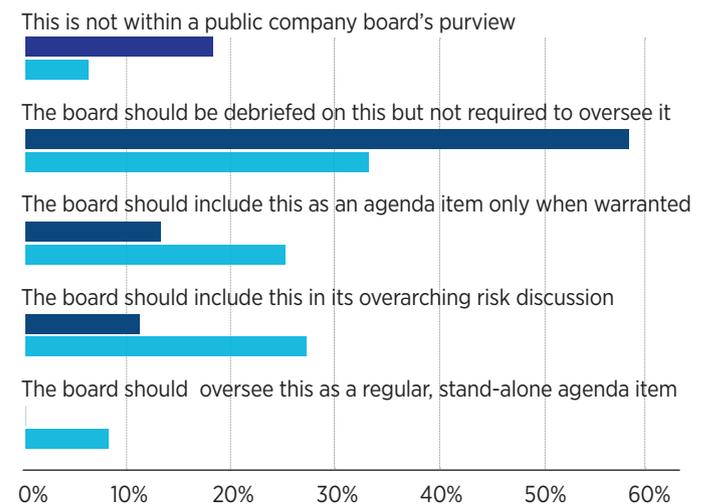
“In your view, which best describes what a board’s involvement should be in the following?”

■ CHRO ■ DIRECTOR

TALENT STRATEGY



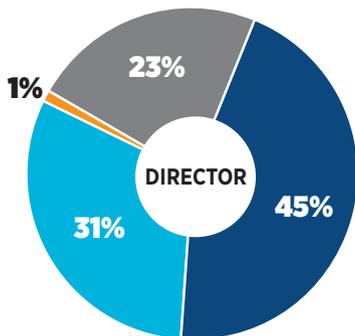
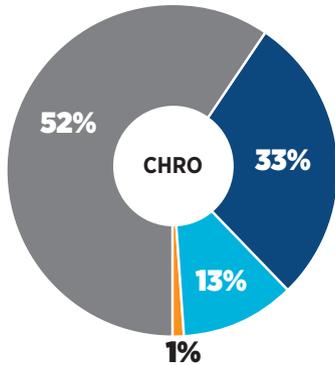
EMPLOYEE WELLNESS



TIME CHECK

“As CHRO/director, how has your time devoted to discussing talent strategy (hiring, upskilling, workforce composition, etc.) changed over the past year?”

- Increased significantly
- Increased slightly
- Stayed the same
- Decreased slightly
- Decreased significantly



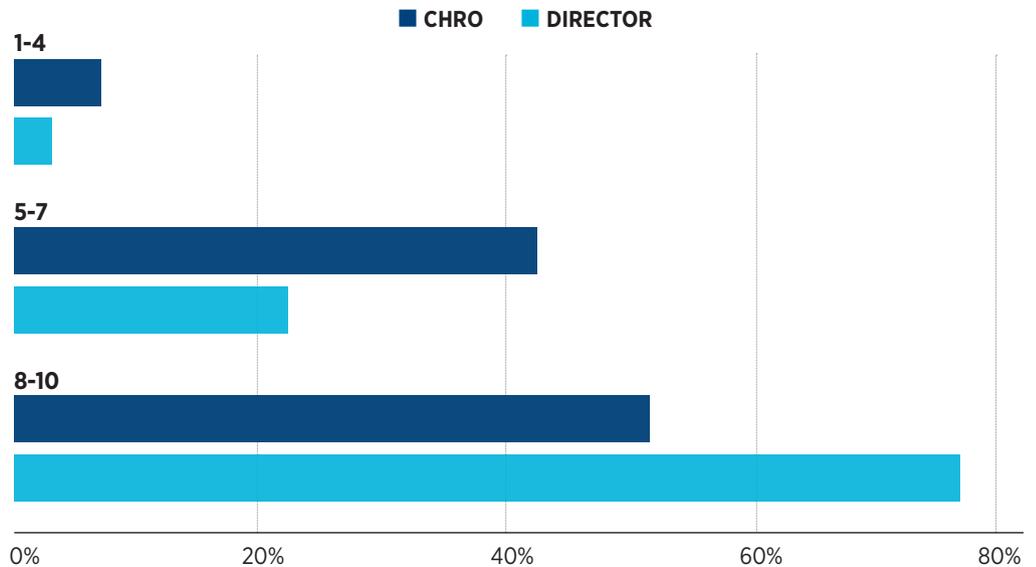
THE BOARD'S ROLE IN TALENT

This shift to categorizing “people issues” as a business risk—and thus a board concern—rather than just part of routine business operations began even before the pandemic. This last year only accelerated the reclassification among directors. That may explain why many directors we polled felt they weren’t getting the key HR data they want. For example, while 100 percent of the directors we surveyed reported sufficient input on CEO and senior executive compensation and 88 percent were satisfied with information related to succession planning, only 64 percent felt they had adequate information on the company’s talent strategy metrics, and just 62 percent were getting enough data on workforce pay equity.

“Talent shortages were a huge issue

LEADERSHIP CONFIDENCE

“Rate your level of confidence in your leadership team’s ability to drive and foster a culture of inclusion and diversity on a scale of 1-10.”



before the pandemic, and they’re a bigger issue now and much more widespread,” says Laurie Siegel, director with Lumen and FactSet, who notes that when the board and management devise a strategic direction for the company, the board’s role “is to de-risk our ability to execute against that.” Right now, she adds, that absolutely means dealing with the skills shortage.

But, says Mike Paolucci, a CHRO at Arena Pharmaceuticals and a board member at Orthofix, part of the problem is that boards don’t always know what they need. “The amount of information about people that we have at our fingertips as CHROs is enormous. So you have to be able to ask for the data the right way.”

Alexander Alonso, the chief knowledge officer at SHRM, says there’s an opportunity here—the data disconnect can be a great place to start improving communication between HR and the board. “It’s critical for CHROs to have conversations with their boards to understand the data needs of the directors. It’s possible that CHROs are providing this information indirectly to the board, but it’s getting lost in the vast amounts of information that boards have to review. Having conversations about which data points to include and how to present them may create an environment where CHROs and directors agree on what metrics

are being reported.”

This might help bridge the divide on the subject of the board’s role on talent strategy—including employee wellness and workplace culture. Among CHROs we polled, 41 percent—the largest segment in the results—felt boards should be briefed on, but not required to oversee, talent strategy. Only 16 percent of directors agreed. “People are the most valuable asset, which makes it one of the biggest risks,” says Gary LeDonne, board member at MVB Financial, but he notes that CHROs might be thinking of talent decisions much further down in the organization, which the board would likely not spend much time on in meetings.

In general, CHROs say they have spent more time over the past year discussing talent strategy (85 percent) than in previous years, compared with just over two-thirds of directors, and 31 percent of board members reported no change in time spent.

Workplace culture followed a similar trend, with 31 percent of boards expressing a desire to be deeply involved in oversight of culture but just 13 percent of CHROs feeling the same way; most of the latter group identified it as a topic boards should be briefed on but not deeply involved in overseeing—“unless there’s a problem,” says Stephanie Phipps, CHRO for Mustang Fuel. If, for example, an employee survey showed

the company was moving in the wrong direction on a cultural issue, “I need to report that to the board, along with a set of action items that I would have developed with the executive team to say, ‘Here’s what we want to do to turn this around.’ The board could approve that or they could make different recommendations, but I wouldn’t see them building a culture strategy.”

Only one in 10 CHROs thought employee wellness should be included in the board’s overarching risk discussion, compared with more than one-quarter of directors—and 58 percent of CHROs said oversight was not necessary on this issue. Before the pandemic, Siegel says she would have agreed. “But since Covid, there has been a massive increase in mental health issues for both employees and their families.” It’s a risk issue, she adds. “Is your workforce capable of functioning as fully as they may have been a year and a half ago?”

OVERLY OPTIMISTIC DIRECTORS?

Perhaps the most profound gap between the perceptions of directors and CHROs from the research—and one worth particular focus among board members—was the way each group assessed the leadership ability of management.

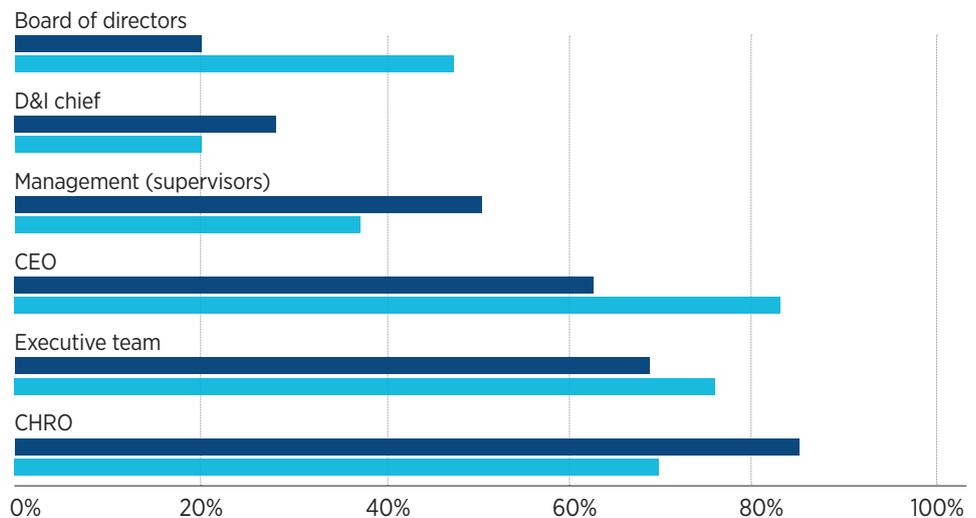
Among our respondents, just 19 percent of CHROs called their companies’ executive teams “a leader” among peer companies, compared with 41 percent of directors. Phipps says that isn’t so surprising. “One of the things that anybody in HR has the ability to see is—everything,” she says. “We are generally the first stop on where the things that aren’t healthy in an organization get discussed, which is important, but it can have the ability to jade our perspective. If you’re a CHRO and your peers are on the executive team, you see the imperfections with some of the decisions they make” much more often than the board will.

Case in point: diversity, equity and inclusion. Among directors, 76 percent expressed high confidence in management’s DE&I efforts—compared with just 51 percent of CHROs. “HR executives [may be thinking], ‘We’ve been talking about this for a long time, but we don’t see enough change,’” says Bruce. Meanwhile, she says she has attended board meetings where directors expressed frustration with the amount of time spent on DE&I. “[They’ll say], ‘I’m so sick and tired of hearing about diversity and inclusion, it’s

WHERE THE BUCK STOPS

“Who is responsible for ensuring inclusion, diversity, equity and representation across the company? (Select all that apply.)”

■ CHRO ■ DIRECTOR



all we ever talk about.’ So I think CHROs are more in reality and boards are more aspirational or optimistic.”

Perhaps tellingly, the two groups even diverged on who was ultimately responsible for ensuring DE&I across the company: 82 percent of directors said the buck stops with the CEO, compared with only 62 percent of CHROs who pointed to the corner office; by contrast, 84 percent of CHROs named themselves as responsible, compared with just 69 percent of boards holding them similarly accountable. “I don’t think there’s any question that the CEO sets the culture and the tone,” says Arthur Bacci, who sits on the board of GreenSky. “The executive team will follow the CEO’s lead. If David [Zalik, CEO of GreenSky] doesn’t make it a priority, I don’t think the executive team would either.”

Mike Nevens, chairman of the board at NetApp and director with TalonX and Ciena, agrees that the responsibility is “unequivocally” with the CEO. “They have to lead by example, they have to insist it’s a priority. They have to say, ‘We’re going to make progress on this, no excuses accepted.’”

Interestingly, 47 percent of directors held themselves responsible, compared with just 20 percent of CHROs saying the same. “The board is too far removed from individuals in the organization who are perpetuating

“I don’t think there’s any question that the CEO sets the culture and the tone.”

—Arthur Bacci, Director, GreenSky

or changing day-to-day life,” says Phipps. “I love the idea of willingness to take responsibility for it, but I don’t think that’s practical.”

In general, Paolucci says the differences in survey responses reflect a larger disparity on “where board oversight starts and stops. A lot of board members used to run big companies, and they’re used to making these decisions.”

The issue of “nose in, fingers out” is hardly a new one, but arguably, the topic of human capital has only recently moved to center stage in boardroom discussion, and metrics such as pay equity are new additions to the agenda. Both boards and management are still figuring out what governance requires—and what it will require in the future. “It’s like any new topic,” says Nevens. “We’re kind of feeling our way.” **CBM**

THE PEOPLE FACTOR

Pressed for greater oversight of human capital management, boards are exploring ways to expand and sharpen their focus on talent.

BY C.J. PRINCE

Human capital management had already been elevated to a board-level issue before Covid hit, but the global pandemic that forced employees to go remote overnight, the social unrest over racial justice, the investor community demanding greater accountability, and transparency around diversity have all pushed talent and human capital issues to the top of board agendas. However, while the need for greater oversight at the board level seems clear, just how to do that is still a work in progress, according to directors gathered for a virtual roundtable cosponsored by Semler Brossy.

“The role of the comp committee is

changing,” said Raj Gupta, former chairman and CEO of Rohm and Haas and current chair of Aptiv. “It used to be audit committees were under fire, but these days comp committees are under more fire than audit. There has been a lot of change, both in terms of agenda as well as expectations.”

To satisfy expectations, around 50 percent of the Fortune 100 have amended their charters to add a human capital element to the comp committee. At Opiant Pharmaceuticals, the board began that process three years ago when it realized there was almost no mention of people in management’s performance goals. “Company success is built on the shoulders of its people,” said independent director Ann MacDougall, who also sits on the board of Atmos XR.

She pushed back, and a robust dialogue ensued. “So, well before we switched over to the expanded charter, a substantial part of our committee discussion related to people, retention, culture. So, the leadup to the formalization of this was organic, within a very strong board.”

Similarly, at Humana, the board had been doing regular deep dives into talent prior to the expanded charter, bringing in heads of each major P&L division to answer questions about how their division supported the strategy and the human capital elements around that, said W. Roy Dunbar, a former director at the company who currently sits on the boards of Duke Energy, SiteOne Landscape Supply and Johnson Controls. “There were many very valuable outcomes from that, not least of all that we started to see the actual mentality and actions of specific leaders, which then helped us with succession plans for the CEO over time.”

Directors agreed that getting deeper into



human capital elements has allowed them a useful window into the company's bench strength. Independent director Lisa Payne shared that at Rockwell Automation, the board routinely has dinner the night before meetings and invites not just the CEO's direct reports but the level below. "And maybe even the level below that," she said. "We get deep into the organization with the HIPOs... You see the collaboration and get a much better feel of the culture in a very casual setting." And then when it comes time for the talent review session, she noted, "I've actually met most of those people." She added that since Covid, they've had virtual "dinners," with breakout groups that allowed people who normally wouldn't attend because of the distance to interact. The virtual meetings have been so successful, the board plans to keep a mix of virtual and in-person meetings post-Covid.

Directors sometimes learn the hard way that relying on management for talent assessment isn't the best strategy. "When we had a quick exit of a CEO, we found out how the depth on the bench was lacking and the quality of people was not what we were led to believe," said Gupta of one of the 14 public boards on which he served.

If the CEO is reluctant to expose their leadership team, Charles Story, former director of Briggs & Stratton, recommended a smaller group discussion. "It's a little bit more difficult for the CEO to be responsive when the whole board is there; they may get their backs up." A better way might be a one-on-one conversation with the lead director, who can often "pull back the onion on some of these issues so that the CEO can hear it much more so than they might otherwise."

Blair Jones, managing director with Semler Brossy, agreed that bench exposure is critical. "I see a lot of opportunity in this broadened mandate that committees have, but unless you combine it with being able to interact with real people and real employees, you sub-optimize the opportunity." She noted that boards should make it a priority to get access to the CHRO. "A good CHRO can really elevate the discussions around this area, bring more to the board and let the board help the company in the ways that they're able."

When directors broaden their manage-

ment connection, they have the chance to solve problems faster and better. Rose Crane, director at Teva and Catalent Pharma Solutions, pointed to an experience at the latter company, which had a production issue with the J&J vaccine in Baltimore. Rather than trying to control the communication channels, CEO John Chiminski encouraged board members to connect directly with his executive team. "We were able to exchange great partnership experiences from the companies we all work for," she said. "It's a whole different level of engagement."

Gupta, who sat on the Hewlett-Packard board while Meg Whitman was CEO, recalled a successful buddy-mentor system. "She basically assigned each one of our executives [and high-potential people] to one board member as a mentor," he said. Tyco, under Ed Breen, had a good practice as well, he added: several board members would go to a site without anyone from the corporate office, meet 10 to 15 executives for dinner and have a town hall with employees. "That allowed us to really get a grassroots sense of what the organization was feeling."

TYING IT BACK TO COMP

Directors noted that comp committees are still exploring ways to tie human capital metrics to reward, even as investors clamor for more transparency. But Dunbar said that underlying goals can be achieved even if boards are not ready for full disclosure. At Johnson Controls, DE&I metrics, for instance, are not expressed in the CD&A, "but they are a clear requirement for the CEO to work with. Every [member of the executive team] has it as a component of their personal goals, and if somebody is missing something on that, they get dinged." He added that as long as the chair of the comp committee is engaging with shareholders in an annual or biannual dialogue about how goals are being achieved, "I've found shareholders are extremely comfortable."

He also pointed out that a variable reward of as little as 5 percent for exceeding human capital goals can be very motivating to executives. Gupta recommended that, for the 20 to 30 percent of compensation not based on financial measures, boards employ a scorecard method. "Have the CEO write their objectives by stakeholder and



A good CHRO can really elevate the discussions around this area, bring more to the board and let the board help the company in the ways that they're able."

—Blair Jones, Managing Director, Semler Brossy

the two or three most important categories in each of those, and the metrics to show improvement." The CEO should then update the board on progress at least every other meeting, and it will then be more apparent why salary or equity awards are being increased or not.

It also ensures that executives are promoted based not only on numbers, Jones said, but on the cultural instincts and the characteristics "that are really going to make the organization successful on a sustainable basis."

And boards do need to maintain that longer-term outlook, said Dunbar, because while the average tenure of a C-Suite executive is three to four years, the average tenure of a board director is 10-plus years. "So, it is incumbent upon us to recognize the longevity and therefore the influence that we can have over time, and also the fact that we need not be muscular, because for us, it's a long game." **CBM**



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