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Focusing on what counts

Board Leadership Center

How high-impact boards are connecting dots and delivering value

The demands on the board's time and agenda continue to mount as a host of critical issues—from cyber risk and business model disruption to investor scrutiny and regulatory demands—collide and reshape the landscape.

As the business and risk environment becomes more complex—driven by technology change and innovation, global markets and supply chains, geopolitical risk, and more—the board's ability to prioritize and devote enough time to substantive issues becomes more vital.

Given these challenges, two critical questions should be top of mind for directors today: Is the board focusing on the issues that are most material to the company's success—e.g., strategy, talent, compensation, key performance indicators, and corporate culture—and connecting the critical dots? Is the board taking a hard look at itself to ensure it has the skills, dynamics, leadership, and processes in place to make the most of its time together and position the company for the future?

KPMG's Spring Director Roundtable Series—which gathered directors and executives in 16 cities—explored how boards are addressing these challenges and continually raising their game as the business and risk landscape redefines what it means to be effective.

As one director said, "We seem to be at an inflection point for corporate governance, with the business and risk environment becoming increasingly volatile, while the expectations for board performance continue to grow." At the same time, he added, "We are in an era of shared governance, with a focus on shareholder empowerment and rights, and activists are bringing a new dimension to the debate."

"As board members, we have responsibility for thinking long term," another director noted. "The board needs to be on offense and stay focused on the critical issues facing the business. Directors need to do their homework, understand the marketplace, and be prepared for the changes that are coming."

Is the board's agenda evolving to stay focused on the "right" issues?

According to McKinsey, many boards still spend the bulk of their time on quarterly reports, audit reviews, budgets, and compliance—some as much as 70 percent—instead of on matters crucial to the future prosperity and direction of the business. Leading boards, however, are developing more forward-looking agendas, focusing more on strategy and strategy-related issues, as well as on improving the board's effectiveness in this business environment.[1]

Among 371 directors and business leaders surveyed, three-quarters said they would like their board to spend more time on strategy and strategic risk. Other strategy-related issues they would like the board to devote more time to include technology and cybersecurity (37 percent); succession for CEO and top management (36 percent); and the talent pipeline (26 percent).

"In the last few years, our board has substantially increased the time we spend reviewing senior talent and the talent pipeline, as well as visiting the business units as part of our strategy review process," one director noted.

Meanwhile, many directors and executives surveyed said they generally do not want to devote *less* time to other issues, such as compliance, audit, or financial

[1] Cristian Casal and Christian Caspar, Building a forward-looking board, McKinsey Quarterly, February 2014

reporting. Nearly one-quarter said no change was needed to their board agenda, suggesting that they were comfortable that their board was bringing the proper focus and attention to the "right" issues.

"The speed of technological change and the volatility in the marketplace today really require that boards have dynamic and forwarding-looking agendas, but a focus on compliance issues remains critical," said one director.

How is the level and nature of the board's engagement changing?

To devote more time to forward-looking or value-creating issues—while also remaining focused on compliance, operations, and so-called rear-view mirror items—boards may need to increase their time commitment, change the nature of their engagement, or both.

According to the National Association of Corporate Directors, directors spend an average of 248 hours per year on board work, e.g., preparation, board and committee meeting time, informal contacts with management and directors, etc.[2] Among the roundtable participants surveyed, 20 percent said they spend significantly more time than 248 hours per year, while another 29 percent expected their time commitment to increase going forward.

During the roundtable discussions, directors emphasized that the time commitment required for board service will vary significantly for a variety of reasons, including the size and complexity of the business, as well as the demands on boards in the event of a crisis, a major transaction, etc. As the Boston Consulting Group has noted, board engagement levels are not static, and special circumstances call for heightened levels of board engagement. Board chairs and lead directors play an important role in setting the tone and engaging directors.[3]

Boosting board effectiveness is not just about spending more time; it is also about changing the nature of board and director engagement with management teams and among directors.

During the roundtable conversations, directors discussed a number of ways in which board engagement is changing, including:

— **Engaging between meetings** – Impromptu discussions keep a board's hand on the company's pulse. Keeping board members informed also minimizes background time, which can slow regular board meetings.[4]

— **Tapping individual directors to lead on specific issues** – As appropriate, individual directors can be assigned as the board's point person on specific issues, such as cybersecurity or risk.[5]

— **Mentoring the next generation of leaders** – In addition to their responsibility for CEO succession, directors may monitor talent and succession for the senior executive team, and some may actively mentor high-performing executives and help with recruiting.[6]

— **Developing an effective process to "connect the dots" and help ensure the alignment of talent, compensation, and culture with strategy** – At a time of dramatic change in both the business and the business environment, there is a risk of misalignment among the company's key governance activities—an issue that has not gone unnoticed by activists.

One director observed that "alignment of culture and talent with strategy is the toughest challenge." The majority of those surveyed say they are satisfied (34 percent) or somewhat satisfied (53 percent) that the board has an effective process to "connect the dots" and help ensure alignment of talent, compensation, and culture with strategy.

How effective is the board in dealing with board composition and succession planning?

Investors are focusing more on board composition to ensure that the board is comprised of directors who can guide the company and its strategy in the future. They are also concerned about low director turnover—average director tenure at S&P 500 companies is 8.5 years, and 21 percent of boards have an average member tenure of 11 years or greater, according to the *2015 Spencer Stuart Board Index*. Investors who feel boards have not been responsive to their concerns are becoming increasingly vocal about director nominations, as evidenced by an increase in proxy access proposals.

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2 National Association of Corporate Directors, 2015–2016 NACD Public Company Governance Survey, 2015

3 Christian Orglmeister, Marcos Aguiar, and Daniel Azevedo, Value-Focused Corporate Governance, bcg perspectives, December 12, 2012

4 Bill Huyett and Rodney Zemmel, Changing the nature of board engagement, McKinsey Quarterly, April 2015

5 Ibid.

6 Ibid.

"It takes true leadership in the boardroom to create the right board," said one director. "Leadership must drive robust succession planning that is clearly linked to long-term strategy, and must insist on robust board and director evaluations."

Only 34 percent of those surveyed said they are satisfied and 41 percent said they are somewhat satisfied that their board integrates discussions about composition and succession planning with discussions about the company's long-term strategy. For a discussion of steps for boards to consider as they work to develop and maintain optimal board composition, see Achieving the "right" board composition.

Has the company enhanced its engagement with major institutional investors on strategy, board composition, transparency, and other issues of importance to them?

During the roundtables, directors and executives discussed the growing influence of major institutional investors. In a year-end letter to directors, attorneys from the law firm Wachtell, Lipton, Rosen & Katz outlined a new paradigm for corporate governance with leading major institutional investors supporting long-term investment and value creation.[7] According to Wachtell Lipton, the influence of major institutional investors is at an all-time high, and their major themes include:

— Pushing for more shareholder power and rights generally but also criticizing and voting against activist proposals they view as short-term focused

— Seeking to establish and publicize their long-term mind-set

— Articulating their perspectives and expectations on corporate governance matters ranging from engagement, board composition, long-term strategy and transparency

— Outlining their expectations that companies engage with them and provide access to independent directors—before the activist arrives

— Emphasizing importance of disclosure and transparency.

As several directors emphasized, a key question for every board is whether it is satisfied with the company's engagement with the large institutional shareholders. Who takes the lead in the company's engagement?

Achieving the "right" board composition

How can boards act to generate the change and turnover required to develop and maintain the "right" board composition? Among the steps discussed during the roundtables:

— Develop a robust succession planning process that includes board and committee leadership. An effective process that is integrated with discussions of long-term strategy can help identify the gaps that the board needs to fill as its strategy and the business environment change.

— Change expectations regarding director terms. Directors should not expect to serve until mandatory retirement age.

— Conduct robust board and individual director evaluations. According to the 2015 Spencer Stuart Board Index, only 33 percent of S&P 500 companies conducted individual evaluations.

— Have difficult discussions with underperforming directors about stepping down.

What is—or should be—the role of the CEO, CFO, investor relations, and the lead director (or other independent directors)? Who addresses what issues?

"When it comes to investor communications, management is in the best position to stay on message," said one director. "But directors need to ensure that management is delivering any feedback, and directors need to participate in investor discussions when appropriate."

Another board member noted, "The expectation now is for direct engagement by directors with investors, particularly when investors request it." He added, "That investor feedback, the feedback of the marketplace, as evidenced by the stock price, and the views of customers, vendors, and employees all roll into the board's evaluation of whether the board has the right strategy and leadership to advance the business."

[7] Martin Lipton, Steven A. Rosenblum, and Karessa L. Cain, "Some Thoughts for Boards of Directors in 2016," Wachtell, Lipton, Rosen & Katz, December 7, 2015

KPMG Roundtable survey findings

To which of the following issues would you like your board to devote less time? (select up to three)

38%	*Financial reporting and disclosures*
37%	*Sustainability and CSR*
34%	*Audit and compliance*
24%	*No change necessary to board agenda*
20%	*Corporate culture*
15%	*Compensation*
10%	*Company performance, KPIs*
8%	*Talent pipeline*
5%	*Technology and cybersecurity*
4%	*Succession for CEO and top management*
2%	*Strategy and strategic risk*

To which of the following issues would you like your board to devote more time? (select up to three)

75%	*Strategy and strategic risk*
37%	*Technology and cybersecurity*
36%	*Succession for CEO and top management*
26%	*Talent pipeline*
23%	*Company performance, KPIs*
21%	*Corporate culture*
9%	*Audit and compliance*
6%	*Compensation*
6%	*Financial reporting and disclosures*
5%	*Sustainability and CSR*
3%	*No change necessary to board agenda*

How would you describe the balance between management's influence, versus directors' influence, in setting the board's agenda?

57%	*Balance is about right*
29%	*Management has too much influence*
14%	*Agenda setting process is inconsistent*

Given the demands on boards and board agendas today, is the current average of 248 hours per year on board work adequate to effectively carry out your responsibilities as a director?

35%	*Yes, 248 hours per year is adequate*
29%	*Yes, 248 hours per year is adequate–but I expect my time commitment will need to increase going forward*
20%	*No, I spend significantly more time*
9%	*Less time is required*
7%	*No, I spend marginally more time*

How satisfied are you that the board has an effective process to "connect the dots" and help ensure alignment of talent, compensation, and culture with strategy?

53%	*Somewhat satisfied*
34%	*Satisfied*
14%	*Not satisfied*

How satisfied are you that your board integrates its discussions about composition and succession planning with discussions about the company's long-term strategy?

41%	*Somewhat satisfied*
34%	*Satisfied*
26%	*Not satisfied*

How satisfied are you with your company's engagement with its large institutional investors? (select all that apply)

53%	*Investor engagement is about right*
23%	*Company could be more proactive (before problems arise)*
16%	*Other/none of the above*
12%	*Directors should be more involved (selectively)*
10%	*Company needs better understanding of its shareholder base*
7%	*Requires more attention by CEO/CFO*
6%	*Investor relations has too much influence*

About the KPMG Board Leadership Center

The KPMG Board Leadership Center champions outstanding governance to help drive long-term corporate value and enhance investor confidence. Through an array of programs and perspectives—including KPMG's Audit Committee Institute and Private Markets Group, the WomenCorporateDirectors Foundation, and more—the Center engages with directors and business leaders to help articulate their challenges and promote continuous improvement. Drawing on insights from KPMG professionals and governance experts worldwide, the Center delivers actionable thought leadership—on risk and strategy, talent and technology, globalization and compliance, financial reporting and audit quality, and more—all through a board lens. Learn more at kpmg.com/blc.

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