Directors Quarterly

Insights from the Board Leadership Center

July 2018

Optimism, tempered by tech, trade, and talent concerns

CEOs tend to be optimists and realists, so it was no surprise to find most U.S. CEOs in our latest global survey expressing "confidence with measured expectations" for their companies' growth. By most accounts, the global economy is in good health, with the U.S. leading the way at 3.8 percent unemployment and tax cuts and investments fueling GDP that could hit 3 percent in 2018. Yet, steadily rising interest rates, high valuations, uncertainty around tariffs and U.S. trade policy, and mounting demand for workers with the right skills will call for a disciplined approach and long-term focus.

In this edition of *Directors Quarterly*, we highlight key findings from KPMG's 2018 Global CEO Survey—including views on technology disruption, cybersecurity, and other challenges that are top of mind for CEOs looking three years out. We also share insights from our recent Director Roundtable Series on oversight of corporate culture based on discussions with more than 500 directors and business leaders across the country in May and June.

This quarter, we also look at how directors can help to create the right conditions for sound decision-making in the boardroom based on our work with the WomenCorporateDirectors Foundation, what boards need to consider with respect to data privacy and governance in an environment where consumer trust is understandably tenuous, and the ongoing debate over multi-class share structures. We also cover financial reporting and auditing developments that companies should have on their radar.

Enjoy the summer months and remember to mark your calendar for our annual Board Leadership Conference on January 7–9 in Orlando.

Dennis T. Whalen
Leader
KPMG Board Leadership Center

What's inside

U.S. CEO Outlook 2018: Growing pains

While U.S. CEOs feel confident about the economy and their own companies' growth prospects over the next three years, overall growth expectations are modest and technology-driven disruption and cybersecurity are real concerns, according to KPMG LLP's annual CEO survey.

"Riding the tailwinds of tax reform and regulatory relief, U.S. CEOs are primed to aggressively pursue growth," said KPMG U.S. Chairman and CEO Lynne Doughtie. "They are highly confident in their business prospects and their ability to both disrupt the sectors in which they operate and handle risks head-on."

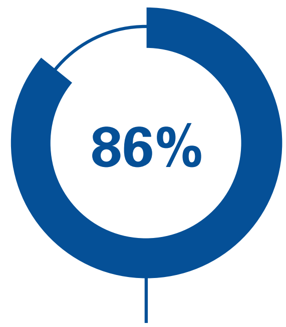
Among the survey's key findings: Nearly all of the CEOs surveyed (98 percent) view technological disruption as more an opportunity than a threat, and 9 out of 10 are confident about their ability to lead their companies through radical transformations.

The survey shows U.S. CEOs are aggressively pursuing digital disruption: 86 percent consider their companies to be active disruptors, up from 72 percent last year. And for a vast majority, technology is the only significant disruption their business faces.

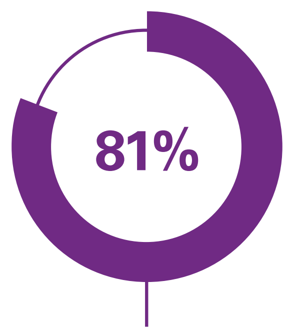
Cybersecurity and emerging and disruptive technology were identified as the risks posing the greatest threat to growth. Sixty-eight percent of CEOs believe that a cyberattack is a matter of when, not if. While the majority of U.S. CEOs feel prepared in terms of their ability to identify new cyber threats (92 percent), only 41 percent consider themselves very well prepared.

For more insights from the 2018 U.S. CEO Outlook, visit *kpmg.com/us/ceooutlook*.

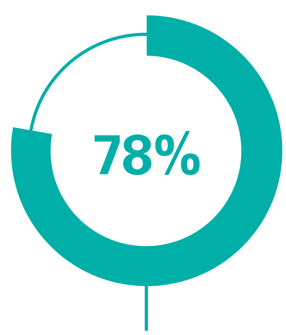
U.S. CEO views on technology-driven disruption



Consider their companies to be active disruptors



Believe technology to be the only significant disruption their business faces



See their technology investments in digital transformation to be strategic (and not tactical)

Board oversight of corporate culture

As we've seen in the headlines, corporate culture is front and center for companies, shareholders, regulators, employees, and customers. Not surprisingly, the focus tends to be on corporate culture as the culprit—with headlines of sexual harassment, price gauging, shady sales practices, and other wrongdoing. As a result, boards themselves are in the headlines—with an expectation that they need to "fix" broken cultures.

Given the critical role that corporate culture plays in driving a company's performance and reputation—for better or, as evidenced by the #MeToo movement, for worse—it is not surprising that boards today are reassessing their approach to oversight of culture. The key question they are asking: How can we "up our game" and take a more proactive approach to understanding, shaping, and assessing corporate culture?

That was the focus of KPMG's Director Roundtable Series, which gathered more than 500 directors and business leaders in cities across the country during May and June. One director described culture as "a little like faith or gravity. You can't see it or touch it, but it's there and it's a really strong force." Another emphasized that "technology has amplified the ability of customers, employees, and investors, to scrutinize not only what products and profits a company makes, but *how* it makes them, and if they don't like what they see, the network effect of social media quickly takes over."

The roundtable discussions explored four key areas of board focus as they reassess their oversight of corporate culture:

– Understand what "culture" is and why it is critical today

– Establish clarity on the foundational elements of the company's culture: zero-tolerance policies as well as behaviors that will help the company excel

– Clarify the board's role in overseeing culture—recognizing that visibility is a major hurdle

– Assess where culture belongs on the board and committee agendas.

Understand what "culture" is and why it is critical today. As Spencer Stuart has noted, culture is not a series of objectives or aspirational values posted on the wall; rather, culture "is the culmination of the shared values, beliefs, and assumptions that shape the behavior of the organization. These 'unwritten rules' guide the thousands of decisions employees throughout the organization make every day." The company's culture is critical because it permeates virtually every aspect of the organization: strategy, execution, risk management, compliance, business processes, employee performance, long-term value creation, etc. It drives corporate behavior in good times and in times of stress.[1]

As one director said, "Done right, culture can be a huge competitive advantage and it can drive shareholder value. We view our culture as one of our greatest advantages." Another director emphasized the importance of expectation and environment: "The board and management should describe what's expected and set the right environment so those expectations are possible. You need feedback to make sure that is happening."

(continued)

[1] George Anderson, Michael J. Anderson, and Jeremiah B. Lee, "What Do Boards Need to Know About Culture?" Spencer Stuart, February 2015.

Board oversight of corporate culture *(continued)*

Who is responsible for the organization's culture? It is almost impossible for the board to create culture, though it can influence culture. The CEO is, by far, the most significant driver of culture, along with his or her senior management team. Understanding an organization's culture is difficult because the underlying drivers of culture are usually hidden. But if you can't see it, describe it, or measure it, it's hard to know if your company's culture is helping or hurting the organization.[2]

Establish clarity on the foundational elements of the company's culture: zero-tolerance policies as well as behaviors that will help the company excel.
As recommended in the *2017 Report of the NACD Blue Ribbon Commission on Culture as a Corporate Asset*, boards should strive for a level of discipline with respect to culture oversight that is comparable to leading practices in the oversight of risk. To do that, the board, CEO, and senior management should establish absolute clarity on the foundational elements of the organization's culture in two areas:

1. Behaviors for which there is zero tolerance
2. Values and behaviors that help the company excel and are to be encouraged.

Zero-tolerance policies

Participants noted the importance of zero-tolerance policies for certain behaviors—such as violence, fraud, racial discrimination, sexual harassment, and, perhaps, drug use—and emphasized the importance of enforcing zero tolerance consistently at all levels of the organization. "If someone behaves in a way that is inconsistent with a behavior for which the company has a zero-tolerance policy and you make an exception for them because they're a top performer, it's essentially granting permission for everyone to behave the same way."

So how does a board and management team develop an effective zero-tolerance policy? The #MeToo movement provides some important lessons for boards as to how to establish absolute clarity regarding its zero-tolerance policy for harassment and abuse. Examples include:

- Send a clear message from board and senior management that they are committed to preventing workforce harassment and abuse at all levels and that the issue is a top priority for the board
- Assess soundness of sexual harassment policies, training, and enforcement
- Assess effectiveness of employee hotline mechanisms, including processing and escalation
- Identify types of complaints that must be brought to the board's attention
- Consider whether compensation incentives—including clawbacks—exist to motivate compliance and the right behaviors
- Monitor red flags
- Clarify duty of officers and directors to share workforce misconduct information with the full board
- Recognize importance of board independence, diversity, and refreshment as essential to good governance.

As one director said, "It's essential for companies and boards to get the zero-tolerance policy right and to make it effective."

Values and behaviors that help the company excel and are to be encouraged

The NACD Blue Ribbon Commission recommended that boards also work with management to establish clarity around the values and behaviors that help the company excel and are to be encouraged—i.e., the behaviors that are key to execution of the company's strategy. Of course, the types of behaviors the company might encourage will vary based on its strategy. For example, a company that is positioned as a disruptor will encourage different behaviors than one that is heavily regulated (see image below).

To help the company excel, what is the culture we want?

Critical alignments

Culture (behaviors)	Values	Incentives
Purpose	Strategy	Controls

Source: KPMG Board Leadership Center, 2018

Obviously, the types of behaviors a company encourages will vary depending on where the company is on the spectrum. Roundtable participants emphasized that the key is for the board and management to agree on the desired culture and behaviors and to ensure that there is alignment of the desired culture and behaviors with strategy, values, and incentives, as well as controls to help identify any outliers.

While the CEO sets the company's culture, the board plays an important role in influencing it by making culture a priority, modeling the desired culture, and selecting the CEO, and through its influence on policies related to succession planning and talent development, incentive compensation, hiring, firing, and promotion decisions.[3]

Speakers stressed the importance of considering culture fit up front, during the hiring process, particularly as part of the CEO succession process. "Be deliberate. Do a tremendous amount of due diligence."

"It starts with hiring individuals who match the company's values," said one director. "It doesn't have to cost a lot of money, but it does cost time in the form of up-front investment in the hiring processes."

Clarify the board's role in overseeing culture—recognizing that visibility is a major hurdle.

In overseeing culture, an important role for the board is to regularly assess and monitor corporate culture. This requires looking beyond the "corporate values" posted in the lunchroom and understanding the unwritten rules as to how things get done; there is often a disconnect between the corporate values and how employees live them. Roundtable participants agreed that one of the biggest challenges for boards in overseeing culture is visibility. The board should have visibility to the tone at the top, but the culture in the middle and bottom is key and difficult for boards to assess—i.e., visibility is a major hurdle.[4]

"Because directorship is a part-time job, it's hard to feel the culture on a daily basis," one commenter noted. "It's important that boards ask management to help the board understand the culture throughout the organization—the top, middle, and bottom."

"It's also important to look at different segments of the population—not just top to bottom," another attendee observed. "There may be pockets of discontent."

Directors discussed the importance of using a variety of methods to gain a better understanding of the corporate culture. Some common methods include:

- Employee surveys
- Visiting company facilities and talking to employees below senior management
- Input from internal and external auditors
- Whistleblower hotline reports
- Customer complaints
- Walking the halls of corporate headquarters
- Monitoring social media
- Reviewing a dashboard of leading and lagging indicators of culture and conduct.

"Use multiple ways to gauge culture, not just one. You need to look at all of these pieces," a director said.

Even in highly centralized organizations, data related to culture is often collected and tracked by a number of different functions, including legal, internal audit, finance, risk management, human resources, ethics and compliance, and customer service. Further complicating matters, in large, dispersed organizations, valuable information may exist at the local, divisional, or regional levels.[5]

Several participants said culture dashboards can be helpful for providing an integrated picture of the organization's culture. The NACD report contains a sample dashboard (see p. 6), which includes cultural indicators such as customer satisfaction data, human resources and employee data, ethics and compliance data, historical performance and geo-mapping. One director recommended that, if your company doesn't have a culture dashboard, ask that a team of executives from internal audit, compliance, and human resources assemble a dashboard. "Just as we saw with cybersecurity dashboards several years ago, we would expect culture dashboards to evolve over time to provide a better, and better integrated, view of the organization's culture."

One CEO noted that his board looks at a culture dashboard and a conduct dashboard quarterly. "The culture dashboard tracks what employees and customers tell us. The conduct dashboard looks at daily actions. How many complaints have

[2] Michael J. Anderson, et al., "Leading With Culture," Spencer Stuart Point of View 2015.

[3] Financial Reporting Council, Corporate Culture and the Role of Boards: Report of Observations, July 2016.

[4] National Association of Corporate Directors, Report of the Blue Ribbon Commission on Culture as a Corporate Asset," 2017 and Anderson, et al., "Leading With Culture."

[5] NACD, BRC Report on Culture as a Corporate Asset.

Board oversight of corporate culture *(continued)*

we gotten? How many breaches of policy were there? What were the consequences?"

Participants also emphasized the importance of drilling down on red flags, such as outsized performance. "If you are doing better than all of your competitors, you should ask, 'Why are we doing so well?'" Others warned to watch for unrealistic corporate stretch goals and behavior that goes unchallenged. "What are the consequences of failure? No harm, no foul is not acceptable."

"Don't let strong performance/results by the company or a top executive cloud the board's focus on culture. Good results generated by the wrong behaviors are not sustainable."

"Beware of the absence of complaints…no organization is perfect, and the absence of problems may signal a culture of intimidation."

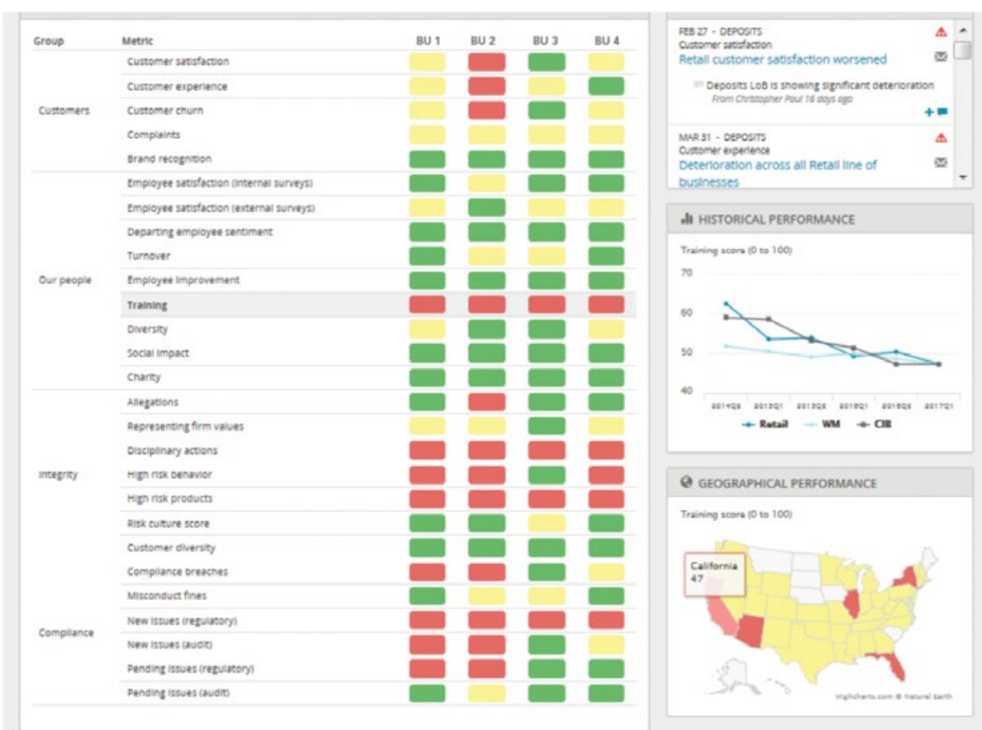
Assess where culture belongs on the board and committee agendas. Where is culture on the board agenda? How is it discussed? As we heard during the roundtable discussions, some boards address culture as a stand-alone agenda item, while others say that they actively discuss and address values, behavior, and culture in a more integrated way, for example, as part of discussions about strategy, risk, customer and employee feedback, compensation policies, health and safety incident reports, customer service, dealings with suppliers and agents, etc. Participants identified several key areas of board focus, including:[6]

- Is the culture really aligned with strategy? Does the culture encourage the values and behaviors that best deliver value creation over the short, medium, and long term? What role does culture play in the performance—or under performance—of the business?
- Do the CEO and management view culture as a key enabler, the differentiator, and source of competitive advantage? Do they understand the importance of culture to the successful execution of strategy?
- CEO and leadership succession and talent development are key ways in which the board helps shape culture.

Determining the most effective ways to discuss culture may be a "journey" for many boards—perhaps at the outset, including culture as a discrete agenda item and also integrating culture into discussions about strategy, risk, and performance. As the board's discussions mature, perhaps there is no longer a need to discuss culture as a separate agenda.

"Our board has dedicated agenda sessions on culture quarterly where they review the culture dashboard and the conduct dashboard," noted one CEO. "When management leaves the room, the directors discuss whether we're measuring it the right way. Then they give the CEO their view on how they think we are doing."

Example of a culture-measurement dashboard



Source: *Report of the NACD Blue Ribbon Commission on Culture as a Corporate Asset*, p. 65, 2017

[6] NACD, BRC Report on Culture as a Corporate Asset and Anderson, Anderson, and Lee, "What Do Boards Need to Know About Culture?"

[7] NACD, BRC Report on Culture as a Corporate Asset.

And in certain circumstances, such as a merger or acquisition, a culture failure, or where the company is undertaking a major strategic shift that requires a cultural change, culture may need to be discussed as a discrete agenda item.

While ultimate responsibility for culture oversight lies with the full board, key committees also have important oversight responsibilities for certain aspects of culture. For example:[7]

Audit committee:

- Results of internal and external audits
- Ethics and compliance
- Whistleblower hotline
- ICOFR and controls around key operational and compliance risks
- Tone at the top and culture in finance organization

Compensation committee:

- Alignment of incentives with culture
- Risks posed by incentives
- CEO and senior management evaluations
- Talent strategy

Nominating/governance committee:

- Board governance policies
- Succession planning for CEO, senior management, and board
- Board composition, diversity, and independence
- Board and individual director performance evaluations

Find more from the Board Leadership Center on corporate culture and the board at *kpmg.com/blc.*

Keeping culture front and center in the boardroom

Where is culture on the board and committee agendas? Is it a priority, with clear roles for the board and key committees?

Does the CEO set the tone needed to achieve the desired results?

Does the culture encourage the behaviors essential to the execution of the company's strategy?

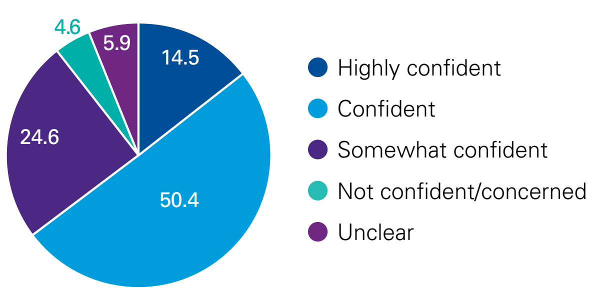
Are we sensitive to critical alignments—purpose, values, strategy, culture, controls, and incentives?

Does management provide the board regular assessments of culture? Could internal audit add more value in its assessment of culture?

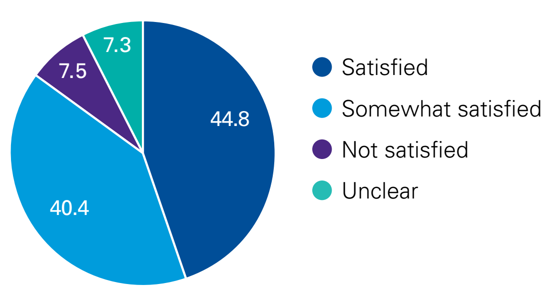
Does the board integrate culture into its ongoing discussions about strategy, risk, and performance, emphasizing the way performance is achieved?

Do directors review the culture of the board and its key committees on a regular basis?

How confident are you that the company's actual culture—including the "unwritten rules" for how things get done day-to-day—reflects its stated culture or corporate values?



How satisfied are you that your board has a good understanding of whether the company's culture encourages behaviors essential to execution of its strategy?



Based on responses from 560 KPMG Director Roundtable registrants

Financial reporting & auditing update

Calendar year-end public companies have already cleared the hurdle of adopting the revenue recognition standard and the financial instruments recognition and measurement standard. However, the expanded revenue disclosures required throughout the year of adoption mean continued obstacles lie ahead.

The U.S. tax reform, enacted in 2017, also continues to significantly affect companies' accounting for and reporting of income taxes and their related processes and controls. With the effective date of the leases standard quickly approaching, the FASB is working to finalize technical corrections and amendments so companies can focus on implementing the final standard. These, as well other accounting and financial reporting developments potentially affecting you in the current period or in the months ahead, are summarized below. (For more detail about these and other issues, see KPMG's *Quarterly Outlook*.)

Current quarter financial reporting matters

U.S. Tax Reform. H.R. 1, originally known as the Tax Cuts and Jobs Act, was enacted on December 22, 2017 and is significantly affecting companies' accounting for and reporting of income taxes and their related processes and controls.

With most of the law's provisions effective January 1, 2018, companies are continuing to refine their estimates of how the law affects their annual effective tax rates. This process includes evaluating whether expenses that were historically deductible before January 1 remain deductible, applying the new rate provisions of the law, determining the effects of the new interest expense limitations, and forecasting whether they will be subject to new taxes on foreign earnings and payments.

Many companies also are continuing to assess the tax effects resulting from adopting the revenue recognition standard and how the adoption interacts with the new tax law, Section 451. Section 451 generally requires accrual method taxpayers to conform their taxable income recognition policies to their financial reporting revenue recognition policies, which may significantly affect how companies identify current and deferred tax amounts.

Treasury also continues to issue tax technical guidance so companies are continuously evaluating the effect of that guidance on their 2018 financial statements. Further, as companies obtain, prepare, or analyze additional information about facts and circumstances that existed at the enactment date, they continue to adjust balances that were recorded provisionally as of December 31, 2017 under SAB 118. Companies are reminded to update their disclosures about provisional balances, as described in the SAB.

Observations on the effects of adopting the revenue recognition standard. First quarter 2018 transition disclosures have been informative about trends in adoption methods and other disclosure matters.

- **Adoption method insights.** Company filings show that the majority of adopters are transitioning using the cumulative-effect method. A company adopting the standard using the cumulative-effect method does not revise its historical financial statements. However, to inform investors about the effects of adoption, the cumulative-effect adopter will, in effect, need to maintain dual reporting to comply with the transition disclosure requirements in the year of adoption. Those companies will need to implement new (or redesign existing) processes and controls to track two accounting methods during the year of adoption to disclose:
  - The amount by which applying ASC 606 affects each financial statement line item in the current period
  - The amount and reason for the significant changes between the reported results under ASC 606 and those that would have been reported under legacy U.S. GAAP.

The leases standard will be effective for public companies in 2019, and companies are beginning to identify more detailed implementation issues.

- **Management's discussion and analysis (MD&A) disclosures.** In addition to the required transition disclosures, many companies are providing additional information in MD&A about the effect of the adoption on prior periods. This presentation is considered a supplemental presentation—not non-GAAP or pro forma financial information.
- **Control changes with implementation.** Companies that have materially changed their internal controls over financial reporting are required to disclose the change in interim and annual filings. Though not required, a number of companies have disclosed the effect of adoption on processes and controls even when management didn't believe those changes were material. When considering whether to disclose internal control changes, it may be helpful to think about the controls associated with adoption in two groups: "onetime" controls put in place to adopt and transition to the new standard and "ongoing" controls needed to account for current and future transactions under ASC 606.

New standards and guidance

Leases standard effective date draws near. The leases standard will be effective for public companies in 2019, and companies are beginning to identify more detailed implementation issues. Public companies have raised questions about the accounting for real estate sale-leaseback transactions that take place before they adopt the leases standard but after they adopt the new revenue standard and about how to apply the optional, short-term lease exemption. They also have questions about whether it is appropriate to use a recognition threshold below which they would not recognize their lease assets and liabilities.

Implementing the credit impairment standard. The FASB's new credit impairment standard will be effective in 2020 for public companies with calendar year-ends. Companies should be analyzing the implications of adopting this standard and considering the adequacy of their disclosures about the expected effects of implementation. Even if a company has not quantified the effects of a new standard, the SEC staff still expects companies to qualitatively describe the expected effects, including how the new policies will compare with current policies.

SEC developments

SEC addresses disclosures about cybersecurity. The SEC has issued interpretive guidance addressing public companies' disclosure obligations under existing law for cybersecurity risk and incidents. It stresses the importance of maintaining comprehensive policies, including disclosure controls and procedures, about cybersecurity risks and incidents. The guidance also reminds registrants about broader prohibitions against insider trading and making selective disclosures about cybersecurity risks or incidents. The guidance became effective on February 26, 2018.

In April, the Center for Audit Quality (CAQ) released a tool that helps board members in their oversight of enterprise-wide cybersecurity risk management. The tool provides sample questions for discussion with management and auditors about cybersecurity risks and disclosures. It also includes a list of resources on cybersecurity from the CAQ, AICPA, and others.

SEC staff issues additional guidance about non-GAAP financial measurers. In April, the SEC's Division of Corporation Finance issued two Compliance and Disclosure Interpretations that clarify when forecasted information provided to board members or other parties in connection with a business combination is excluded from the definition of non-GAAP financial measures.

In March, the CAQ issued guidance to assist audit committees in advancing their oversight of a company's non-GAAP measures. The guidance addresses key matters to consider, including whether the non-GAAP measures present a fair and balanced view of the company's performance. A companion video includes interviews with audit committee chairs discussing real-life examples of how audit committees are thinking about their oversight role.

What boards can expect as iGen joins the workforce

Just when boards and management think they have finally figured out how to accommodate millennials as employees and customers, along comes iGen to reverse many millennial trends.

As the first generation to spend their entire adolescence in the age of smartphones enters the workforce, professor and author Jean Twenge, a social psychologist who wrote the book on iGen, offers some insights based on her research about what companies can expect. She shared her views in an interview with the KPMG Board Leadership Center. Below are edited excerpts.

KPMG Board Leadership Center (BLC): If you were talking to a corporate board, what would you tell them about how to engage iGen as a customer? As an employee?

Jean Twenge: iGen is very concerned with safety, so anything that appeals to their desire to be safe, to feel protected, and to relieve stress will appeal to them. As consumers in the digital age, they have high expectations for customer service, convenience, and speed—they take it for granted that information can be found, and products ordered, within seconds. Anything less and you will lose them instantly.

As employees, iGen'ers are interested in stable jobs where they can build their skills in a nurturing environment. They are still interested in work-life balance like the millennials before them but are more realistic and are more likely to realize that it takes hard work to succeed.

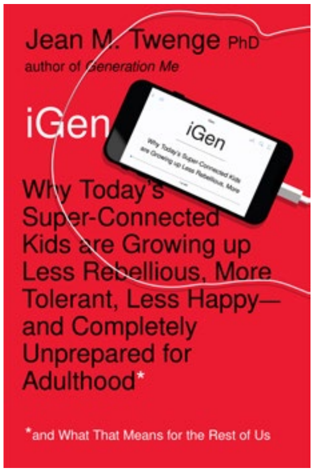
It's important to know that today's college students and young college graduates are not millennials anymore—they are iGen, and they are different. Recognize that your young consumers and entry-level employees are no longer the optimistic, overconfident young people you'd grown accustomed to—increasingly, they are part of a new generation with different attitudes and needs.

BLC: In iGen you discuss a shift in the view of education. Let's call it vocationalism vs. humanism. How do you think that this view of education informs the progression of iGen into the workplace?

Twenge: iGen—born after 1995—is more likely to go to college to get a good job; compared to previous generations, they are less interested in learning for learning's sake. Although it's great that iGen is motivated to find good, stable jobs, they may also be missing out on some of the inherent joy that can come from learning and working. It may take some time for them to enjoy work instead of focusing on meeting the next goal. The baby boomer idea to enjoy the journey and not just the destination is new to them.

BLC: In your book, you talk about how managers should approach iGen regarding engagement and compensation. Without giving away too much, what are some aspects that corporate directors, who oversee companies and managers, should understand about iGen at work?

Twenge: Get ready for a new generation. Although iGen shares many attributes with millennials—born from 1980 to 1994—such as valuing equality, they have reversed many other millennial trends. iGen'ers are less self-confident and less optimistic than millennials were at the same age, and their expectations are more realistic. They are ambitious and hardworking but may need more guidance and nurturing. Also expect to see more issues around social skills—iGen spends less time in person and, thus, arrives at the workplace with less experience with face-to-face social interaction.



BLC: Do you believe that the characteristics you observed in iGen will be persistent? Are there any signs of change? Do they differ based on socioeconomic status or culture?

Twenge: iGen is growing up more slowly, spending more time with screens, experiencing more anxiety and depression, and spending less time with their friends in person. These trends appear across socioeconomic groups, regions of the country, and racial and ethnic groups—they are very pervasive. These trends are continuing as iGen'ers move through college, with more college students reporting higher levels of anxiety and depression. There are only a few studies from other cultures right now, but they also show increases in mental health issues after 2012.

iGen'ers are interested in stable jobs where they can build their skills in a nurturing environment. They are still interested in work-life balance like the millennials before them but are more realistic and are more likely to realize that it takes hard work to succeed.

BLC: You observed iGen as more libertarian but less politically affiliated. Do you see this changing?

Twenge: iGen is less likely to identify with a political party than previous generations were when they were young; they are much more likely to instead say they are political independents. In terms of specific beliefs, they support individual rights and are against government regulation in most cases. One place where this might be changing is in gun rights; although polls show less support for gun control among this group, the tide might be turning for restrictions supported by most Americans, such as more stringent background checks, bans on assault rifles, and raising the age for legally buying a gun from 18 to 21.

BLC: On mental health and inclusion, what are some societal, workplace, or community practices you have observed that are trying to challenge the "in-person deficit" posed by iGen?

Twenge: iGen'ers want to connect with other people—that is a generational universal. Many try to do that online but find it's a poor substitute. Anything that can engineer real, face-to-face interaction will help. In a recent study, people were asked how much they thought they would enjoy talking to a stranger on a train. Most thought they wouldn't like it. But when they did talk to someone they didn't know, they enjoyed it. Imagine how much bigger that effect would be with talking face to face with people you do know.

BLC: How does iGen respond to professional feedback? Is peer or familial feedback handled differently?

Twenge: Both millennials and iGen'ers were carefully protected by their parents, but iGen also experienced the Great Recession as children and adolescents and saw early on that life was not fair. Perhaps as a result, iGen'ers are more realistic than millennials were at the same age. That has affected how they expect and respond to praise: While millennials sought praise because they expected it, iGen needs praise for reassurance.

BLC: How might iGen attitudes toward social media, socialization, religion, sex, and politics bring about changes in the workplace? In how companies understand this generation as customers?

Twenge: Having grown up with smartphones, iGen hasn't had to wait for anything, so convenience is key, and anything that creates more stress for them is out.

Creating the right conditions for sound decision-making

Awareness of how we make decisions leads to processes that help build decision-making muscles, within an organization and in the boardroom. The most effective boards take practical suggestions developed through the learnings of behavioral economics and social psychology to help guide their companies with clear eyes. At the 2018 KPMG Board Leadership Conference, Michael Lewis, author of books including *Moneyball* and *The Undoing Project*, described his approach to writing. He cautioned against starting with a theory and then seeking supporting facts. Instead, Lewis said he "wanders around" to get the real story. His approach is instructive for the boardroom, as it highlights the importance of thoughtful, unbiased inquiry and probing questions as a prerequisite to deep understanding that enables sound decision-making.

Decision-making in the visionary boardroom, the 2018 Women Corporate Directors Thought Leadership Commission report developed in partnership with KPMG and chaired by Susan Angele of BLC, includes insights from experienced corporate directors and experts in board governance and group decision-making around the world. Some of these insights are shared in the following.

Limit time spent looking backward

When asked about barriers to the board's ability to oversee strategy, 51 percent of U.S. public company directors surveyed by the National Association of Corporate Directors said that lack of sufficient agenda time for in-depth strategy discussion was a top concern.[1] Since oversight of risk and compliance-related topics is time-consuming, Herta von Stiegel says that it takes a lot of discipline to limit the time spent looking backward. She has found it helpful to empower the committee chairs to take deep dives on the more performance and compliance-oriented discussions. "This takes trust and you have to have the right people and the right chairs for it to work."

Broaden the discussion

As Monique Leroux says, "Sometimes you start, as a board member, with a simple question and you discover, after a discussion with management, that this question was fundamental and very strategic."

Connie Collingsworth recommends that the board chair "be aware of the board's body language," and solicit input from directors who may be reluctant to speak up. Reference to the "hidden profiles" experiments described in the report can help the chair remember that all the relevant information may not come out in conversation naturally, and extra efforts to get all the input on the table may be warranted.

Look to experts, but do so thoughtfully

The most effective boards welcome experts but are careful not to defer unduly. As noted by the authors of "Intelligent Boards Know Their Limits," expertise, diversity, and inquiry are key practices that make a board "intelligent." However, they added a caution with regard to experts: "This presents the perfect setting for a wrong decision if boards do not seek 'intelligence' by inquiring further and testing the so-called experts." Beware of the halo effect; an expert's area of true expertise may be narrower than it appears.

Mine diversity to maximize value

Consider what one of Marty Evans' boards calls a "gallery walk" as a means of mining the diversity of experience in the room. Rather than observing or providing a presentation on a topic, a few members of management are posted at stations around the room to provide information on a topic in a more informal setting. A few small groups, consisting of a mix of board and senior management, move from station to station. The interesting part, as Evans found, was that the groups often had different discussions on the same topic due to the different perspectives among the groups. "We always have a debrief with everybody involved. And a couple of times, we couldn't believe how different the conversation was for the same alleged topic," she says.

For more on this topic, including a look at how to counter decision biases and assess the effectiveness of management's decision-making processes, read the full report at *kpmg.com/us/wcd.*

1 National Association of Corporate Directors, 2017-2018 NACD Public Company Governance Survey, p.16.

2 Alan Zeller, Anil Gaba, and Ludo Van der Heyden, "Intelligent Boards Know Their Limits," INSEAD Knowledge, February 24, 2017.

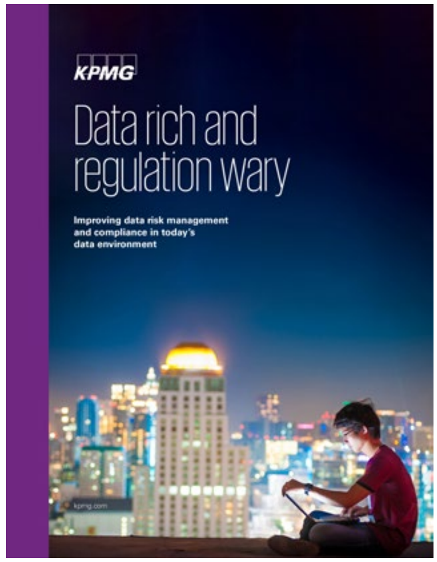
Data rich and regulation wary

"Breach of trust" adds to data governance challenges

Consumer data is a valuable asset for most organizations looking to extend their customer reach and competitive advantage. While consumers are willing to "share" detailed information about themselves, recent headlines demonstrate that they do not look kindly on breaches in data privacy or misuse of personal data by organizations they trust. Indeed, the potential backlash from customers, regulators, and the public for inappropriate use of data is prompting many businesses and boards to discuss data governance with a cautionary principle in mind: "Just because we can, doesn't mean we should."

Regulatory and public scrutiny of data management continues to grow, most recently with the European Union's General Data Protection Regulation taking effect in May, impacting all organizations that touch the data of EU residents. In the United States, the U.S. Federal Trade Commission has committed to make enforcement of the EU-U.S. Privacy Shield Framework a high priority, and a number of states are adopting their own data security laws.

Given the regulatory, legal, and enterprise risks that can arise from a failure related to data privacy or security, boards will want to understand the data program and the related policies, controls, and monitoring processes the company has in place to manage and protect data maintained across the enterprise and held by third parties.



To better understand how their companies are managing privacy and security risks around consumer personal data and protecting their brand from reputational risks, including consideration of unintended exposure of user data, identity theft, and other legal restrictions, boards should consider the following questions:

What is our risk tolerance level for privacy, consumer protection, and reputational risks?

Do we have the appropriate governance structure in place to manage these risk?

Are the appropriate resources being allocated to data privacy and security?

Is the data privacy and security program aligned with the company's business strategy?

Do the company's customers know what data is collected and how it is used? Are the associated policies and processes clearly articulated and understood, both internally and externally?

Are user agreements clear, concise, and understandable to the average consumer, and are they readily accessible and sufficiently updated and reviewed?

Does the board receive regular reports on the company's risk mitigation activities related to data privacy, compliance, and security controls?

What is the escalation process for incidents related to data privacy and security?

Is the company's incident response plan up to date and has it been tested recently?

Does the company assess and provide ongoing monitoring of partner and third parties with respect to privacy, contractual obligations, potential misconduct, and reputational risks?

For more on data privacy and security, see KPMG LLP's Data rich and regulation wary: Improving risk compliance in today's data rich environment.

Governance Debates

One share, one vote —or not?

by Claudia H. Allen

The concept of "one share, one vote" dominates the public company landscape in the U.S. Yet, at a distinct minority of companies, founders and other insiders hold a class of equity with multiple votes per share—typically 10—while the public holds stock that carries one vote per share, or in a small number of cases, no votes.

The super-voting stock creates a disconnect between economic interest and voting power, and the holders of super-voting stock are typically able to control the board and all major decisions. Proponents maintain that a multi-class structure allows visionary founders to pursue their strategy without having to respond to short-term pressures. They also argue that many founders would elect to keep their companies private if ceding control to the public were the price of being a public company. Critics of multi-class structures argue that they insulate management from accountability and that such structures should not last forever—even after the founder is gone—with some likening such companies to dictatorships.

Many large tech companies have dual (or even triple) class structures, and they are becoming more heavily weighted in stock indices as a result of their increasing valuations. The *Financial Times* reported that businesses with unequal voting rights represented 4 percent of the MSCI World Index, by weight, in 2005, with that percentage rising to 10 percent currently. Moreover, a majority of the companies with unequal voting structures in that index are U.S. companies.[1]

Yet, multi-class structures are not new in the U.S. For example, Dodge Brothers went public in 1925 with two classes of stock, and such structures were often established at media companies, where the high vote stock was viewed as insulating editorial content from outside pressures.

The debate over multi-class share structures has heated up yet again as the result of several factors, including the 2017 IPO of Snap Inc. in which the shares sold to the public have no voting rights, the decision of certain major index providers to exclude or change the weighting of companies where the public holds low (or no) vote stock, and the reaction of institutional investors to changes made or proposed by index providers.

Index providers

In July 2017, FTSE Russell announced that unless the public holds more than 5 percent of a company's voting rights, that company will not be included in its indices. Approximately 35 companies that were already public would have been excluded based on this low threshold, and they have until September 2022 to comply if they wish to remain in FTSE Russell's indices. FTSE Russell has indicated that it may revisit the threshold.[2]

S&P Dow Jones subsequently adopted a policy under which companies with multi-class structures will no longer be added to the S&P Composite 1500 and its component indices (the S&P 500, MidCap 400, and SmallCap 600). Since S&P Dow Jones grandfathered multi-class companies already in the indices, the impact is primarily on companies contemplating an IPO.[3]

At present, MSCI is seeking input on a proposal that would keep multi-class companies in its indices but reduce their weighting to reflect the voting power of the public float.[4]

The practical impact of excluding a company from an index is that portfolio managers may not be able to buy the company's stock and may purchase less of the stock than would otherwise have been the case if the company is underweighted.

Institutional investors

The top 10 institutional investors, including Blackrock, Vanguard, and State Street, generally oppose multi-class structures.[5] Yet, many investors have not embraced the index providers' initiatives.

For example, Blackrock has been vocal in its opposition to excluding companies from indices based upon a multi-class structure, arguing that "broad market indexes should be as expansive and diverse as the underlying industries and economies whose performance they seek to capture… index providers should make every effort to reflect the investable marketplace…"[6] Vanguard has taken a similar stance on excluding companies from broad indices,[7] as has Norges Bank Investment Management (NBIM), one of the world's largest investors, with assets of more than $1 trillion.[8]

Blackrock also opposes MSCI's proposal to underweight companies with unequal voting rights and has suggested that MSCI offer a range of alternative indices that reflect investor preferences relating to issues such as unequal voting rights. Underlying Blackrock's stance is its view that regulators, and not index providers, should set governance standards. NBIM has similarly suggested that the MSCI methodology would be appropriate for a "parallel set of indices that investors can follow at their discretion."[9]

Notably, while Blackrock believes "one vote for one share" is the preferred structure for public companies, it recognizes "the potential benefits of dual-class shares to newly public companies as they establish themselves; however, we believe that these structures should have a specific and limited duration." The Council of Institutional Investors (CII), which has long argued in favor of one share, one vote, also raised the concept of a "sunset" on dual-class structures when responding to the MSCI proposal. In particular, CII suggested exempting companies "that choose to adopt firm, reasonable, time-based sunset provisions in their governing documents," noting that "the core of our concern is lack of accountability in the long-term, beyond a reasonable time horizon for understanding risks and opportunities."[10]

Valuation

A central question underlying the debate over multi-class structures is whether such structures positively or negatively affect value. While studies have produced mixed results, MSCI recently issued a report finding that "unequal voting stocks in aggregate outperformed the market over the period from November 2007 to August 2017, and that excluding them from market indexes would have reduced the indexes' total returns by approximately 30 basis points per year over our sample period."[11] A subsequent academic paper found that dual-class firms have a valuation life cycle, with higher valuations at IPO that dissipate after six to nine years.[12] The authors concluded that "some sort of a sunset provisions may be useful." Further contributing to the debate, SEC Commissioner Robert Jackson, Jr. recently released the results of his preliminary analysis of 157 dual class IPOs over the past 15 years that found: "Seven or more years out from their IPOs, firms with perpetual dual-class stock trade at a significant discount to those with sunset provisions."[13] Commissioner Jackson expressed a hope that stock exchanges will consider listing standards that provide for some form of sunset.

Yet, the listing standards of several countries permit multi-class structures, and as competition for listings increases, more exchanges, including Hong Kong and likely Singapore, are allowing these listings, causing some opponents of super-voting stock to lament a race to the bottom.

The question remains whether investors will lose their appetite for low (or no) vote shares. To date, that appetite has not waned, although complaints of corporate tyranny have increased.

Directors should consider the following questions:

– If a company is contemplating a multi-class IPO, should the super-voting stock sunset, either after a fixed number of years or after a specified event (such as the founders owning less than a specified percentage of equity)?

– Will the founders/insiders agree to such a trigger, including in the case of companies that are already public?

– Has the board considered the impact of the company being excluded from one or more indices?

1 Attracta Mooney and Robin Wigglesworth, "Google, Facebook and Snap Challenge Governance Standards," Financial Times, May 27, 2018.

2 FTSE Russell, "FTSE Russell Voting Rights Consultation – Next Steps," July 2017.

3 S&P Dow Jones Indices press release, "S&P Dow Jones Indices Announces Decision on Multi-Class Shares and Voting Results," July 31, 2017.

4 MSCI press release, "MSCI Reopens the Consultation on the Treatment of Unequal Voting Structures and Releases a Discussion Paper," January 31, 2018.

5 Nick Dawson, "Swimming Against the Current," Harvard Law School Forum on Corporate Governance and Financial Regulation (HLS Forum), August 14, 2017.

6 Barbara Novick, Open Letter Regarding Consultation on the Treatment of Unequal Voting Structures in the MSCI Equity Indexes, May 3, 2018, HLS Forum.

7 Dawson, "Swimming Against the Current."

8 Carine Smith Ihenacho and Séverine Neervoort, NBIM letter to MSCI, Inc., May 31, 2018.

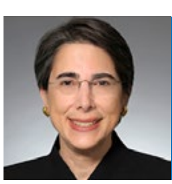
9 NBIM letter to MSCI, May 31, 2018.

10 Kenneth A. Bertsch, letter to MSCI Equity Index Committee, HLS Forum, May 9, 2018.

11 Dimitris Melas, "Putting the Spotlight on Spotify: Why Have Stocks with Unequal Voting Rights Outperformed?" MSCI Blog, April 3, 2018.

12 Martijn Cremers, Beni Lauterbach, and Anete Pajuste, "The Life-Cycle of Dual Class Firms," European Corporate Governance Institute, revised May 25, 2018.

13 Speech by SEC Commissioner Robert J. Jackson, Jr., "Perpetual Dual-Class Stock: The Case Against Corporate Royalty," February 15, 2018.



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Chair and Lead Director Symposium – NACD Global Board Leaders' Summit, Washington, DC
Sept. 29

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For more information, visit *kpmg.com/blc.*

Selected reading

Governance challenges 2018: Board-shareholder engagement in the new investor environment *NACD*

The future of compliance: Top 5 investments to prepare for the future today *KPMG*

In a new era for boards, culture is key *Spencer Stuart*

Getting climate smart: A primer for corporate directors in a changing environment *The B Team & Ceres*

Orientation to match a new reality *Semler Brossy*

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