On the 2018 private company board agenda

Board Leadership Center

Board agendas should continue to evolve in 2018 as the game-changing implications of technology/digital innovation, scrutiny of corporate culture and leadership, growing demands for companies to address environmental and social issues, and investor expectations all drive a sharper focus on positioning the company for the future. Drawing on insights from our work and interactions with directors and business leaders over the past 12 months, we have highlighted six items for private company boards to consider in their 2018 agendas—on critical challenges at-hand, and on the road ahead—as they help guide the company forward.

Help the company keep its eye on the ball: long-term value creation.

One of the board's most important roles is to empower the CEO and management team to think and act long-term—investing in talent, driving innovation, and taking the long view on corporate performance. Of course, the short-term cannot be ignored—there is a genuine need for short-term stewardship—but don't let it distract from focusing on the long term. The challenge for the board is to help the company align near-term activities and results with long-term value creation.[1]

Indeed, major asset managers and public pension funds have made clear their expectations for public companies to focus on long-term value creation and the factors driving it—strategy and risk, talent, investment in research and development, culture and incentives, and, more recently, environmental, social, and governance (ESG) issues, particularly climate change and diversity. These same investors are beginning to bring those concerns to private companies, particularly those controlled by private equity and venture capital funds. On ESG issues—which are squarely in the sights not only of investors as well as employees, customers, and communities—the board can help management widen its aperture to understand how the company's strategy and operations impact all of its key stakeholders and drive long-term performance. (See KPMG's "ESG, Strategy, and the Long-View."[2])

Be particularly sensitive to risks posed by the tone at the top and culture throughout the organization.

As recent headlines have demonstrated, many of the crises that have caused the greatest damage to corporate reputations were driven by the conduct of and tone set by leadership, as well as the risks associated with the culture throughout the organization. The right tone at the top and culture are the sine qua non of any effective risk management program. Have a laser-like focus on the tone set by senior management and zero tolerance for conduct that is inconsistent with the company's values and ethical standards, including any "code of silence" around such conduct. Be sensitive to early warning signs and verify that the company has robust whistle-blower and other reporting mechanisms in place and that employees are not afraid to use them.

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[1] Report of the 2015 NACD Blue Ribbon Commission: The Board and Long-Term Value Creation.
[2] *ESG, Strategy, and the Long-View: A Framework for Board Oversight*, at kpmg.com/blc

Corporate culture—what the company does and how it does it—permeates virtually every aspect of an organization, is critical to the execution of strategy, and needs to be front-and-center in the boardroom. Understand the company's *actual* culture (the unwritten rules, versus those posted on the breakroom wall); use all the tools available—surveys, internal audit, hotlines, social media, walking the halls, and visiting facilities—to monitor the culture and see it in action; recognize that the tone at the top is easier to gauge than the mood in the middle and the buzz at the bottom. How does the board gain visibility into the middle and bottom levels of the organization? Do employees have the confidence to escalate bad behavior and trust it will be taken seriously? Make sure that incentive structures align with strategy and encourage the right behaviors, and take a hard look at the board's own culture for signs of groupthink or discussions that lack independence or contrarian voices.

Focus on developing a board that is fit for purpose looking forward, recognizing that diversity and independent perspectives are key.

A board that adds value to the business is fully engaged, aware of its own strengths and weakness, and is always striving for improvement. This requires a board that considers its own evolution—building a mix of skills, perspectives, and backgrounds that align with the company's future needs. That said, it's clear that the world is changing faster than boards. And, unlike public company boards, private company boards often face little outside pressure to refresh as the business changes. Is a stale boardroom failing to encourage the innovation and culture that is required for growth?

A changing business and risk landscape (competitive threats and business model disruption, technology innovations and digital changes, the Millennial-effect, global volatility) requires a proactive approach in order for the board to deliver value and oversight. Is there a plan in place to help ensure that the board is positioned to serve as a strategic asset to the company? Can the controlling investor or owner provide greater resources to those tasked with strategy and oversight?

Private company boards need to take a closer look at who serves on the board, how independent they are, their gender and diversity, time on the board, and connections to the CEO or founder. Take a hard look at the board's composition and how it assesses its effectiveness and positions the company for the future, i.e., board evaluations, skills/diversity matrix, succession planning, board and committee leadership, and ongoing director education. Keep the critical value of this effort front-and-center: Diverse thinking drives better governance—and better business decisions.

Expect disruption to continue full-force, with technology and "digital" at its core.

The raft of start-ups upending traditional business models should put disruption high on board agendas. Advances in digital technologies such as cloud computing, robotic process automation, machine learning, artificial intelligence (AI), and blockchain are transforming how companies do business. Moreover, the speed and impact of these technologies—automating, self-learning, reshaping business processes—have the hallmarks of another "new economy" (the Internet was the last one). Help the company test its strategic assumptions and keep sight of how the big picture is changing. What disruptive trends are directors seeing in other industries?

Understanding how the company collects, protects, analyzes, and uses data has become table stakes for broader, potentially game-changing questions: What are the goals of the company's digital strategy and how can the use of big data and advanced analytics drive the business? Do we have the right tools, technology, resources, and talent to develop a quality big data program? How do we determine what information drives value for the organization, e.g., insights into customers, employees, suppliers, business processes, and emerging risks?

Learn to live with cyber risk—and continue to refine the board's discussions about cyber risk and security.

Not only is the cyber threat not going away, it is growing more sophisticated and aggressive, with implications for nearly every facet of the business. Hacks at prominent organizations punctuate the new reality that any system "on the grid" is vulnerable. Boardroom discussions should be moving from prevention to detection, containment, and response and to addressing cyber risk as an enterprise-wide business issue that can potentially impact strategy, compliance, product development, M&A, expansion into new geographies, and relationships with vendors, suppliers, and customers. A robust and frank boardroom dialogue is vital to making cybersecurity a core competency across the business.

How often is the maturity of the company's cybersecurity risk management framework evaluated? How does the company keep up with regulatory changes and new legal requirements? Does the company stay abreast of industry practices and connect with law enforcement? Does the company have an incident readiness and response plan that has been reviewed and tested? Who leads the plan? Does the board get the information/reports it needs (cyber dashboard) to oversee cybersecurity efforts? Is there a C-suite executive who can effectively communicate with the board on cyber issues in the context of the business and in language the board understands?

Monitor the implementation plans and activities for major accounting changes on the horizon—particularly the new revenue recognition and lease accounting standards.

The scope and complexity of these implementation efforts and the impact on the business, systems, controls, and resource requirements should be a key area of focus for private company boards and audit committees. Based on the experience of public companies—which have earlier effective dates for the new standards and are therefore further along in their implementation efforts—many companies tend to underestimate the time, resources, and level of complexity associated with implementing the new standards.

The new revenue standard (effective January 1, 2019 for calendar year-end private companies) provides a single recognition model across industries, companies, and geographical boundaries. While the impact will vary across industries, many companies—particularly those with large, complex contracts—will experience a significant accounting change when implementing the new standard. It will require companies to apply new judgments and estimates, so investors, boards, and audit committees will want to inquire about the judgment and estimates process and how judgments and estimates are reached.

Under the new lease standard (effective January 1, 2020 for calendar year-end private companies) lessees will recognize most leases, including operating leases, on the balance sheet. This represents a wholesale change to lease accounting, and many companies will face significant implementation challenges during the transition. Implementation of these two new standards is not just an accounting exercise; boards and audit committees will want to receive periodic updates on the status of implementation activities across the company (including possible trouble spots) and the adequacy of resources devoted to the effort.

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, the WomenCorporateDirectors Foundation, and more—the Center engages with directors and business leaders to help articulate their challenges and promote continuous improvement of public- and private-company governance. Drawing on insights from KPMG professionals and governance experts worldwide, the Center delivers practical 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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