On the 2019 private company board agenda

Board agendas should continue to evolve in 2019. The game-changing implications of technological innovation and growing demands to address environmental and social issues should drive a sharper focus on long-term value creation and positioning the company for the future. Combined with mounting trade tension and political swings around the world, the year ahead will require a careful balance of near-term focus, agility, and long-term thinking.

Drawing on insights from our work and interactions with directors and business leaders over the past 12 months, we've highlighted seven items for boards of private companies to consider as they focus their 2019 agendas on the critical challenges at hand and on the road ahead:

- Take a hard look at board composition: Is the talent in the boardroom diverse and aligned with the company's strategy and future needs?
- Recognize that connecting digital disruption with risk management and strategy is more important—and more challenging—than ever.
- Help ensure that M&A and new financing deliver the value that they should.
- Make CEO succession and talent development throughout the organization a priority.
- Assess, monitor, and reinforce culture as a strategic asset and critical risk.
- Continue to refine boardroom discussions about cybersecurity and data privacy as *risk management* issues.
- Be vigilant about potential conflicts of interest.

Take a hard look at board composition: Is the talent in the boardroom diverse and aligned with the company's strategy and future needs?

The changing business and risk environment, marked by business model disruption, digital innovation, shifting customer expectations and tastes, and culture-related risks, requires a proactive approach to board building. Is there a plan to help ensure that the board serves as a strategic asset to the company and has the right composition to help guide the company in the future as its strategy evolves? While determining the company's current and future needs is the starting point for assessing and enhancing the board's composition, there is a broad range of board composition issues that require board focus and leadership—including succession planning, diversity, individual director evaluations, removal of underperforming directors, and board refreshment, as well as the potential impact of ownership transitions. For companies operating without a formal governance committee, the board chair, CEO, lead director or a special committee of the board should assess whether the current board has the right composition and develop a board succession plan based on future needs.

Recognize that connecting digital disruption with risk management and strategy is more important—and more challenging—than ever.

Advances in digital technologies such as cloud computing, robotic process automation, machine learning, artificial intelligence (AI), and blockchain—and the *speed* of these advances—are disrupting business models and transforming how companies do business. As discussed in the 2018 NACD Blue Ribbon Commission report, *Adaptive Governance: Board Oversight of Disruptive Risks*, traditional enterprise risk management processes may not be designed to address the disruptive risks posed by these digital advances or to assess the continuing validity of key assumptions on which the company's strategy and business model are based. Help management reassess the company's processes for identifying the risks and opportunities posed by digital advances and for assessing their impact on the company's strategy. Does management have an effective process to monitor technology changes in the external environment? Does the process provide an early warning that adjustments to the strategy might be necessary?

Also, 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 help drive the business? Does the company 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 —for example insights into customers, employees, suppliers, and business processes—and how do we manage the data in a responsible, ethical manner?

Help the company test its strategic assumptions and keep sight of how the big picture is changing by connecting dots, thinking differently, and staying agile and alert to what's happening in the world. In short, digital disruption, strategy, and risk should be hardwired together in boardroom discussions.

Help ensure that M&A and new financing deliver the value that they should.

Was 2018 a turning point in the capital markets? According to Dealogic, almost 200 companies went public in the United States through November, raising $45 billion, and more than 80 percent of those companies were unprofitable in the year prior to their IPO—the most forgiving market for new issues since 1980 according to University of Florida professor Jay Ritter. Merger activity was up 36 percent to $1.5 trillion, a record-setting annual pace in the U.S. and globally. Yet, in the latter half of the year, the bond and loan markets fell to multiyear lows in issuance and syndication as investors showed an unwillingness to support riskier businesses longer term.

How will rising interest rates and equity market volatility impact the company's ability to execute on a strategy that includes ongoing funding requirements, raising public debt or equity, or closing in-process transactions? Among the key areas of board focus: Test alignment of any transaction or financing with the company's strategy and challenge the value creation potential, necessity, and urgency of the deal. Consider the range of financing options (whether as buyer or seller) and deal structures. Closely monitor key aspects of the due diligence process before approving the transaction. Examine the postmerger or postfinancing plan in detail and track performance against the plan.

Make CEO succession and talent development throughout the organization a priority.

Few board responsibilities are more important than hiring and firing the CEO—a reality that continues to hit the headlines, particularly if the board is caught flat-footed. Given the complex and disruptive business and risk environment today, it is essential that the company has the right CEO in place to drive strategy, navigate risk, and create long-term value for the enterprise. The board should ensure that the company is prepared for a CEO change—both planned and unplanned. CEO succession planning is a dynamic and ongoing process, and boards should always be thinking about developing potential candidates. How robust are the board's CEO succession planning processes and activities? Are succession plans in place for other key leadership roles? Succession planning can be a considerable challenge for founder- or family-led companies, and a high level of emotional intelligence is often required to navigate the discussions, particularly if the board has determined that it is in the best interest of the company to move on from the family or founder as chief executive.

Closely linked to the importance of having the right CEO is having the talent required—from the top of the organization down through the ranks—to execute the company's strategy and keep it on track. We expect companies will face an increasingly difficult challenge in finding, developing, and retaining talent at all levels of the organization. Does management have a talent plan that aligns with its strategy and forecast needs for the short and long term? Which talent categories are in short supply and how will the company successfully compete for this talent? More broadly, as millennials join the workforce in large numbers and talent pools become globally diverse, is the company positioned to attract, develop, and retain top talent at all levels?

Assess, monitor, and reinforce culture as a strategic asset and critical risk.

Corporate culture is front and center for companies, shareholders, regulators, employees, and customers—as it should be for every board. Headlines of sexual harassment, price gouging, shady sales practices, and other wrongdoing—with corporate culture as the culprit—have put boards squarely in the spotlight: Where was the board? And what is it doing to fix the culture?

Given the critical role that corporate culture plays in driving a company's performance and reputation—for better or for worse—we see boards taking a more proactive approach to understanding, shaping, and assessing corporate culture. Among the messages we hear: Have a laser 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.

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 their concerns 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 not only on results but also on the behaviors and attributes driving them.

Continue to refine boardroom discussions about cybersecurity and data privacy as *risk management* issues.

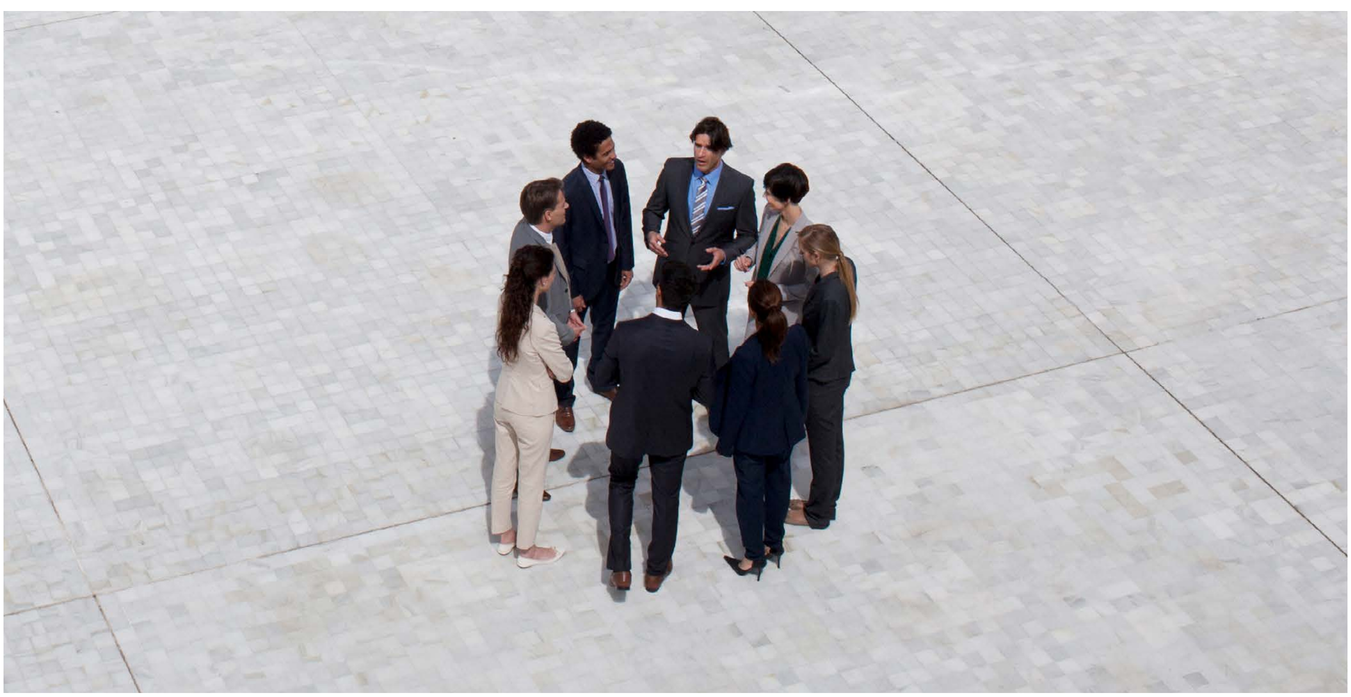
Cyber threats continue to grow more sophisticated and aggressive, with implications for nearly every facet of business. Hacks at major companies punctuate the new reality that any organization on the grid is vulnerable. Yet, "private companies are less likely than their public peers to have fully mature legal, audit, and compliance functions that can offer additional perspectives on cyber and data privacy risks and vulnerability," according to the *2017–2018 NACD Private Company Governance Survey*. Boardroom discussions should be moving beyond prevention to *detection, containment, and response*—and to addressing cybersecurity as an enterprise-wide business issue that affects 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 helping the company learn to live with cyber risk and making cybersecurity a core competency across the business.

How frequently is the maturity of the company's cybersecurity risk management framework evaluated? How is the company keeping up with regulatory changes and new legal requirements? Is the company staying abreast of industry practices and connecting with law enforcement? Does the company have an incident readiness and response plan that has been reviewed and tested? Is the board getting the information it needs (cyber dashboard) to oversee cybersecurity efforts?

What risks do the use of big data pose, and who is responsible for making decisions about the collection and use of data? Europe's recently enacted General Data Protection Regulation and other data privacy rules such as California's Consumer Privacy Act should prompt rigorous assessments of companies' data practices. Indeed, with data privacy linked so tightly to trust and reputation, a running reality check is essential: "Just because we can doesn't mean we should."

Be vigilant about potential conflicts of interest.

Conflicts of interest, including related-party transactions, often pose a significant challenge for private company boards, whose directors may also represent third parties, such as private equity or venture capital companies, investment funds, or family councils. While the interests of the private company shareholders and a third-party entity that a director represents are in most cases aligned, conflicts do arise—in the form of management fees, debt and equity financing terms, compensation to a family CEO, dividends and distributions, timing of "exit" strategies or ownership transitions, etc. Be vigilant to identify early on any potential conflicts and work with legal counsel to develop an appropriate course of action to surface and resolve any conflicts.



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Contact us

kpmg.com/us/blc

T: 1-800-808-5764

E: us-kpmgmktblc@kpmg.com

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