Board Matters Quarterly offers thought-provoking perspectives and insights into leadership and governance issues for boards and audit committees, supporting them to navigate the increasingly complex business environment.

Boards must prioritize business needs and embody the agility required to thrive amid the changing economic landscape. Read more in our discussions on key board concerns in this issue.

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Strategic priorities for greater board impact

The oversight burden on boards is intensifying given how the speed of change is fundamentally rewriting business models and strategies. What are the strategies for boards now and beyond?

Seasoned board of directors can attest to the speed of change in business. Technology has fundamentally overturned the way business is done, simultaneously making systems more integrated and decentralized, and generating a wealth of data for insights and oversight. Such systemic change has led to disparate progress across organizations and industries, and increased consumer and shareholder expectations.

Above and beyond the impact of emerging technologies, industry convergence and workforce transformation, shifting consumer attitudes, increased climate risk, political polarization and other megatrends, boards need to be adept at assessing risks and seizing the upsides in a calculated manner. Arguably, the tasks of overseeing strategy and risk management has become even more challenging – and staying focused on some key strategic priorities can help.

Embracing duality

Driving near-term growth while pursuing innovation that supports long-term opportunity and sustainability is an inherent challenge. Rather than perceiving the duality as a tension, boards must appreciate the synergy to inform a stronger and more resilient long-term strategy – and gear management towards that. Ultimately, both must honestly answer the question: what is being done well today that will not make the company better and stronger tomorrow?

The drive for efficiency and value can also be seen in the increase in regulatory scrutiny and activist campaigns. If viewed as two sides of the same coin, boards and management will appreciate that the outside perspective can constructively challenge biases and blind spots, injecting a much-needed objective perspective to “business-as-usual”.

By Max Loh
Operating in such a business environment means that one-off, annual board strategy sessions need to be updated with frequent revisits to the strategic plan, and its key elements and assumptions. Regular evaluation of the company and its business units, products and solutions, underperforming assets and operations at risk from technology, digital and customer disruption will keep the company vigilant and open to opportunities as they arise.

**Broadening risk and strategy governance**

Trust will be the most critical differentiator in the future for a company and its shareholders and broader stakeholder group. Invariably, in the journey of transformation where innovation is key and exposure to failures are heightened, sustaining trust becomes harder.

To do so, boards need to ensure that in governing risk management, they have the right composition of board members with expertise aligned with the company’s strategy and risk oversight needs, and astute leadership to challenge management and seek external insights as appropriate.

In the past, many boards have charged their audit committee with oversight of the company’s enterprise risk management program – this is changing with the ownership of the strategy and risk oversight more distributed across the board given the dynamic nature of businesses today.

Beyond adequate compliance, risk and audit processes, boards must also check that adequate attention has been put into ensuring that employees, as key internal stakeholders, are aware of their personal responsibilities relating to anti-bribery and corruption and risk management.

Further, the approach to critical enterprise risks should incorporate assessment of the risks, investments and developments in their industry. These added insights, often obtained through third-party research, can help to validate risk mitigation and consideration of strategic opportunities in
areas such as culture, workforce transformation, sustainability, geopolitics, regulation, along with the evolving cybersecurity and data security landscape.

**Investing in talent and culture**

Today’s talents seek to work for companies that have a clear purpose, strong culture and respected reputation. Nonfinancial performance features not just on the shareholders’ agenda, but also on the minds of job-seekers. Organizations that address environmental and social issues, and provide learning and growth opportunities, are often magnets for diverse talents with mindsets that are primed for the future.

The board should have a strong pulse on how executive, mid- and lower-level management demonstrates and communicates the company’s values, and the company’s programs in promoting culture to drive the right behaviors and actions. To this end, a chief human resources officer can help the board to understand the workforce of the future and guide management on where and how to invest in talent and technology for an overall return on investment.

**Building a mindset of self-evaluation**

There are numerous means to an end. Along the journey, boards should ask whether adding a new or adhoc committee can enhance oversight capabilities or ease workload. Alternatively, committee memberships can be refreshed, reallocated or expanded to improve performance.

As well, companies now no longer just manage shareholders, but a growing web of stakeholders – corporate leaders and employees, customers and suppliers, communities and investors – who are increasingly focused on the broader purpose of the organization. Well-governed companies demonstrate their responsiveness through sustained engagement and enhanced disclosures directly addressing stakeholder interests. Stakeholder communication should clearly and effectively present how the organization is addressing issues, governing and executing its strategy.

Boards of today need to have a mindset of continuous self-evaluation, from the quality of the information they receive to the outcomes of their decision-making. Boards can consider the questions below in evaluating their progress:

- Does the board represent the right mix of relevant skills, specialized expertise and industry knowledge to shape an agile, multi-stakeholder strategy that drives current business and future opportunities?
- Should the board bring in outside perspectives to understand the forces shaping the competitive environment?
- How is the company communicating to all stakeholders its efforts to provide sustainable, inclusive growth integrated with core business strategy?
- Is the board continuously reviewing its governance of culture, talent and innovation given the ever-growing significance of intangible capital to competitive advantage?
- How are you considering the risk of being unprepared versus the cost of being prepared?

One of the greatest challenges of business leaders today is to embody the agility required to manage seemingly opposing concepts and embrace ideas that may not have worked in the past. To that end, boards should be directed by their strategic priorities, to not only sustain, but to thrive, as the business evolves with its environment.

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Intelligence without trust: a risky business

Artificial intelligence is fundamentally changing the business landscape. Boards need to keep pace with emerging frameworks, policies and legislations so that their business achieves a balance between algorithmic transparency and accountability.

Companies and entire industries are looking to harness data analytics to make more accurate and effective decisions, within and across organizations. Such real-time and accurate insights have enabled boards and their management to be more effective in conducting their duties.

While the management are generally better-informed today, their time is still monopolized in reviewing and approving routine decisions. Applying artificial intelligence (AI) to data analytics systems could potentially relieve the resource burden of some of these decision-making efforts.

AI will eventually transform the business landscape, but its pace of development is hampered by a lack of trust. Without mature risk awareness and the right frameworks and controls, applications of AI today have not evolved much beyond proofs of concept and isolated solutions — there is still some way to go before autonomous decision-making can be done confidently and securely across the organization.

AI mimics the learning function of the human brain, which means it could be deliberately or accidently corrupted and even adopt human biases, potentially resulting in mistakes and unethical decisions. Control of AI systems by the wrong hands is also a concern. Any AI system failure could have profound ramifications on security, decision-making and credibility, and may lead to costly litigation, reputational damage, regulatory scrutiny, and reduced stakeholder trust and profitability.

In a move that addresses some of these concerns, in January 2019, the Singapore government published the Model Artificial Intelligence (AI) Governance Framework for public consultation, guided by two key principles: Firstly, the AI decision-making process...
must be explainable, transparent and fair. Secondly, the AI solution should be human-centric.

The trust hardware

While creating a framework for using AI and managing the associated risks seems complex, it is similar to setting up the controls, policies, processes that are already in place. Companies are already evaluating human behavior against a set of norms; next would be to design, develop and deploy AI solutions that are aligned to the organization’s values, and societal and ethical norms.

It is important to think about AI from a full-systems view instead of the individual components, as AI algorithms do not usually operate in silo but with other algorithms, robotics capabilities and Internet of Things sensors. Additional risks can arise from this multitude of systems interacting with one another.

“Boards should understand how AI is applied and be aware of the emerging frameworks, policies and legislation to ensure that their business has the right balance between algorithmic transparency and accountability.”
Further, third-party AI applications present another set of conveniences, and also a host of vulnerabilities and limitations. The risk profiles of these applications should be thoroughly understood to fully appreciate its offerings.

Such considerations will impact the strategic purpose of the system, integrity of data collection and management, governance of model training and rigor of techniques used to monitor system and algorithmic performance. The dynamic and learning nature of AI means that its behavior will continue to evolve even after implementation, demanding an added level of agility and vigilance in governance.

**The leadership software**

The responsibility to implement checks and balances on an AI system requires active input of the management, with oversight of the board. Leading best practices include setting up a multi-disciplinary advisory board that will provide independent guidance on the AI development journey, proposing governance and accountability mechanisms regarding the AI code of conduct, and rolling out regular and independent ethical, design and risk audits to test and validate the systems.

Boards should also understand how AI is applied within the organization and in the industry, and be aware of the emerging frameworks, policies and legislation to ensure that their business has the right balance between algorithmic transparency and accountability.

**Questions for boards:**

1. Does the board understand the potential impact of AI on the business model, culture, strategy and sector?
2. Does the board believe that the past will be a good predictor of the future? If not, how can an AI model be built to work in the future?
3. How are the insights and outcome of the AI model explained and deployed in a sensitive and defensible manner?
4. How do we build sufficient human overrides to ensure oversight and compliance for AI-driven processes and transactions?
5. Has the management assessed how the adoption of AI impacts the integrity of its finance function and its financial statements?
Is there a business case for blockchain?

With qualities such as “immutability”, “trust”, and “decentralization”, the idea of adopting the blockchain is tempting. As companies explore blockchain as a solution, boards need to understand the technology and its impact, to adequately assess if the investment justify the outcomes.

Blockchain was first introduced widely in 2009 with the rise of the cryptocurrency Bitcoin. The draw of Bitcoin is its premise of disrupting peer-to-peer payments without the need for a trusted authority, such as a financial institution. As the technology behind bitcoin, blockchain has attracted a wide range of supporters.

With qualities such as “immutability”, “trust”, and “decentralization” associated with it, the idea of blockchain is tempting. The industrialization of blockchain is just beginning, and many are moving beyond proof-of-concepts to production. While a technology like blockchain may solve certain issues, it introduces new ones as well. In reality, business problems are typically multifaceted and require multi-prong solutions involving people, process and technology.

As companies explore blockchain as a solution, boards need to understand the technology and its impact, so as to adequately assess if the business case to implement blockchain in the companies that they oversee is robust and if the investments justify the outcomes.

Understanding blockchain
A unique quality of blockchain is its ability to improve trust between participants by having multiple points of verification through peer-to-peer networks that manage transactions in a decentralized manner.

Instead of a single central trusted authority validating a transaction, individual parties in a blockchain ecosystem are both participants and gatekeepers to its consensus protocol. Transactions in the network are validated by the individual
entities before being grouped into blocks, and then subsequently linked to the previous block chronologically (hence the name blockchain) and secured using cryptography. This bundling of blocks produces an immutable shared record of truth.

Broadly, there are three blockchain models: public and permission-less, private and permissioned, and hybrid blockchains.

Public and permission-less blockchains resemble bitcoin, the original blockchain, whereby all transactions are public, and no permissions are required to join these distributed entities. On the other hand, private and permissioned blockchains are limited to designated members; transactions are private, and permission from an owner or manager entity is required to join the network. These are often used by private consortia to manage industry value chain opportunities. Lastly, hybrid blockchains allow for different blockchains to communicate with each other, enabling transactions between participants across blockchain networks.

At its most basic, blockchain is used for time-stamping and notarizing information, for record-keeping purposes. The basis of blockchain prevents the double counting of assets and thus makes a good platform for recording ownership and transfers.

The business case for using blockchain strengthens when there is a need for secure and transfer ownership rights in a digital format. Tokenization is the process of converting ownership rights of a physical asset into a digital token on a blockchain. Assets with value can be represented by unique digital tokens on a blockchain, and be bought, sold and exchanged via programs called “smart contracts”. Blockchain-based contracts minimize the level of manual intervention in creating, executing and enforcing a contract, resulting in lower cost, while raising assurance of the execution and enforcement processes.

The future of blockchain is fully realized when we have public blockchains in regional or sector-specific networks that are decentralized, interoperable and secure, and regarded as the preferred ecosystem for digital transactions.

Defining the issue and outcome
To determine if blockchain is relevant for the company, it is important to first have an overview of the ecosystem, to assess the scope of work to be done. For example, Enterprise Resource Planning (ERP) systems have been the default for integration of processes within a company, and will likely
continue to be so as ERP functions and processes have matured over the years and are readily available for deployment.

However, integrating end-to-end operations beyond a company across a business ecosystem is not as straightforward. The presence of multiple parties in an ecosystem, each running its own ERP or operational system justifies the use of blockchain as a tool for secure integration of systems.

EY teams previously deployed the first worldwide wine certification project on blockchain for an Italian winery, and subsequently employed this end-to-end product visibility and traceability via blockchain technology on a variety of products such as sake, mozzarella cheese, and even animal vaccine. The assurance of authenticity and counterfeit prevention were key priorities of these enterprises.

In assessing if blockchain can help to meet the objectives, the nature of the problem was dissected: there are multiple parties involved, from cultivation to production and distribution; and trust and visibility between parties within the ecosystem is necessary as each operates independently.

Using proprietary data gathered directly from the field through to production and distribution supply chain, the bottles of wine are tokenized and tracked on the wine blockchain. The consumer can then scan a QR code on each bottle of wine to find out its origin and destination.

While this does not eradicate counterfeits, it is more difficult for a counterfeit to be sold in the market. The authenticity will be questioned when the data recorded on the blockchain does not correspond with where the bottle has passed through and is eventually sold.

Assessing readiness for blockchain

The upsides of blockchain are clear: it eliminates the need for intermediaries as the user transacts directly with the provider, or even a host of stakeholders along the supply chain, driving efficiency, reducing cost and improving transparency.

However, the blockchain platform is complex and implementation of blockchain should be carefully managed, with sufficient privacy tools, legal considerations and integration with the business ecosystem for a standardized system for transactions.

Before embarking on the blockchain journey, boards need to ask these questions:

1. Is blockchain the most effective for the business issue, or can the problem be solved using a centralized database?
2. Which business function is responsible for overseeing and managing the implementation of blockchain?
3. What is the strategy to manage the implications and impact of blockchain to the business?
4. What are the digital trust and information security concerns raised by customers, partners and suppliers, and how are they addressed?
5. What are the regulations governing blockchain currently, and how can the business comply and collaborate to further the ecosystem?

The industrialization of blockchain is just beginning. It has the potential to integrate entire business ecosystems, like how ERP systems integrated information systems for an enterprise. Adopting this technology, while answering with certainty the key questions, will bring a differentiated solution for whole new business needs.
Independent directors: involve or interfere?

Independent directors (ID) straddle the fine balance between involvement and interference with a company’s affairs, but does it have to be so? With the right intent and alignment, IDs and the management can meet at the equilibrium of “welcomed interference”.

Much of the corporate headlines today on fraud, business impropriety, undisclosed interested party transactions and lapses in accounting judgment can be traced to the topic of governance. For an independent director (ID), the greatest fear is to see their company in the news for the wrong reasons.

What can an ID do to avert unwanted publicity? While the roles and responsibilities of IDs are clearly spelt out in the Companies Act and the SGX rules, the lived experiences of IDs may be a different and less straightforward one.

For the purpose of this article, we must assume that IDs are working with good and honest companies that are facing vagaries of today’s competition and complexities, rather than those that are improper or dishonest.

Realities of the role

IDs have a unique role to protect the sanctity of governance in the corporate system. They are appointed to be a check and balance to the company’s management and executive directors, safeguard the company’s assets and protect the interests of public shareholders.

To discharge their duties, IDs need a sufficient understanding of the business. Some IDs commence duties with an intense onboarding program, then...
plough through volumes of information and data in the following months. Others may be given only brief notes and high-level information that are deemed necessary without creating information overload. Whichever is the case, the responsibility – and exposure – of IDs remain the same.

While all is well when a strategic decision is endorsed by the board and management, when that decision turns problematic years later, shareholders will invariably question of the IDs have been diligent.

Take cyber risk management as an example. Discussions around the appropriate level of security is a concerted decision and often a judgment call. IDs are critical in ensuring that the management has been rigorous in assessing risks, evaluating the options and costs of investments, and examining the basis for concluding the optimal level of security required. Yet, even with the best intent in risk management, given how the cyber landscape is rapidly evolving, a cyber attack can still occur.

Should the IDs have probed deeper in the decisions back then, and to what extent?

Without a doubt, it is the responsibility of the ID to ask questions and request for more information when required. When this information raises even more questions, some IDs may feel compelled to rationalize or settle on the management’s explanation to avoid being seen a hindrance or
High-performing boards help the management to perform at the top of their game. Each have their own role but bring synergy — while the management runs the business, directors bring a wealth of knowledge, ideas and experience from the outside.
model is sorted out. To that end, IDs, in robustly challenging the business model, can bring benefits in driving the integrity and sustainability of the business. IDs must take a firm stand not to allow accounting discussions to distract from the real business issues. At the same time, they have the authority to assert and guide management in arriving at an acceptable accounting position that complies with rules.

Balancing the act

With multiple dynamics at play – the personalities of management, board governance and culture – there is no one size that fits all in how IDs get involved without interfering.

IDs are encouraged to align with the management on the cadence and protocol on access to information and decision-making. As the company evolves, it is necessary to revisit the relevance of the arrangement. With change, the involvement of IDs will naturally increase. The management also needs to proactively engage directors early to avoid surprises that will hamper board confidence. Transparency will build trust and benefit all parties.

High-performing boards help the management to perform at the top of their game. Each have their own role but bring synergy – while the management runs the business, directors bring a wealth of knowledge, ideas and experience from the outside.

For IDs, it is not a question of involvement or interference, but how to navigate involvement sensibly, even if the occasional deep dive could be perceived as interference. This is a continuous journey of learning and at some point, IDs and the management must strive to meet at the equilibrium of “welcomed interference”.  

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Private equity versus public boards: how different?

Whether public or private, a company’s board of directors functions as stewards of its long-term performance and integrity. Awareness of the governance models in public versus private equity-backed companies can help boards identify their blind spots and be more holistic in discharging their duties.

By Luke Pais

Assets under management of the global private equity (PE) industry have grown nearly 80% over the last 10 years to be a leading alternative asset class. PE’s track record of creating value for investors can be traced to its governance model, which is based on concentrating equity and thus decision-making in only a few hands – the PE firm and management. This provides the alignment in interest, focus and expectations that are necessary to harness the engagement required to generate superior returns.

In addition, because the PE business involves general partners fund managers raising sequential limited-life funds, PE groups have a real urgency and reputational stake in efficiently executing on value enhancing strategies and returning investors more capital than they invested.

These hallmarks set PE-boards apart from its public company counterparts. Yet, because PE applies very high-conviction, but transitory capital, to generally younger and smaller-sized companies, it may not be so much a competing governance model to the more traditional public company model as it is a complement.

Having said that, the concentrated and illiquid ownership of PE-backed companies and the diffused and liquid ownership of public companies give rise to different board-level focuses and behaviors – and varying strengths and differences.
Public boards

In contrast to private company boards, public boards operate in a more complex and challenging environment given that they must manage a broader range of shareholders (and stakeholders) with diverse interests and expectations, while at the same time be monitored continuously by the market. Compliance and risk management therefore tend to be the chief concerns, given their regulatory interface and diverse shareholders.

To sustainably operate in this environment, a public board’s strengths must include its ability to be process-oriented in complying with market and accounting rules, guard against reputation risk from how the company is perceived by the public, along with addressing its broader responsibilities of supervising and oversight of management, including participating in the review and approval of company strategy as well as succession planning.

With the board’s overwhelming focus on compliance and risk management, this could leave less time and resources to focus on strategy development and execution. This may make the company more risk-averse in terms of strategic and investment decision-making.

The same compliance-centric focus combined with daily performance measurement by the market and quarterly earnings estimate releases could make the board and company short-term oriented. Annual meetings, quarterly earnings, and daily stock prices provide transparency but could also discourage boards and the management team from having time horizons much longer than a year.
Private boards

With ownership concentrated and fewer regulatory requirements, PE-backed boards have a much more straightforward operational and value creation focus. PE sponsors work closely with management in developing the strategy – often prior to close of the transaction and embedded in the “100-day plan” – as well as executing it.

In its role as chair of the board, the PE firm often brings in operating partners where needed and augments or replaces members of the management team. The strict investment and exit timetable of the PE investment, and need to return investors’ capital at an attractive multiple, drive this process.

By virtue of its equity being concentrated in management and PE group’s hands, the PE-backed board benefits from a powerful alignment of incentives, expectations, and engagement to create value over a five to seven-year investment window. The board is also not distracted by capital market rules and transparency requirements that come with being a listed company. Growing experience-building boards, supporting management teams, and assessing and valuing companies, translates into highly knowledgeable boards with access to deep pools of CEO-level talent.

Yet, these strengths of the PE-backed board model can also be its weakness. For example, tightly aligned interest and the lack of truly “independent” board members may contribute to “group think” and the inability to properly identify and assess risks. Similarly, operating within a limited life fund provides a healthy urgency to create value but at the same time, this investment window may not match what might be optimal for the company and its broader stakeholders.

Complementary models

Whether public or private, a company’s board of directors functions as stewards of a company’s long-term performance and integrity. Thus, good governance is key to a company’s ability to create lasting value. Knowing the strengths and weaknesses of the two models of governance can help both PE and public boards identify their blindspots and be more holistic in discharging their duties. This knowledge would also be useful for directors who are involved with both PE-backed and public boards.

Instead of viewing the two as competing governance models, it may be more accurate to say that the public company and PE-backed governance models are complementary. A company in its young and growth phase or one that is undertaking a lot of changes, may be more suited for private concentrated ownership that provides the necessary focus and commitment to level up. Stable and larger companies may benefit from a public model of diffused and liquid ownership that addresses the strategic, financial, risk and governance challenges for longer-term sustainability.

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