Top priorities for US boards in 2017

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Geopolitical developments, innovation and technology are rapidly accelerating change in the global economy and affecting how companies create competitive advantage. Boards should continue to rethink and address their organization’s strategy, risk management and whether the required talent is in place to deal with such changes. Boards may need to rethink their own composition and structure to stay fit for purpose. Institutional investors continue to seek more communication and engagement around these important issues.

In 2017, the EY Center for Board Matters expects boards to heighten their focus on the following six priorities:

01. Overseeing competitive strategy in a world of disruption and convergence
02. Seizing opportunity while enhancing risk management
03. Navigating the dynamic geopolitical and regulatory environment
04. Optimizing long-term capital allocation strategies
05. Embracing the talent agenda and the workforce of the future
06. Strengthening board composition through strategic alignment
Overseeing competitive strategy in a world of disruption and convergence

Digital technologies are changing the competitive landscape by enabling the introduction of new and disruptive business models, presenting new challenges to incumbent companies. Technological change is creating new competitors, blurring sector lines, reordering supply chains and lowering price points. Operating in a complex global environment complicates matters further.

Organizations are typically structured and incentivized to focus on fulfilling the needs of existing stakeholders – potentially blinding them to disruptive opportunities that often do not initially meet those needs. Companies are responding by undergoing a strategic rethink, and boards are enhancing their oversight of corporate strategy. Digital transformation continues to be a critical strategic imperative. It is essential to driving new growth, streamlining operations, increasing profitability and delivering better customer experiences.

Seizing the upside of disruption can involve a number of strategic responses that companies and boards should consider. For example, taking a holistic approach to digital strategy across the internal organization and the extended enterprise can achieve more effective business problem identification and responsiveness to new opportunities.

Experimenting with multiple business models through a deliberate and structured process can surface and qualify innovative ideas more quickly. Instituting practices such as “protected” spaces, sanctioned employee think time, and specific incentives that encourage innovation can help to build a culture where innovation thrives. Developing metrics for innovative projects that may be different from those used in evaluating other investments can help evaluate pilots and scale up the most promising ones. Boards should consider, advocating and supporting new and innovative approaches to strategy.

Questions for the board to consider

- Is the board overseeing strategy to continually reimagine the future of the company’s business model and consider ways to seize the upside of disruption? If so, how fresh and varied are management’s and the board’s sources of new ideas?
- How is the board defining the company’s industry and competitors in this era of convergence, and do those definitions include nontraditional peers and global players?
- Is the board leveraging the insights generated by analytics and big data in their oversight of the company’s strategy and objectives?

Seizing the upside of disruption can involve a number of strategic responses that companies and boards should consider.
Seizing opportunity while enhancing risk management

The same disruptive forces that are forcing a rethink of strategy are also rapidly changing the risk landscape and pushing companies to reconsider their approach to risk. To sustain growth and performance in 2017 and beyond, companies need to apply a more balanced, agile and integrated approach to enterprise risk management. Boards will want to confirm that management gives appropriate consideration to managing risk-return trade-offs to drive value creation.

Based on a recent EY Governance, Risk and Compliance survey, opportunity exists for enhanced alignment of risk and strategic goals; 97% of executives say they made progress linking risk management and business objectives, but of these, only 16% consider them closely linked.

In today’s rapidly changing digital world, boards are recognizing the importance of analytics and big data, clearer risk ownership, and more comprehensive processes and operational models in risk management. Companies, too, are focusing more on strategic, high-value risk areas while working to better utilize risk management programs and technology platforms to predict and manage preventable risks.

Similarly, boards are thinking more strategically about cyber – going beyond understanding what “crown jewels” need to be protected to focus on company-wide needs in assessing, responding to and mitigating a full range of digital technology risks, whether driven by external or internal, corporate or non-corporate actors. Leading boards recognize that cyber preparedness can be a critical advantage in the current competitive landscape.

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Questions for the board to consider

- Is the board applying a nuanced approach to risk management so as to support the realization of opportunities associated with strategic risk taking while minimizing exposure to preventable and external risks?
- How proactive and agile is the company’s approach to assessing and addressing risk in the digital age, including its use of data, analytics and technological platforms?
- On cyber, has the board considered its risk appetite in terms of business disruption, loss of information or system downtime and also considered how the company might differentiate itself from peers?
Navigating the dynamic geopolitical and regulatory environment

Prior to the 2016 election in the US, EY’s October Capital Confidence Barometer found that 29% of global senior executives viewed political instability as the greatest economic risk to their core business over the next 6 to 12 months. Leading boards will be vigilant in questioning whether and how the political and regulatory environment may heighten company risks and offer opportunities for growth.

The current US legislative and regulatory environment is incredibly dynamic and uncertain as election results at the national and state levels are generating expectations of significant policy change. The conditions are similar in some ways to the developments following Brexit, Britain’s vote to leave the European Union.

The new US administration’s priority focus areas likely will include tax policy and reform, health care and the Affordable Care Act, infrastructure spending, energy, global trade agreements and financial regulatory reform. While not much legislative or regulatory activity is expected during the Congressional “lame duck” session, the president-elect has outlined an ambitious agenda for early 2017.

Tax is likely to grow in prominence as a board-level topic in 2017. Within the US, policymakers are already beginning to consider tax reform proposals that may advance in the early part of the year. Stakeholders are beginning to monitor and provide input into this process. Companies can prepare for changes by modeling the potential effects of some of these tax proposals on their specific situations and taking steps to engage in “no-regrets” planning in anticipation of reform.

Globally, the Organisation for Economic Co-operation and Development (OECD) Base Erosion and Profit Shifting initiative has focused on country-specific reporting requirements as one of its action items. This has led to increases in disclosures, including on non-traditional reporting areas. The European Commission also is likely to continue its investigations into “State aid,” which have been criticized by US policymakers, due in part to the retroactive nature (up to 10 years) of the Commission’s decisions and the perceived targeting of US entities.

Boards and audit committees will need to confirm that the appropriate project management plans are in place to address regulatory changes, with consideration also given to new accounting standards including revenue recognition.

Questions for the board to consider

- Does the board’s oversight include considerations of anticipated changes in the US and global laws and regulations?
- Is the board overseeing tax planning and possible compliance risks related to US tax policy changes, including potential US tax reform, OECD initiatives and other factors such as new accounting standards?
- As institutional investors continue to speak with a greater voice in boardrooms, are there plans in place for the C-suite and board members to enhance corporate disclosures on areas of interest to those investors?
Optimizing long-term capital allocation strategies

Amid this ongoing period of unprecedented business and technological innovation and transformation, many boards are overseeing business strategies and investments never before considered and at a much faster pace. Leading boards recognize that preserving the company’s competitive edge may require acquiring new technologies, partnering to extend product lines and geographic reach, investing in organic innovation initiatives and experimenting with new business models.

EY’s October 2016 Capital Confidence Barometer found that while organic growth remains intact, a near-record 57% of senior executives are actively pursuing acquisitions in the next 12 months and about half have more than five deals in the pipeline. There also is innovation in the deal space with the use of M&A, joint ventures, partnerships and strategic alliances; and 91% are using big data and analytics as part of the deal process.

Leading boards also are increasingly asking how capital allocation strategies are enabling corporate strategy and contributing to long-term value creation. Today’s marketplace demands greater clarity about how capital decisions support corporate strategies as institutional investors look more closely into the recent wave of stock buybacks, questioning whether capital allocations decisions are being made with an overemphasis on short-term returns at the expense of long-term value creation.

Boards that confirm companies are articulating thoughtful approaches to capital allocation decisions beyond highlighting short-term pressures such as challenges from activist hedge funds are better positioned to assure investors they are evaluating capital allocation decisions with an eye to the long term.

Questions for the board to consider

- How confident is the board that the capital allocated for innovation, digital transformation, acquisition and other growth initiatives is sufficient for achieving the company’s strategic priorities, particularly relative to peer companies and potential new entrants?
- How does the board balance the need to invest in the company for the long term with pressures to return capital to shareholders through buybacks and dividends?
- Given the growing attention of institutional investors on capital allocation decisions, is the board validating that the company is clearly communicating the rationale for allocation decisions and the alignment with long-term strategy?

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Embracing the talent agenda and the workforce of the future

Historically, access to capital has been key to growth, but trends now point to human capital management as a fundamental differentiator. As a result, boards are allocating more of their agenda to strategic initiatives on talent in recognition of the critical roles that talent and culture play in competitiveness.

Boards also want to be sure that management is considering the benefits of a purpose-led organization to motivate employees to drive change (versus having change “imposed” on them), to channel long-term innovation, and to better deliver value and meaning for customers, employees and other key stakeholders. “Purpose,” which explains why a corporation exists, speaks to nontraditional definitions of value, such as corporate sustainability and societal impact, and purpose-led organizations have been associated with competitive advantages such as enhanced shareholder returns, customer attraction and engagement, and employee satisfaction and retention.

Today’s workforce is more contingent than ever before, and according to Intuit, contingent workers (e.g., freelancers, independent professionals, temporary contract workers) are expected to account for 40% of US workers by 2020. The contingent nature of the workforce is furthered by the expansion of the machine economy, where artificial intelligence and robotics are leading to labor displacement and disruption, including of white-collar and creative work.

At the company level, these developments are spawning business model innovations and changes around how a workforce is designed, managed and optimized for team performance, as well as how work is perceived and defined.

To adapt to this evolving landscape, forward-looking boards are overseeing that management is adopting leading practices such as reviewing the end to-end people strategy and monitoring successes and changes with robust metrics and a more analytical approach. Applying a risk methodology to human capital challenges (such as critical skills shortages, succession planning, attrition, etc.) can enable companies to better assess possible risk mitigation strategies.

Questions for the board to consider

- Does the company have a compelling purpose, and do the board, management and employees understand what the organization is working toward and why?
- To what extent is the board engaged on the company’s talent agenda, embracing the new global digital leadership competencies to drive innovation, growth and competitiveness in the digital age?
- Given the wave of technological transformation, how is the organization embracing the shift to a more mobile, digitally empowered and contingent workforce while also mitigating associated risks?

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Strengthening board composition through strategic alignment

In an era of rapid strategic and technological change, board composition is likely to change. Boards may need to consider whether changes are necessary to address a company’s evolving oversight needs, provide fresh perspectives and provide a dynamic boardroom culture. Leading boards will ask whether they have the diversity of perspectives, skills and knowledge – current day and going forward – to navigate this complex competitive landscape. This may result in hiring outside experts or adding directors with specialized expertise in particular areas, such as digital, cyber and environmental matters.

Investors and other stakeholders are expected in 2017 to accelerate their engagement on a host of issues related to board diversity, including gender and minority representation. The average S&P 1500 board is less than 20% female, and investors and other stakeholders will continue to press for change. Similarly, in 2017, tenured boards will increasingly face the prospect of investors voting against the re-election of directors. Many sitting directors could be vulnerable based on the tenure and renewal concerns voiced by a number of investors: today, nearly 20% of S&P 1500 directorships are held by individuals who are 68 or older and have served on the same board for a decade or more, up from 14% in 2010.

To better address evolving oversight challenges, boards are increasingly creating additional committees beyond the key committees that oversee the critical board responsibilities of audit and financial reporting, executive compensation and director nominations and succession planning. Since 2013, the S&P 1500 saw the most net growth in stand-alone board level committees on compliance, risk and technology matters.

Questions for the board to consider

- Do the skills of individual board members align to the company’s forward-looking strategy and current risk management challenges, and does the company’s current board committee structure support board effectiveness?
- Does the board have a robust assessment process in place, succession planning efforts to address gaps in expertise and refreshment plans to provide new or different perspectives?
- Does the board actively seek diverse candidates to enhance its gender and racial diversity, and are directors actively enhancing the diversity of their own personal networks?

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Conclusion

2017 will continue to present many opportunities and challenges for corporate boards. By prioritizing and asking the right questions, directors can be prepared to better understand the risks, identify the opportunities and successfully fulfill their oversight role.
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Effective corporate governance is an important element in building a better working world. The EY Center for Board Matters supports board and committee members in their oversight roles by providing world class insight and solutions for directors tackling complex boardroom issues. Using our professional competencies, relationships and proprietary corporate governance database, we are able to identify trends and emerging governance issues. This allows us to deliver timely and balanced insights, data-rich content and practical tools and analysis to boards, board committees, institutional investors and other governance stakeholders.

Visit ey.com/boardmatters for more information about the EY Center for Board Matters and to access our latest articles and resources. You will also find an online version of Top priorities for US boards in 2017 that includes links to additional information about the six priorities identified in this document.

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