Top priorities for US boards in 2018
In this time of uncertainty, disruption and economic growth, companies are challenged to achieve short-term objectives while taking steps to survive and thrive in the long term. Accordingly, boards of directors are expected to understand and provide oversight of new risks and strategic opportunities. Meanwhile, investors, employees and customers are calling on companies to demonstrate their values and explain their positions on an array of issues. These forces and topics – such as emerging technologies, capital and talent allocation, shareholder engagement and board composition – are complicating and expanding the board’s agenda.

The EY Center for Board Matters anticipates the following priorities will be top-of-mind for board members in 2018:

1. Understanding technology’s impact on strategy, business models and cybersecurity
2. Anticipating and planning for geopolitical and regulatory changes
3. Aligning risk management with strategy and operating performance
4. Balancing short- and long-term capital allocation pressures from shareholders
5. Overseeing culture and talent in a time of innovation and transformation
6. Engaging with stakeholders on long-term governance and environmental and social issues
7. Accelerating board effectiveness through composition, structure and assessments
Understanding technology’s impact on strategy, business models and cybersecurity

New and evolving technologies are disrupting business models and entire industries, which are converging at an unprecedented rate. Digital, mobile, cloud computing, the Internet of Things, augmented reality, artificial intelligence, data analytics, robotic process automation and blockchain require boards and management to actively rethink strategy and change business models. Technology is not just an “enabler of business” ... it has quickly become the “heart of business.” Technology also has made cybersecurity and business continuity critical risk management issues.

Evolving technologies are enticing businesses and customers to change behaviors, and providing opportunities for digitally enabled companies to overcome historic barriers to entry, create new business models, and offer new products and services to customers.

These rapid changes call for boards to regularly advise and consult with management on a more agile strategy. The standard once-a-year, off-site, deep-dive strategy session is being supplemented with strategy briefings at each board meeting. While strategy remains a full-board responsibility, some boards are forming ad hoc committees that meet between board meetings to sustain focus and momentum on long-term strategic initiatives and business transformations. To further inform the strategy-setting process, companies are also working with external consultants to determine ways to constructively disrupt existing business models and develop offerings that better serve customers.

Business model transformation brought on by technology disruption and innovation often requires a longer-term focus and investment cycle, which can impair short-term results. As companies pivot to “future proof” their businesses for the long run, boards must stay well informed on these issues and provide the necessary support for management to invest in longer-term strategic priorities, and communicate these priorities to investors.

These days, boards are doing a better job of planning for cybersecurity, business continuity and resiliency. However, prevention and response plans are just that, “plans.” It is impossible to predict the implications of a cyber incident or natural or man-made disaster – all of which are occurring more frequently. According to EY’s 2017 Global Information Security Survey, while 69% of respondents have some form of formal cybersecurity incident response capability, only 8% describe their plan as robust and involving third parties and law enforcement. Boards should strongly consider conducting formal tabletop exercises with management that simulate expected and unexpected events in order to assess how plans may work in practice.

Questions for the board to consider

- How is the board staying current on new and evolving technologies and their potential impact on the company’s industry, strategy and business model?
- Is the board overseeing strategy to continually reimagine the future of the company’s business model and considering ways to see the upside of disruption?
- Does the board engage in tabletop exercises to simulate a response to a cyber incident or a natural or man-made disaster?

Boards must provide the necessary support for management to invest in longer-term strategic priorities.
Anticipating and planning for geopolitical and regulatory changes

Economists are forecasting stronger global growth in 2018 against a backdrop of heightened geopolitical volatility and regulatory uncertainty. Boards need to work with management to address risks and strategic opportunities in light of these dynamics.

Globally, the business community faces varied challenges from country to country. The United Kingdom will continue to negotiate its exit from the European Union, resulting in continued uncertainty. China is actively seeking to improve its global position in technology and business. Tensions in the Middle East are poised to escalate. North Korea continues to raise security concerns globally. The US-Russia relationship continues to grow more complex. And the future of US trade agreements, including the North American Free Trade Agreement, is uncertain following the US withdrawal from the Trans-Pacific Partnership Agreement. In the meantime, other countries are seeking to fill the trade vacuum by reaching new agreements that do not include the US.

In the US, a fractious political environment and uncertainty about the Trump Administration’s domestic agenda, including tax reform, health care, trade and immigration reform, is significantly impacting business and will continue to demand close monitoring. US tax reform legislation is expected to reduce the top corporate tax rate, reduce or restrict many corporate tax deductions and preferences, and substantially reform the international tax provisions. If adopted, tax reform will likely have wide-ranging effects on company structures, operations and business planning.

From a regulatory perspective, policymakers appear to be focused on global developments related to taxation, data privacy, cybersecurity and national security, causing certain industries to face increased regulatory scrutiny. Additionally, companies need to maintain their attention to compliance as new and complex regulations take effect, including changes to accounting standards on revenue recognition, leasing and credit loss; the auditor’s report; and global data privacy rules.

Given the potential implications of these geopolitical and regulatory issues on capital markets, trade, currency and commodities markets, interest rates, as well as security, it is important for companies to take a proactive approach. Companies need dedicated resources to provide knowledgeable and timely updates and scenario analysis for management and the board.

Questions for the board to consider

- How is the company monitoring the evolving geopolitical landscape and pending regulatory proposals? How is this information collected and communicated to the board?
- How do you convert geopolitical intelligence to actionable business initiatives?
- How has the company modeled and considered the effects of US tax and other regulatory reform proposals from a financial reporting, treasury, supply chain, human resource and investor perspective?

Given the potential implications of geopolitical and regulatory issues, it is important for boards and management to work together to take a proactive approach.
Aligning risk management with strategy and operating performance

When we published Top priorities for US boards in 2017, we highlighted the importance of seizing opportunities while enhancing risk management. In particular, we emphasized the need to apply a more balanced, agile and integrated approach to enterprise risk management (ERM) in order to sustain growth and performance.

In September 2017, the Committee of Sponsoring Organizations published “Enterprise Risk Management – Integrating with Strategy and Performance,” an update of their 2004 ERM framework publication. This update addresses the evolution of ERM and the need for companies to improve their approach in managing risk to meet the demands of evolving business environments. It additionally highlights the importance of considering risk in both the strategy-setting process and in driving performance.

With continued technology disruption in a time of geopolitical and regulatory uncertainty, it is critical for companies to take calculated risks and proactively seize new opportunities. To do so, boards need to support a shift in ERM practices from a “protect” effort to a “protect and grow” approach in order to drive and sustain value creation.

Such an approach will require a better understanding of the interplay between risk, strategy and performance, leveraging ERM capabilities to gain a competitive advantage. This starts by explicitly considering risk in strategy selection and continually monitoring how risks are impacting the strategy or any risk factors that may call for a rapid strategic pivot. In addition to positioning risk in the context of strategy and performance, boards should see that management teams can clearly articulate the company’s risk appetite and are appropriately monitoring its risk culture.

Effective ERM programs view risks along the lines of key assumptions and uncertainties that drive variability of business results and aligning risk management with the entirety of the business. By doing so, companies can better anticipate risks that may impact performance and plan for actions to minimize any potential disruptions.

The effort to align risk management with strategy and performance should closely complement more traditional protection-focused risk management efforts. The board should sustain and continue to enhance oversight of sound ERM practices focused on financial reporting and overall compliance. However, as ERM practices get better focused on strategy-setting and performance and such practices advance and mature, financial and compliance risks should inherently decline.

 Boards need to support a shift in ERM practices from a “protect” effort to a “protect and grow” approach in order to drive and sustain value creation.

Questions for the board to consider

- Is the company's ERM framework aligned with strategy to improve performance and more clearly inform decision-making?
- Has management clearly articulated the risks to achieving its strategic goals and properly applied the company’s risk tolerance levels to determine risk-management priorities?
- Do the company's ERM practices incorporate forward-looking insights and data analytics to determine trends and predictive indicators?
Balancing short- and long-term capital allocation pressures from shareholders

The need to balance near-term opportunity with long-term value creation is one of the more difficult objectives for management and the board. During 2015-16, S&P 500 companies paid out over 100% of their earnings in the form of dividends and stock buybacks, although this has begun to abate in 2017. At the same time, incumbent businesses are getting blindsided by new entrants, often from adjacent industries through innovation and evolving technologies.

Passive investing, or so-called “permanent capital,” is quickly becoming the norm for many investors. These and other factors require large institutional investors with long-term investment mandates to better understand how companies allocate capital to investments that will provide competitive growth and long-term sustainability.

The global economy appears synchronized in an upward trajectory for the first time since the end of the global financial crisis. With interest rates still low, and policymakers showing caution around benchmark rate increases, conditions look set for a period of strong growth and low cost of capital. Investments could be further stimulated with US tax reform favorably targeted toward US businesses. These dynamics should embolden management to increase their capital allocated toward investments and with a focus on the long term.

EY’s October 2017 Global Capital Confidence Barometer (CCB) found that identifying opportunities for growth, including M&A, joint ventures (JVs) and alliances, will be the most prominent boardroom thinking during the next six months. JVs and alliances can provide both immediate tailwinds and the tools to achieve long-term strategic targets. The CCB noted a significant increase in corporate venture capital investments that doubled in number and tripled in value between 2012 and 2016, and the trend is expected to continue. Technology, innovation and accelerating R&D are the most prominent reasons for such investments, which allow for greater optionality and long-term prospects.

The potential for shareholder activism related to short-term results remains high and will continue to be an issue. The ability of management to convey and execute a long-term strategy, backed by an investment strategy mixed between asset replenishment, reskilling of staff, innovative R&D, and strategic M&A and JVs, should compel investors to stay the course for the long run.

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?

The ability of companies to convey and execute a long-term strategy should compel investors to stay the course for the long run.
Overseeing culture and talent in a time of innovation and transformation

Intangible assets comprise a significant amount of the S&P 500 companies’ market capitalization, and much of that capital can be attributable to the companies’ workforce. As business models continue to transform and industry convergence accelerates, stakeholders are asking boards about their oversight of culture and the related transformation of human capital. From building a culture where innovation thrives, to defining the company’s purpose, to investing in retraining their workforce to meet the demands of evolving business models, a company’s culture and talent strategy is even more critical to competitive strength and long-term value creation.

Talent strategy should build on the company’s operating norms and practices. A dynamic working environment built on teamwork, inclusiveness and a strong code of ethics (e.g., equal pay and opportunity, and protection against harassment and discrimination) can create a culture of innovation and performance. A company’s purpose, which serves as the foundation of the organizational culture, ensures alignment between leadership and the workforce and brings a common view of how the business will evolve. Studies show that today’s employees are three times more likely to stay with a purpose-driven company.

Talent strategies should also be directly informed by corporate strategy and aimed at building organizational agility, flexibility and resiliency. For management and boards, having a clear view of critical capability needs and skills of the business going forward, and developing long-term workforce plans, are emerging as top priorities.

Workforces are evolving with business models, and today’s boards often oversee a portfolio of workforce assets, including traditional, virtual and contingent (or contract) employees, along with automation and digital robotic technologies. The World Bank predicts that 40% of the global workforce will consist of contingent employees by 2020 – a mere two years from now. Companies that learn how to effectively manage this anticipated change, seize the opportunities presented by new workforce models and manage through the related risks will be clear talent winners in the new gig economy.

Finally, across many industries, companies have placed a significant focus on customer intimacy and the overall customer experience in recent years. However, they are finding that the success of these initiatives directly relates to an equal focus on the employee experience. Therefore, having a “people first” culture just might be the answer to long-term success.

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 strategy and embracing the new global digital leadership competencies to drive innovation, growth and competitiveness in the digital age?
- How can the company optimize its workforce assets (traditional, virtual, contingent and digital robotic technologies) to attract and retain the best talent, achieve its short- and long-term strategies, and mitigate risks?

Having a clear view of talent needs and understanding long-term workforce plans are emerging as top priorities for boards.
Engaging with stakeholders on long-term governance and environmental and social issues

A fundamental shift in the capital markets is underway as massive amounts of money continue to flow into index and exchange-traded funds. And the world’s largest institutional investor, BlackRock, recently predicted that new global regulations could push an additional $2 trillion to $5 trillion of assets into these passive investments. This so-called “permanent capital” is managed by institutional investors, who are charged under a mandate by their own investors to invest for the long term – in many cases, decades.

This past year, some of the largest institutional investors (the Investor Stewardship Group) issued a voluntary corporate governance code for US-listed companies, intended to support collaborative investor and company efforts to create long-term value. Many of the founding members already had in place individual policies, engagement practices and proxy voting guidelines in support of long-termism. At the same time, investors and other stakeholders, including employees, customers and communities, have begun to weigh in about a company’s views, culture and purpose in a broader societal context.

These market dynamics and related developments are highlighting governance practices that reflect a long-term, multi-stakeholder view. It is also increasingly clear that addressing the key interests of a broad base of stakeholders is vital to the long-term sustainability of a business. These practices relate to traditional business matters as well as an expanding body of governance matters. This includes a shift from the more traditional governance issues, such as performance-based compensation, majority voting and annual director elections, to increasingly high-profile environmental and social topics, such as climate change, political spending and lobbying, diversity and inclusiveness, health care, immigration and more.

Boards and management should engage on long-term business, environmental and social matters more than ever before. They also need to understand the priorities of their key active and passive investors and other stakeholders, offer engagement and, where appropriate, adjust their governance practices to address investor and stakeholder priorities in ways that foster long-term business growth.

As activist hedge fund investors continue to grow in number and seek corporate targets, a long-term business strategy inclusive of many stakeholders, with strong execution and governance practices aligned to the interests of long-term investors, can be a critical advantage – and defense.

Questions for the board to consider

- Does the company have a long-term strategy that incorporates sustainability concepts? Does the company make public disclosure on these topics in a way that is responsive to investor and stakeholder concerns?
- Does the board understand the views of key investors and stakeholders regarding their priorities, and positions on governance and environmental and social matters?
- Are the independent leaders of the board and key committees prepared to engage with the company’s key investors and stakeholders, if requested to do so?
- Does the company have processes in place to review and consider alignment of its publicly stated positions on environmental and social matters and its actions?

Boards and management need to understand the priorities of their key investors, offer engagement and, where appropriate, adjust their governance practices to address investor priorities in ways that foster long-term business growth.
Accelerating board effectiveness through composition, structure and assessments

In today’s climate of uncertainty and disruption, boards must be agile and flexible. The board’s skill set, composition and committee structure must continuously be assessed to ensure that they are aligned with the strategic direction of the business. And board and committee meetings need balance to address the current and future state of the business, along with the ever-growing regulatory and compliance agenda.

Board members should realize that they are “temporary guides” – overseeing the evolution of their companies for the benefit of investors and other key constituents for only so long as they are well qualified to do so. As such, directors should have the clear expectation that their tenure directly corresponds to their ability to meaningfully contribute to the company’s forward success. This is not board refreshment for refreshment’s sake: this is board evolution in sync with company evolution.

Similarly, boards must examine their structures to assess whether they are optimally allocating work. Deliberate consideration should be given to who oversees key issues. Some boards may want to move selected responsibilities from the full board to a committee or vice versa, create a new committee or otherwise redistribute work. Consideration should also be given to temporary or long-standing “working committees” that meet as often as necessary with management and/or consultants to address newer and emerging issues.

Studies show that diverse teams produce better results because “group think” is avoided and because the application of different perspectives on an issue enables the discovery of multiple possibilities, including the identification of actual and potential problems and solutions. Investors therefore want to know how a board’s mix of current knowledge, skills, experience, background and perspectives – in addition to characteristics such as gender, nationality and age – enable it to effectively oversee the company’s business and evolution.

To enhance board effectiveness, boards should conduct annual assessments of the board, its committees and each of its members. Detailed action plans should be prepared from the results of the assessments to ensure renewal and continuous improvement. High-level insights into the assessment process, along with resulting actions, should also be disclosed, given the growing interest of shareholders in such process. Such disclosures highlight how board members are the best qualified to guide the company and why they represent a critical advantage to the company as it continues to navigate toward long-term growth.

Questions for the board to consider

- How does the board view its current structure? Is workload effectively allocated between the board and its committees? Should any work be reallocated or any structures changed to optimize oversight?
- Are individual board members positively contributing to the board’s oversight responsibilities? Does each board member take the time and collaborate to understand the issues he or she is charged with addressing?
- Does the board assessment process result in the identification of concrete action items to enhance board composition, structure and effectiveness?
- Do the disclosures concerning the assessment process build trust, secure support and address concerns of investors and governance stakeholders?

Boards must examine their composition and structures to assess whether directors provide a meaningful contribution to the company’s forward success.
Boards and management must work together to balance short-term objectives with long-term sustainability and growth. The considerations in that balancing act are complex, numerous and interconnected. From the impact of technology on strategy to risk management and from workforce talent to board effectiveness, investors and other stakeholders are paying close attention to how companies govern for the future.

Boards will be challenged to help management successfully navigate risks and capitalize on opportunities while living up to stakeholder pressures.
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