Building a better working world

EY Center for Board Matters

# How private company boards are leading for what’s next

**Private company boards are focused on recovering from effects of the pandemic, as well as positioning their companies for long-term growth. They are scanning for future opportunities and integrating risk oversight, while prioritizing innovation, culture, human capital management and diversity.**

That is what we heard in our discussions with seasoned private company board directors as part of the National Association of Corporate Directors 2020 Virtual Summit (Summit). Approximately 300 private company directors gathered to share experiences, hear insights from several panels of seasoned directors and EY leaders, and explore how private company boards are looking ahead to what’s next. This report captures our views and key director insights from the Summit to help advance private company boards’ strategic leadership and oversight in these transformative times. We focus on three panel discussions:

- Dealing with disruption and delivering long-term growth
- Overseeing human capital
- Supporting effective risk oversight

# Dealing with disruption and delivering long-term growth

The pandemic is accelerating business-model disruption that was already underway. According to the NACD Private Company Governance Survey[1] conducted in 2019, directors at private companies ranked growing business-model disruption as the top trend most likely to impact their organizations, and 2020 certainly affirmed this expectation. These developments are putting increased pressure on companies to innovate and disrupt themselves to seize emerging opportunities in a rapidly changing business environment. As moderator Steve Klemash, EY Americas Center for Board Matters Leader, put it, in today's business environment, boards should challenge whether the company is "doing the *right thing* for too long." The same NACD survey showed that nearly two-thirds of private company directors (62%) reported that their companies can no longer count on extending their current strategy over the next five years, and this majority has likely grown since the start of the COVID-19 crisis.

Understanding megatrends is essential for thriving amid disruption, and a key role of the board is keeping eyes on the horizon to help management identify emerging risks and opportunities. James Bly, US EY Private Family Enterprise Business Services Managing Director, Ernst & Young LLP, explained: "It's important to identify weak signals that might translate into future megatrends — doing so effectively can be the equivalent of catching a good wave while surfing." The latest EY Megatrends report[2] gives insight into the major forces at play that may be outside of the board's traditional scope of analysis. Forces such as human augmentation, moving beyond globalization, climate impacts and the rise of Gen Z are leading to trends in relation to, for example, decarbonization, the behavioral economy, synthetic biology, media and more.

There are various ways for companies to keep a pulse on megatrends and business-model disruption. For example, one director panelist suggested that companies become part of the innovation ecosystem by participating as an angel investor, investing in a venture capital (VC) fund, reaching out to external experts and thought leaders, and monitoring deals to observe trends. Many websites of VC funds and angel groups disclose some information in regard to their investments. Knowing who's getting funded can help boards identify trends, keep an eye on potential competition and understand new business models that might have an impact in the industry.

Panelists also discussed the necessary time and budgetary allocations related to megatrends and innovating for the future. Many directors recommended making sure appropriate time and resources are made available to the board for educational opportunities and discussion regarding long-term megatrends. Directors also said boards should balance budgetary constraints with making long-term plays necessary for profitable growth. Reviewing capital allocation strategies across different time frames (1–3 years, 3–5 years and 5–10 years) can help keep the long term in focus.

While long-term growth also requires a clear innovation strategy, many of the private company directors surveyed by the NACD cited innovation as an area for improvement. They said that their companies don't yet have clear innovation strategies, processes or initiatives and haven't yet defined what innovation means to them. Our director panelists agreed that to foster innovation, it's important that all employees understand and feel engaged in the innovation strategy for transforming and disrupting the business. Innovation is a team sport, and management, with support from the board, should create a context that enables collaboration among disparate teams and disciplines within the company. Embedding certain innovation projects in external collaborative programs and communities like incubators or accelerators can also help with access to mentorship, training and networks for dedicated teams focused on developing or scaling ideas. A key part of the board's role is ensuring the company's executive compensation program incentivizes innovation.

"

Directors at private companies ranked growing business-model disruption as the top trend most likely to impact their organizations, and 2020 certainly affirmed this expectation.

1 NACD, *Private Company Governance Survey*, 2020.

2 EY, *Megatrends 2020 and beyond*, June 2020.

# Overseeing human capital

The board's role in relation to human capital has been shifting in recent years alongside the rise of intangible assets and transformations in work and the workforce. These changes have been accelerated by the pandemic. There is an unprecedented increase in remote work, flexible work and contingent work and a new openness to reimagining how work is done. Diversity, equity and inclusion (DEI) and culture have also been given new emphasis, and Summit participants explored how private boards are governing these important topics.

Findings from the NACD survey showed around 60% of private company board directors reported that in relation to human capital, they discussed human capital risks as well as enterprise-wide talent development training and strategy. However, only 28% of private company boards reported that they had communicated clear expectations to management on board reporting related to human capital.

Meg Paschall, Principal, People Advisory Services, Ernst & Young LLP, explained that "in this new working environment in which many employees are not ready to return to offices and some companies have decided that remote working will be a big part of their long-term future, there is a need to be more intentional about culture." Boards are increasingly requesting reporting on culture-related metrics to understand whether there is alignment between purpose, values and culture throughout the company.

Organizational culture begins with the tone from the top, and directors agreed that in this rapidly shifting environment, more regular discussion of culture at the board level and deeper insight into the employee experience and perspective are needed. As companies adapt to new ways of working, boards should seek to understand what is working well, what isn't and what new behaviors or values may need to be introduced. For example, one panelist discussed how in this era of the blurring of home and work, transparency, as well as clear boundaries, is becoming more important than ever. Boards also need to make sure that the right policies are in place. For example, they should consider how virtual new director and executive onboarding or virtual acquisitions will be managed. Having plans in place ahead of time can help these processes run more smoothly when they are needed.

On oversight of DEI, private company boards tend to be less diverse than public boards, and this is a missed opportunity. By embracing DEI, private companies can perform better across all dimensions. It's not just about doing the right thing. It's a matter of purpose and profits, and boards can serve both by leading on DEI. This includes hiring a CEO who embodies the company's values and culture, guiding the mindset of the executives, and measuring, overseeing and rewarding progress. Chief human resources officers are also increasingly embedded in the executive team, with shared accountability for DEI issues, and having more direct interaction with the board.

> "
>
> Boards are increasingly requesting reporting on culture-related metrics to understand whether there is alignment between purpose, values and culture throughout the company.

## Supporting effective risk oversight

The pandemic has reshaped the risk landscape. The evolving business environment is unlikely to resemble the past several years, which may lead to new risks, as well as old risks manifesting themselves in new ways. These developments are pushing private company boards to reconsider how their organizations manage risk and how they should oversee it.

Seventy-four percent of directors in the NACD survey reported that their board had communicated clear expectations to management on the types of risk information needed for board reporting; however, only 50% felt that this reporting was easy to understand or enabled effective analysis. Also, only 28% reported considering major risk interdependencies.

One panelist suggested that companies are moving away from risk as a discrete subject. Risk is inherent in all aspects of business so it's important to make sure risk is addressed for every challenge being discussed and to incorporate opportunities/upsides presented by risk analysis. Justo Villasmil, Ernst & Young LLP Consulting Partner, explained that "resilience is also linked to purpose and values which create the foundation for strong teams and customer engagement, ensuring the business is adapting to changing needs."

One solution Summit participants discussed to enhance risk management is tailored crisis simulation exercises, which can help create plans for when problems arise and highlight skills gaps in the board and management team. Scenario planning can also be a great asset for the board to understand different situations and outcomes based on a range of assumptions, including the low-likelihood, high-impact scenarios. This helps provide comfort to the board on resilience and enables them to ask the right questions regarding preparedness.

Directors said it can be helpful to plan for more than one channel of communication from management to the board when it comes to a crisis. Because it can be a challenge for CEOs to run the business and run the crisis response, CEOs might need to temporarily delegate some of their usual tasks, with oversight, to enable them to execute crisis management plans or create a designated crisis management team or committee to provide support.

As for how the board structures its oversight of risk, private companies vary in terms of whether they have a risk committee. Any division of responsibilities can work as long as roles are clear. The full board must understand that it retains accountability for the board and its committees. Importantly, risk discussions should not be limited to financial risks, and there should be robust discussion on whether risks being taken are aligned with the risk appetite the board has already agreed on.

"

One solution Summit participants discussed to enhance risk management is tailored crisis simulation exercises, which can help create plans for when problems arise and highlight skills gaps in the board and management team.

## Conclusion

Private company boards play a critical role in helping their organizations navigate head winds as they position themselves for future growth. Potential disruption is highlighting the importance of understanding megatrends and overseeing capital allocation for the long term. With today's growing awareness of the importance of employee satisfaction, wellness and equity, overseeing human capital has become a key focus for private company boards. Finally, private boards are facing an uncertain business climate, changing customer preferences and quickly shifting business models. These developments are pushing private company boards to reconsider how their organizations manage risk and how they should oversee it. With all these challenges, private company boards often have the advantage of fewer regulatory burdens and a greater ability to be nimble and adaptable. By keeping a focus on leading for what's next, private company boards will play an important role in overseeing sustainability and resiliency in a fast-changing environment.

## EY | Building a better working world

EY exists to build a better working world, helping create long-term value for clients, people and society and build trust in the capital markets.

Enabled by data and technology, diverse EY teams in over 150 countries provide trust through assurance and help clients grow, transform and operate.

Working across assurance, consulting, law, strategy, tax and transactions, EY teams ask better questions to find new answers for the complex issues facing our world today.



**About the EY Center for Board Matters**
Effective corporate governance is an important element in building a better working world. The EY Center for Board Matters supports boards, committees and directors in their oversight role by providing content, insights and education to help them address 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 for directors, institutional investors and other governance stakeholders.



US SCORE no. 12338-211US
CS no. 2103-3723501

ED None



**ey.com/us/boardmatters**

**Looking for more?**
**Access additional information and thought leadership from the EY Center for Board Matters at ey.com/us/boardmatters.**