Governance Rebooted

CORPORATE GOVERNANCE IN A DISRUPTIVE DIGITAL AGE

Executive Summary

Corporate governance has existed for centuries, but truly came of age after World War II [1]. Since then, many of the developments in corporate governance have been driven by corporate scandals and the accompanying legislation. While this 'bandaid' approach has worked for the past 60 years, it is creaking under the weight of new and different demands, emerging from the advent of the Digital Age, and resulting shifts in the corporate landscape.

The Industrial Age, particularly since the 1960s, has been largely benign in terms of structural corporate disruption. For decades, and with the exception of a handful of short recessions [2,3], businesses grew in size, diversity and, with globalization, internationally. With this growth came a new ownership mix, driving a different investor-manager balance of power, and changes in the boardroom.

Even as some changes were occurring in corporate governance, the environment in which boards governed was relatively structured and stable. When new topics were added to the board's agenda or became too weighty, committees and other supporting processes were introduced to deal with them without changing the basic structure and approach.

The step changes demanded in almost every facet of business in the Digital Age are straining this current board structure further. Six drivers are fuelling an increasingly urgent need to rethink governance and board structure:

Real-time Responsiveness – in a time when many critical events can occur in minutes and go viral, the current pre-set board meeting structure and agendas leave boards continually playing catch up

Intangibles – in a Digital Age where intangibles increasingly dominate balance sheets, companies' offensive and defensive strategies have to reflect heightened sensitivity to particularly volatile valuations

Radical Transparency – businesses are less able to shield their activities, developments and communications from unwanted scrutiny in an age of whistle-blowers, leaks and hacks. Digital Age boards will need a highly nuanced and more pragmatic approach to what sits behind the confidentiality wall

Multi-stakeholder – accountability to an increasing number of influential parties, some of which can have a disproportionately outsized effect on company operations and valuations in given scenarios

Exceptional Complexity & Uncertainty – the Digital Age, with its increasingly influential complex algorithms, multi-vectoral tipping points and knock on effects is ratcheting up complexity exponentially, and the lack of visibility on trajectory and speed of change is generating enormous uncertainty

Concentration – the Digital Age rise of Winner-Takes-All business models creates a host of challenges for the governance of both dominant firms and those in their ecosystem

Future-fit boards, investors, leaders and stakeholders will need to innovate and design new structures that can synthesise these drivers. Five key areas of initial focus are:

Composition – that considers functional, cognitive and psychological diversity

Structure – developing more agile governance structures and practices

Priority – agendas focussing less on repetitive business as usual items

Greater symbiosis – establishing more rapid-response feedback loops with stakeholders

Education – continual education for informed, relevant input

Investors, especially those participating in private markets, have a significant role to play. The growing trend in Environmental, Social and Governance ('ESG') investing requires an adjustment to what we call 'Digital Age ESG': that is, ESG objectives that take into account the Digital Age and its challenges to all three pillars.

We invite you to join us in tracking, aggregating and highlighting the best tools for Digital Age ESG toolkit [Please see What Next below].

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Introduction

As ramifications of the Digital Age spread further, wider and faster, pervading daily life, organisations are going through a tumultuous time, with disruptions - both *digital and analogue - happening on several fronts. Not least is that of governance*: how it is best conducted and delivered to add worthwhile value in a world that is vastly different from the late 60s, when corporate governance began expanding in depth and breadth.

In a future where all businesses are inescapably heavily dependent on, or morphing into technology companies, boards have to adapt accordingly. The ancillary effects on talent, process, culture and time allocation for boards are considerable. While bringing the knowledge of younger, 'digital natives' or ex-CTOs onto boards might help, it doesn't necessarily address the wider challenges of managing the aggregate and strategic, second order effects of this digital revolution. Such matters require a mix of capabilities from experienced handling of diverse situations, to dynamic scenario assessment and nuanced stakeholder consideration.

The Digital Age's disruptive effects on products, markets, supply chains and business models will drive the focus of many boards over the next decade. When combined with emerging geopolitical and demographic developments, as well as divergent regulatory jurisdictions, the strain on board resources will be considerable.

The complexity of each of these moving parts is also rising, with technology putting an even greater spotlight on supply chain intricacies, fine-tuned resilience plans, data integrity and harvesting practices, cybersecurity, and increasingly, dense AI black-box solutions – not to mention the wider implications and deployment challenges of such solutions.

This is exacerbated by the level of immediacy demanded by the Digital Age, where growing transparency, along with social media mean that issues can go viral in seconds, thus testing boards' ability to be on point and on call 24X7. The recent global outbreak of COVID-19 is a perfect example of unforeseen events can rapidly spiral out of control, drawing a board into firefighting mode. This impact can be both amplified and understood through the lens of a digitised and more inter-connected world.

DIGITAL AGE: an age of rapid shifts and tipping points – caused or enabled by new and intersecting technologies – with knock on effects on global developments and businesses

Whether the current Industrial-Age structure of boards, with their committees and, on average, six annual meetings, will rise to the challenge of this new demand is questionable. While a transitional period with hybrid arrangements is reasonable, new Digital Age board structures need to emerge: ones that better allow businesses to access real-time intelligence on the myriad technological and other impactful, disruptive developments that are shaking up status quo. These new structures also need to take advantage of a multi-stakeholder universe, while fulfilling a range of compliance requirements, both regulatory and self-imposed.

Organisations and their boards will need to contemplate the following key questions:

- How does our Digital Age-fit board look, function and govern?
- How does our board govern in real-time?
- How do we govern amid a seismic disruption with very little visibility of outcome?
- How do we create sustainable marketplaces, supply chains and brands that support our resilience for this future?

Indubitably, organisations that are going to be around in 25 years' time recognise that they can either:

- Be passive and watch the game – but risk their survival
- Be active and play in the game – with the hopes of securing survival
- Be different and change the rules of the game – leading the way and thriving

This is the moment to change the rules of the governance game.

The Role of Governance

Governance plays a foundational role in moments of transition, providing the underlying principles that form a solid basis for change. It forms the underpinning that holds an organisation together, without which the business could find itself splintering in orthogonal directions.

In a time of step change, like that of the Digital Age, it is especially important for the ropes of governance to hold. Carried out well, it should provide the lens through which each significant decision is made, as well as supplying underlying stability through change. In fact, a considered, explicit constitution and endorsement of governance principles can drive the development of a business's reinvention, shaping what emerges from the ashes of the old.

Yet expectations of governance are evolving. Far beyond the Industrial Age regulatory compliance – which itself has been developing in response to various scandals – the court of public opinion is now front-running regulators, and is more exacting and volatile than that of the law. Society expects companies to operate in a thoughtful, ethical and sustainable manner, and deviation from these expectations can inflict a heavy toll – both financial and reputational. Boards are reacting to these expectations through more careful introspection, to determine the core values of their businesses. The emerging dialogue around purpose, ethics and principles is helping guide companies through these times of Digital Age upheaval.

This is resulting in an interesting evolution of self-disruption and self-governance amongst the leaders of the pack. For example, leader Microsoft, who foresaw cloud as the future, took a substantial risk by pivoting away from its bread and butter Windows product suite to cloud-based Azure, starting in early 2010 and formalising it in 2018. It has also now set itself as a leader on consumer privacy. The opposite can be said of Intel, who missed the shift to mobile and has been playing catch up since[4].

On the self-governance front, Unilever published its Sustainable Living Plan, also in 2010, which in the words of its then CEO Paul Polman, was the basis for a "new business model."[5] It has since set the standard for premium corporate sustainability, and subsequently been a continual fixture at the top of the *Dow Jones Sustainability Index*, attracting supportive shareholders, employees and enviable press coverage. Front-runners like these are seeing rewards via stock price rises, attracting top talent, loyal customers and collaborative regulators. Those who continue to cling to old models and follow – perhaps even game - the minimally required compliance regulations, will find it challenging to stay relevant over several decades, even with 'network effects.'

Industrial Age Boards

WHY THE OLD MODEL NO LONGER WORKS

Industrial Age boards had the relative luxury of being able to take for granted a certain amount of stability, predictability, as well as linear, sequential developments in their operating environments. This led to the current structure of boards, focussed on a set number of repeat items that were revisited at a given board meeting each year, with Any-Other-Business a placeholder for afterthoughts.

As a result, boards largely operated along the following formula:

Stability of Underpinnings – the past six decades have been characterised by overall operating stability in business models, with most firms looking for incremental growth either through new markets, M&A or product development.

The digitisation of life in general – through the advent of internet, smart phones, exacerbated by cloud and now AI have upended businesses, changing not only where and what they create and sell, but also cost structures and how to maximise monetisation with completely different models.

In turn it is undermining the very foundations of many businesses. This is leading to an acknowledgement that governance as a planning and decision-making tool, as currently conducted using historical context and long deliberations, is no longer viable for future-fitting an organisation. Today's businesses are dealing with exponential and stochastic developments that are far from the linear and sequential ones of the past

Regular Meetings – the old paradigm of four to six meetings per year was based on boards chiefly addressing a number of standard items with an isolated day dedicated to strategy. Today, most boards are meeting more frequently than six times – even if offline – and are speaking of a wider set of concerns. Not only do they still oversee the legacy items, but have been adding an increasing number of new ones, like cybersecurity, technology and sustainability to their agendas. Board packs have swelled, meeting lengths have extended, and strategy cannot be kept caged up and only let out once a year

Specialist Committees – traditionally created to handle a few key priorities areas of focus for a board, committees deal with important detail that might unduly consume time of the entire board. In view of the small number of directors on boards and their time constraints, there is only a limited number of committees viable for an average sized board. Yet they continue to mushroom, with new ones dedicated to technology, sustainability and social impacts, in addition to the legacy ones of audit, risk, remuneration, nominations and others

A recent example of how Industrial Age boards are caught on the backfoot is perfectly illustrated by the advent of COVID-19. The spread, developments and impacts of this deadly virus happened unbelievably quickly and most likely in between board meetings for most firms, a significant number of which are going to struggle to survive the virus's economic effects. A situation evolving this rapidly, with hugely disruptive effects – enabled, explained and potentially solved via ubiquitous technology, cannot be adequately addressed by an Industrial Age board structure.

In an Industrial Age where businesses had the time to contemplate and drive change, the legacy structure worked to a large degree. However, as complexity has grown with globalisation, supply chain fragmentation, environmental and other disruptive impacts, boards have struggled to continue delivering thoughtful governance within the current structure's constraints. The advent of the Digital Age and its implications for rapidly upending businesses, is further straining the ability of boards to deliver their real value: ensuring that businesses remain relevant and sustainable.

Digital Age Context

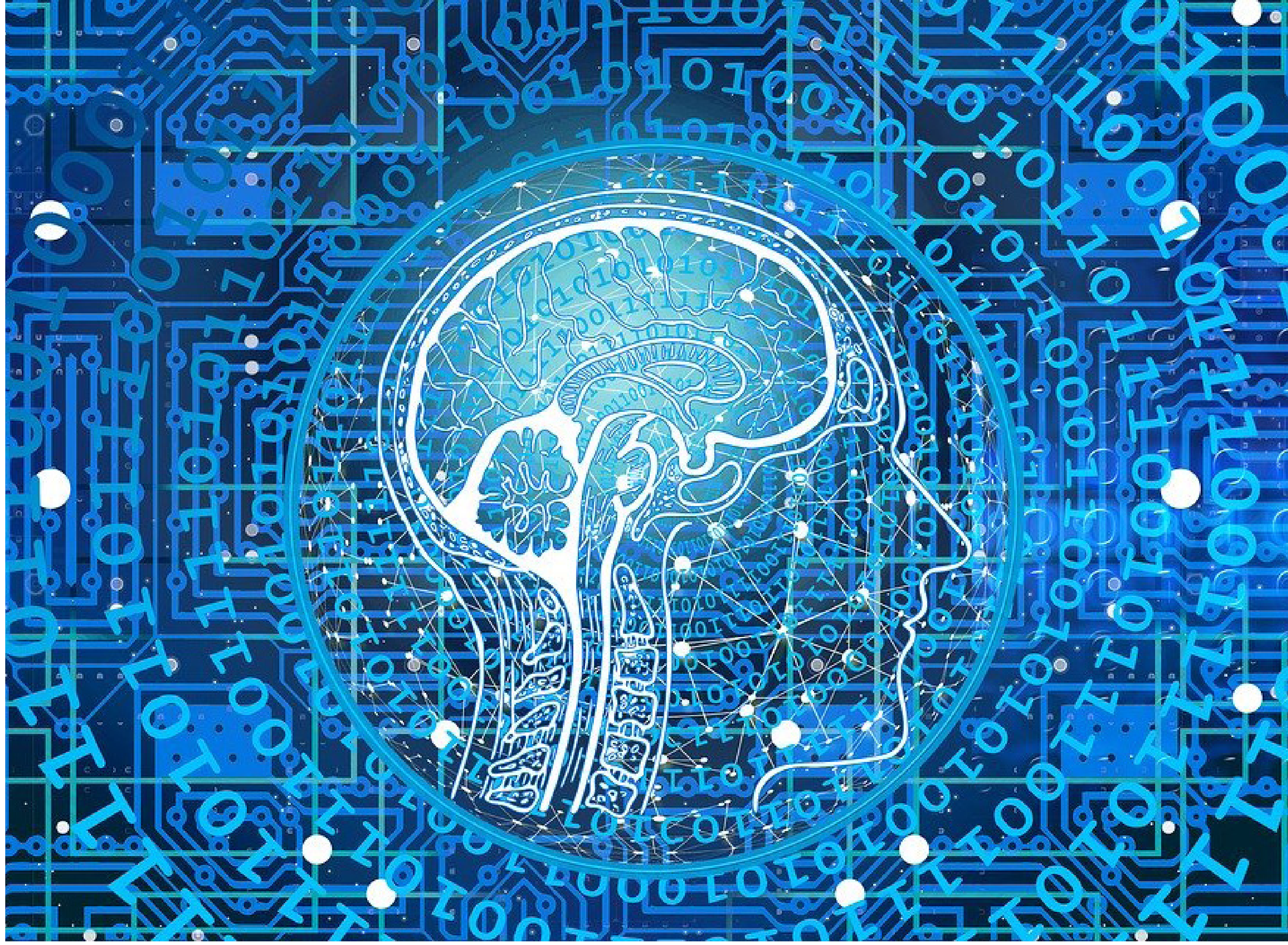
DIGITAL AGE ATTRIBUTES DRIVING THE NEED FOR CHANGE

Six key Digital Age drivers are forcing a reboot of governance: real-time risks and opportunities, increasingly intangibles-based balance sheets, growing transparency, accountability to a wider number of stakeholders, a prolonged period of exceptionally high complexity and uncertainty, and new concentrations of corporate power. Combined, they require a fundamental shift in the way boards govern their businesses, as expanded on below:

Real Time Responsiveness – boards are increasingly confronted with the need to address issues that may emerge spontaneously, have instantaneous consequences and can go viral. This applies not only to events and risks facing the business itself, but also to opportunities that arise out of competitive landscape changes, or rapid global developments. The ability to largely disengage between board meetings is a luxury the Digital Age does not allow. Moreover, the innovation cycle and transformation of a given business itself may have to move at lightning speed in order to stay ahead, and strategy likewise has to continually evolve. Digital Age boards will therefore have to govern in an agile, resilient and nimble manner

Intangibles – as the value of companies becomes increasingly weighted by intangibles such as reputation and brand, algorithms and data, IP and inventions, the calculus of risk changes considerably. Intangible value can fluctuate much more rapidly and unpredictably than that of bricks and mortar businesses. As was discovered the hard way by WeWork investors, even having an asset-light, bricks and mortar business does not protect from huge fluctuations in a valuation based primarily on the intangibles of a 'physical social network.' This will be further exacerbated in an economic downturn and a stock market driven by robo-trading. Boards will need to consider more carefully how to stabilise stock prices and build foundational value that survives the accompanying volatility

Radical Transparency – companies will have to be particularly selective about what they keep highly confidential in the Digital Age. The resources to keep much of their operations at a high level of confidentiality will exact a heavy toll and could render a company's business activities unwieldy and unsustainable. Set against a backdrop of continuous disruption, where change can be both unexpected and instantaneous, the inevitable solution to any divergence between what is espoused, versus what is lived in reality, is authenticity. Behaviour that genuinely reflects the declared intention of an organisation will require a highly nuanced vision of what it stands for, and a culture within that accurately mirrors this internally and externally. Any meaningful deviation can cause heavy damage and needs to be addressed appropriately



Multi-Stakeholders – Digital Age organisations and their boards need to be consistent in their actions and messaging to a range of stakeholders (customers, employees, supply chain participants, politicians, NGOs & regulators). The most successful approach is continual micro- engagement with those stakeholders on an agile and on-going basis, and the integration of corresponding feedback into best practices, products and services. The industrial age one-way megaphone, from the company out to its stakeholders, is being inverted, with stakeholders from all corners now broadcasting their wants and needs to companies, often in very public fora. Companies leading the charge will utilise this as an enormous opportunity to innovate and iterate based on such feedback, creating loyal stakeholders in the process. Boards need to be aware that not every situation can be an all-around win-win and anticipate how they will balance when stakeholder desires conflict. They will need to develop a more methodical approach to quantifying and assessing trade-offs

Continued...

Exceptional Complexity & Uncertainty – while the old complexities still exist, the Digital Age, with its advanced and ubiquitous technologies is layering on additional variables, which can intersect in unpredictable ways. Since the Digital Age will ultimately change every aspect of business, societies and governments, it is impossible to predict when, or what, the by-products of such a radical shake-up might be or look like. The reality is that we are in overlapping waves of transition, with intersecting variables that can converge to catapult us into yet another wave. A prime example of this was the advent of mobile, which on its own was one vector, but layer on turbo-charged and cheap computing power, then the development of cloud and a whole new set of businesses and business models are made possible. Digital Age boards will have to live with much higher levels of opacity and build greater resilience and nimbleness to be able to take advantage of such multi-vector change.

Concentration – Digital Age business models, with their network - and other exponential[6] - effects, are engendering an increase in the Winner-Takes-All corporation. This serves to concentrate immense power in very few boards. The wider community of companies in the supply chain and general ecosystem will need to have a cleareyed view as to whether they will be the winner or serving one, and steer accordingly. Nonetheless, they need to keep their antennae out for potential sudden swings that provide a window of opportunity or risk. The Digital Age will introduce fascinating shifts in the balance of power between the large behemoths and their distributed ecosystem

An important governance issue also arising with the Digital Age is that of power balance between the star founder and their board. Behemoth technology companies are being taken public with the expected traditional governance structure. Yet some start up founders retain immense control of their organisations through a separate class of shares allowing them outsized decision making clout versus other shareholders. The boards of powerful companies such as Facebook, Alphabet and Amazon can suggest, advise and perhaps influence, however the ultimate voting power resides with the founders. As was observed when Facebook and Uber were confronted with regulatory and consumer approbation, the founders prevailed – some longer than others – where most other C-suite members would have been quickly dismissed.

How boards perceive and act upon Digital Age opportunities and risks is vastly different from that of the Industrial Age, in terms of skill sets, process and the type of governance they exercise.

Future-Fit Boards

Future-fit boards will not look or act like the boards of today. The real time impacts of an ever faster moving world and stakeholder feedback expectations, among others, will require a more agile structure and continual access to intelligence. Moreover, as stated previously in this paper, the rising complexity and demands being made of board members will render them unable to meet the ever rising soft and hard governance demands, let alone claim to be truly 'non- executive,' or in some cases, independent.

The current composition, structure and priority will not serve organisations that want to pursue both an innovation agenda and business longevity. While some progress has been made on one front – composition – the Digital Age will require a far wider diversity of inputs:

Composition – future-fit boards will need to incorporate wider psychological and cognitive diversity in its members, beyond the functional ones most sought after at the moment. This will provide the widest inputs essential for scenario planning, more balanced deliberation, as well as nimbleness. While it is useful to have solid historic industry expertise on the board, a future-fit board will require many additional inputs as businesses morph – including strategic technology acumen. Board members who can quickly assimilate and mentally model change, see opportunity in uncertainty and exhibit an increased sensitivity to prioritised stakeholders are key

Structure – boards are going to be confronted with a slew of small yet critical decisions as their organisations make tight and wide turns to stay relevant - and preferably lead in the Digital Age. The Industrial Age, top-down, rigid, one-size-fits-all structure, coupled with a few, discrete and often lumpy meetings, will render the board a bottleneck to agile progress. New distributed, micro-decision structures that have access to compact, relevant intelligence and that continually adapt with this new age might better serve a more granulated and proactive approach

Priority – with a wide-ranging agenda, future-fit boards will need to strike an important balance between hard compliance and soft self-governance items that serve to evolve the business. In rapid, transitional times, the focus of boards cannot rest primarily on hard governance. Today's annual, one-off 'Strategy Day' will be severely challenged by the continual adjustments required as businesses morph, and board agendas will need to allocate priority more dynamically to reflect continually evolving scenarios and strategies

Greater Symbiosis – creating more channels that filter up intelligence from the coalface of business into the boardroom, is essential. A board's sensitivity to internal developments and external feedback will inform the pivots necessary to thrive and prosper in the Digital Age. This requires deliberate processes and focus by the appropriate board members

On-Going Education – organisations will need to consider how to create dedicated processes and partnerships that allow a continual education of their governance members. In contrast, today's board members largely receive only occasional and brief training courses. Some effort will need to be expended in determining how, what and with whom this continual training can occur, to ensure an amplified return to the business

Role of Investors & Shareholders

Investors as shareholders, have a significant role to play in ensuring that boards are future-fit. Their contribution to the selection and approval of independent non-executives is key to balancing the skills and profiles of the executive members. Considering their dual objective of ensuring a well-executed transition to a Digital Age-ready model, alongside a sustainable performance over the coming decade or two, they are particularly well incentivised to select appropriate talent to their boards. This is especially acute in the ever-expanding private markets, where private equity fund managers hold immense sway in the selection process.

Other than direct involvement in the selection process, investors and their representative bodies and proxy advisors have a role in signalling acceptable best practices. The growing trend in ESG investing requires an adjustment to what we call 'Digital Age ESG': that is, ESG objectives that take into account the Digital Age and its challenges to all three pillars. This paper is primarily focussed on the 'G' of governance, but both 'E' and 'S' will be significantly affected by the Digital Age and we are following those developments closely.

What Next

CREATING A FUTURE-FIT GOVERNANCE TOOLKIT

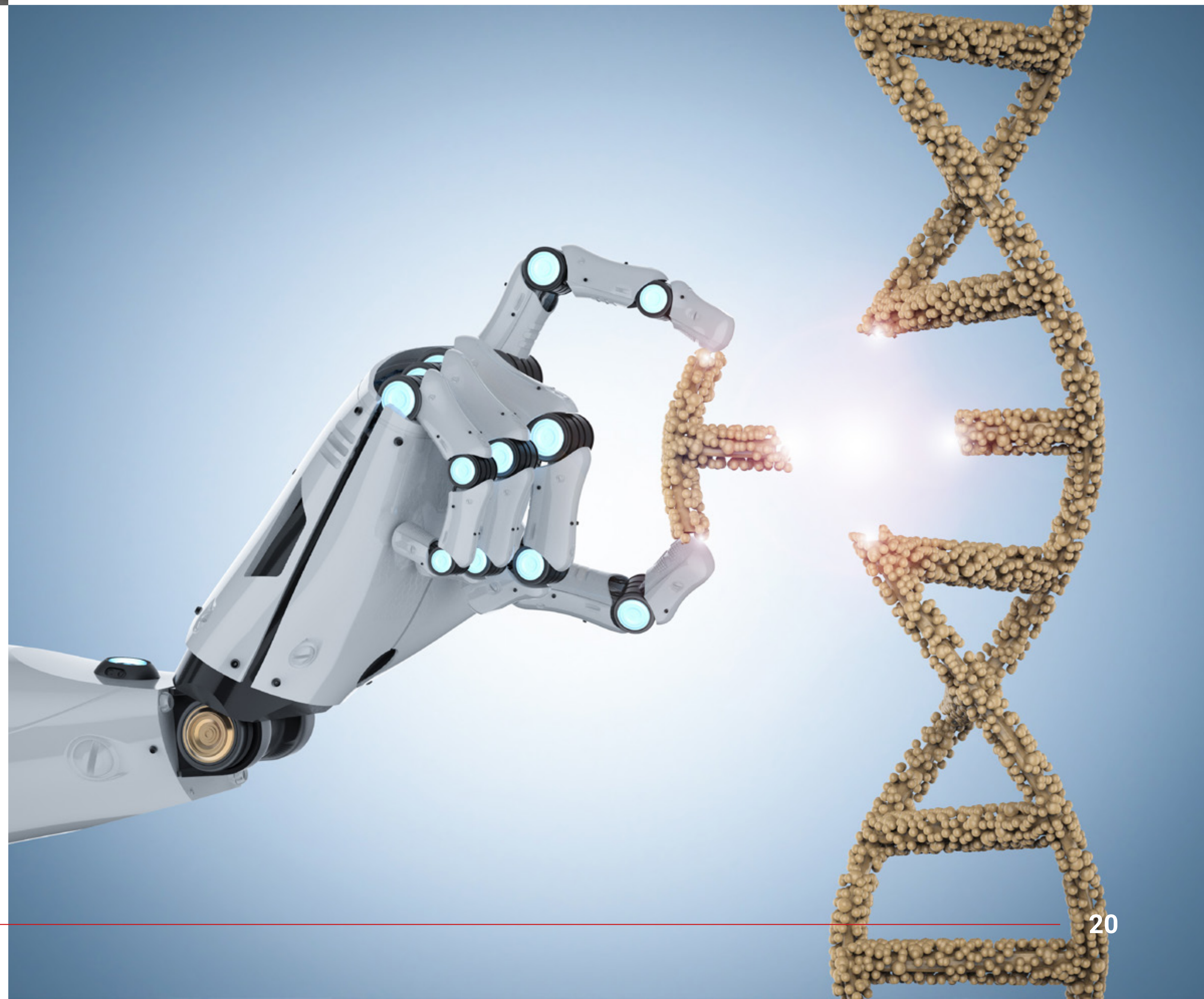
We are in the midst of a transition from a patchwork of Industrial Age bandaids to a Digital Age, future-fit, governance structure. This will require exceptional questions, insights and an emerging best practices toolkit, that a range of businesses can draw upon to tailor to their circumstances.

There is no one-size-fits all solution – and nor is this a one-off exercise.

There is no one structure that will work globally, for all industries, different sized firms, with varying ownership structures, strategies and trajectories. Agility applies both to decision making, as well as to the composition, format and review cycle of governance structures. Each firm will have to determine which tools in the toolkit serve it best – adapting and evolving accordingly. The one thing we can be sure of in this Digital Age, is that the 'stability' of standing still is no longer an option.

Businesses and their owners have enormous opportunities and risks in anticipating this continued disruption. A deliberate, thoughtful and agile governance structure is essential for organisations to survive and thrive in the Digital Age. There is little point in developing an agile organisation while its board is locked into a more stultified structure. Early adopters of well-crafted, Digital Age governance tools will build a fundamental competitive edge and create through it a governance premium 'moat.'

We invite global leaders to join us on this journey by sharing your thinking, challenges and most of all, newly discovered agile governance tools. We would like to nurture a vibrant and innovative community of leaders that learn from each other and help create an ever- growing body of evidence on the optimal Digital Age tools of governance. Please do reach out to us with stories, examples and any interest in developing agile boards.



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