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Ingredients for success
Striking the right balance



2016 Directors' Alert
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Dear readers,

Stakeholders are pushing boards for greater oversight in many areas; the media and general public are focusing increased attention on organizations and their tax strategies, compensation programs, and business models. Regulators have introduced a variety of new disclosure requirements—from political donations and conflict minerals, to cyber security breaches and taxes paid.

Boards cannot afford to ignore these new demands. What they do need to do, however, is ensure that they still devote sufficient time to the activities that create the greatest value for the organization, such as overseeing its strategy and management in achieving its objectives; satisfying themselves that the organization appropriately identifies, manages, and mitigates a growing number of risks; and ensuring that the organization creates the culture required to attract the talent it needs, especially at the C-suite level.

In short, boards need to identify the essential activities—the ingredients for success—and strike an appropriate balance in terms of the time and effort devoted to each of them.

We hope these insights help stimulate discussions at your board.

Chantal Rassart
Partner
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Corporate Governance

This edition of Deloitte's annual Directors' Alert examines some of the major opportunities and challenges likely to affect organizations and boards of directors in 2016. As always, there are opportunities—keeping strategy attuned to the changing environment, executing it properly to move the organization ahead, and seizing the opportunities to innovate and emerge stronger—and there are risks, which are not only becoming more complex but, in the case of cybercrime, also inevitable. Boards also need to be sure the organization has the flexibility to respond to changes in its environment as the best choices in the past may not be the optimal ones for today, which means that organizations need to regularly rethink and reassess their approaches to everything, from how they deliver goods and services to customers to how they plan their tax strategies and the way they manage talent.

Our objective is not to provide solutions to the issues raised since the best approach for every organization will depend on its own particular circumstances. Instead, our goal is to assist directors in identifying the issues of importance to their organizations.

Dan Konigsburg
Managing Director
Global Center for
Corporate Governance

For this publication we interviewed practitioners from Deloitte member firms ("Deloitte") around the globe who work closely with boards of directors. We asked them to identify the top issues facing the organizations and boards they work with, and to provide insights into the opportunities and risks in areas that boards and management should consider when developing their strategies.

This publication also includes interviews with three directors who provide their perspectives on the corporate governance challenges and the opportunities that lie ahead.

Each article includes questions that directors may ask to further explore the issues with their own boards. In addition, articles are supported with tools and resources so directors can "dig deeper" to broaden their understanding of the issues and improve their board's effectiveness in dealing with them. These additional resources, listed on page 42, can be downloaded from our website, or obtained by contacting your Deloitte partner.

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Developing a resilient, innovative organizational culture



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Change is coming. Technologies such as artificial intelligence, advanced robotics, networks, advanced manufacturing, and collaborative connected platforms will certainly disrupt many organizations' business models within the next few years. Additional changes could occur as the organization alters the way people work and the way the organization interacts with others in its ecosystem. Inevitably, some new innovative developments may have a sudden, widespread impact, while many others could be the result of a series of smaller changes that, together, create a significant change.

With fast-evolving advanced technologies already digitally disrupting business models in almost every industry, innovation has increasingly become a focus area of the board. While boardroom discussions may have once viewed innovation solely from a risk perspective, many boards understand that their organizations must anticipate and harness the opportunities that innovation and technological disruption create to expand their market share and enhance their brand value.

Organization-wide innovation

Organizations can approach innovation from two perspectives. They can look at how implementing new technologies or different processes would enable them to do more—such as entering new markets or growing market share. Or they can look at what might happen to the organization, its products, and market share if it does not innovate. To fully understand the opportunities and risks, organizations need to view innovation from both perspectives.

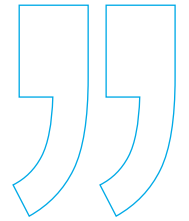
To be effective, innovation should be derived from the core purpose of the organization and contribute positively to building value. Empathy-based innovation, for example, begins with a focus on the organization's customers and looks at creating new ways to reach them. Other innovations are inspired by social issues.

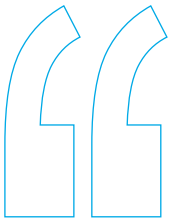
Having a solid understanding of and being aligned with the company's long-term vision and objectives enables organizations to more effectively make short-term decisions around capital, talent, innovation, and the pace of change. It is also important for the organization to have an externally oriented culture so it can anticipate and respond to external disruptors.

While some industries, such as automotive, have long invested in research and development (R&D), innovation is something that organizations in every industry need to focus on. And while innovation may have once been the responsibility of the R&D department, innovation today needs to be part of an organization's culture. A resilient, innovative organizational culture—one that promotes, encourages, and provides incentives for all members of the organization to engage in innovative behaviors and practices—can help organizations withstand disruption in the future while offering important benefits immediately.

Innovation needs to be a proper process within the organization—it is not just about developing new ideas and approaches, it is also about the way the company organizes itself and innovates on a day-to-day basis. The board members should have oversight of this process and the way in which management is building an innovation culture within the organization.

—Marc Van Caeneghem





The board should have an innovation management system with its own key performance indicators (KPIs) that exists in parallel with the business management system and allows the board to monitor innovation KPIs—new business ideas, proof of concept projects, the organization’s innovation budget, and the key innovation projects that the organization invests in—and understand how those innovative ideas create value for the organization and contribute to achieving its business objectives.

—Takeshi Fujii

To develop a culture of innovation, management and the board must set the tone at the top, communicating the importance and value of innovation, aligning it with the organization’s business objectives, and tracking, measuring, and rewarding innovative performance. Innovative organizations need to be prepared for some failures; not every new approach will work out as planned, but failures should still be celebrated, provided that the organization learns from them.

Innovative organizations possess:

- **Awareness**—It’s impossible to prepare for something you’re not aware of and don’t understand. Highly innovative companies ensure they are aware of the forces that have the potential to disrupt their businesses and their industries, enabling them to better position themselves to take action today to face the impact of disruption tomorrow.
- **Organizational agility**—When disruption occurs, organizations need to be able to rapidly redeploy systems, assets, and people to address external opportunities and threats. By embracing new ways of working and making decisions, companies can avoid becoming mired in the bureaucracy that brings change to a screeching halt.
- **Effective resources**—Investing in advanced technologies and using resources effectively can increase an organization’s resilience in the face of change. By acquiring and deploying the best people, technology, and financial resources, companies can improve their competitive position and prepare for future disruption. Developing effective research strategies and learning how to enhance the organization’s in-house capabilities by taking advantage of crowd sourcing are also important.



Innovation and the board

Boards need to have innovation on their agendas, not just in terms of new technologies, ideas, and projects, but also in the way the organization's innovation process is managed on a daily basis. Boards should clearly understand the organization's performance drivers—beyond operational performance—to assess how the organization could continue to deliver value.

Boards may also wish to set out an innovation appetite that defines the board's expectations for management around the way innovation is nurtured and rewarded in the organization. Boards also need to be aware of the organization's customers and their preferences and behaviors—and whether those preferences and behaviors are changing. They should also have an awareness of trends occurring in the organization's industry that may provide insight into where disruption may occur. To facilitate this understanding, directors should consider exponential learning opportunities, such as attending technology or industry events, meeting with experts, key customers, and suppliers as well as taking the time to visit the organization's own business units.

Questions for directors to ask

1. Does the board understand how innovative technologies could disrupt our organization's business model? Are we looking at adopting innovative technologies and approaches that can better create value and capture greater market share for our organization? Do we track innovative developments occurring in the industry?
2. How often do directors meet with the organization's business unit leaders to gain their perspectives? Does the board meet with suppliers and others in the organization's ecosystem? Does the board have a strong understanding of what is happening among our competitors?
3. Who "owns" innovation in our organization? Is it the responsibility of an R&D department or do we have an innovation culture where everyone plays a role in developing and implementing new ideas and approaches? Has the board formally set out its expectations of management around innovation?
4. Does our organization have a set of defined innovation KPIs linked to our key growth objectives and if so, how do we track those KPIs? Does the board receive regular reports on these KPIs?

Strategy in the face of disruption



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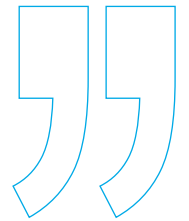
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As organizations become ever more closely integrated with their supply chain partners, boards need to address some key fundamentals, such as what is core to the organization and should be retained compared to what the organization can rely on its partners to provide. Organizations have to determine what part of the product or service they own and what customers they own, compared to the parts of the delivery model and customer relationship they are willing to share with others.

—Jonas Malmund



As the pace of disruptive change continues to accelerate, an organization needs strategies that have the flexibility and agility to keep pace with and adapt to those changes, while continuing to keep the organization focused on its long-term objectives to create value to the stakeholders.

Strategies have always been built on a set of assumptions and expectations about markets, customers, suppliers, competitors, risk points, and other factors. When those assumptions change, organizations need to rebalance their strategic choices to reflect those changes—often quickly.

Strategy, therefore, needs to be flexible and agile to enable management to quickly assess and address issues affecting the organization and its business model so the organization can take action when competitors or customers are beginning to make a move, rather than having to wait to respond until after that move is made.

When considering strategic options, the key is to focus on retaining and building value—organizations need to get their value proposition right and keep it right in the face of disruption or other changes. Today, when a successful product or manufacturing process can be copied almost instantly, an organization's value proposition can shift virtually overnight. Organizations, therefore, need to understand the elements of their strategy that provide them with a competitive advantage, and how they will sustain that advantage.

Understanding the organization's value proposition includes recognizing when the strategy needs to be adapted and being able to make those changes quickly. The media has reported the experiences of many companies that were slow to react to dramatic disruptions, sometimes because they were unwilling to believe that a strategic approach that served the organization well had suddenly been surpassed and was now obsolete.

Organizations that wait too long to adjust their strategies and transform themselves eventually need to do so under pressure of both margins and time, and are inevitably less successful in managing that process.

Engaging with business unit management and with industry and subject matter experts will help boards to better understand, assess, and challenge management's strategic choices. It will also help boards recognize when the strategy's underlying assumptions are changing.



Boards need to focus on the risks associated with strategy, but should also understand the opportunities, especially as they relate to the organization's value proposition. All organizations need to listen carefully to their customers, and the board itself should be carefully attuned to what customers are saying about the organization and its market and what can be learned from those comments to increase value.

—Javier Garcia



Questions for directors to ask

1. Are there indications that our route to market and the traditional way we have of working with suppliers or customers is at risk of becoming disrupted? When should we make our move? Do we need to be the first adopter or a fast follower?
2. Where is our organization positioned in the delivery channels we use to go to market? What role do others in our ecosystem play in these delivery channels? What is core to our organization that must be retained? In what areas can we rely on partners?
3. What part of the customer or client relationship do we own? What relationships do our supply chain partners have with our customers or clients? What access should our partners have to our customers? What access should they have to our product portfolio?
4. What are the risks of disruption to our supply chain, our markets and our customers? Are we able to recognize when our legacy products or services are becoming disrupted? How nimble were we in our response? Did we make adjustments quickly or were we reluctant to admit our long-standing value creators were losing market share and customer support?

Building an irresistible work environment

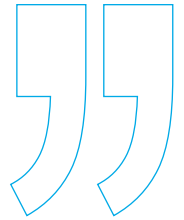


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Boards should consider taking a more proactive approach and giving more focused attention to the organization's learning and development activities, in particular the way that strategic learning and development programs are aligned to build the organization of tomorrow.

—Abhay Gupte



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In an era of heightened corporate transparency, greater workforce mobility, and severe skills shortages, the top human resources issue facing organizations around the globe and in all industries is to create a workplace culture that engages, retains, and motivates workers.¹

The challenge of creating a culture defined by meaningful work, deep employee engagement, job and organization fit, together with strong leadership, is important from more than just an HR perspective—it is a key business opportunity. Highly engaged companies can hire more easily, deliver stronger customer service, have lower voluntary turnover rates, and greater profitability in the long run.² For this reason, building such a working environment and culture isn't something that should be delegated to the HR department—it should be a key responsibility for all of the organization's leaders.

Most organizations recognize the importance of having an inclusive culture where the work environment is compelling and enjoyable for everyone. Despite that, however, few organizations have actually achieved that objective. Survey data shows that only 13 percent of the global workforce is "highly engaged"³ and upwards of half of the workforce would not recommend their employers to their peers.⁴

Organizational culture can be negatively affected by stressful situations, such as when the organization encounters financial difficulties, undergoes layoffs, or is engaged in a merger. More often, however, other factors challenge organizations in their efforts to build an inclusive culture.

One of these factors is the nature of the workforce itself, which is far from homogenous and, as a result, there is no "one size fits all" solution that will appeal to every worker. Employees of different genders, ethnicities, backgrounds, ages, and other characteristics all have different expectations about their employers, jobs, and workplace preferences. Furthermore, organizations can no longer define their workforce as the set of employees who come into their premises each day; today, to access the talent with the expertise they require, organizations are hiring greater numbers of hourly, contingent, and contract workers.

Another disruptive factor is social media. Websites such as LinkedIn, Facebook, Glassdoor, and others, make it easy for employees to learn about new job opportunities and gain intelligence about other organizations' cultures.

In this environment, organizations need to treat their employees like customers—today's employees cannot be considered

as just workers; they must also be viewed as associates or “volunteers” who choose to come to work at the organization.

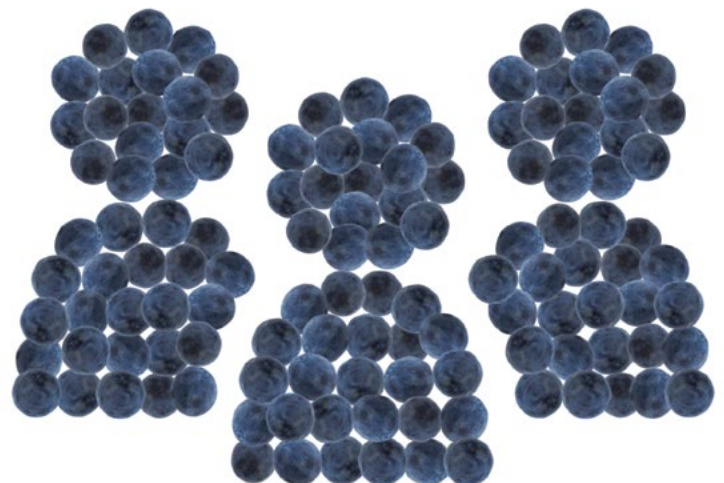
Organizations that create cultures characterized by meaningful work, hands-on management, career and growth opportunities, a flexible and humane work environment, and a trust in leadership can be rewarded with the strong engagement of their employees.⁵ To build such a culture, organizations need to understand their employees’ motivations, which are much different than those of workers in the past. Today’s employees have a new focus on purpose, mission, and work-life integration.⁶ Since more than twice as many of them are more motivated by work passion than by career ambition,⁷ organizational leaders need to focus on making the work environment compelling and enjoyable for everyone. One key to doing that is to understand the Millennials⁸; their desires, needs, and values will shape organizational cultures over the next decade.

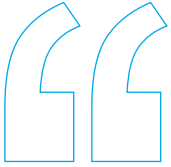
Leadership

Leadership is a longstanding concern for organizations and their boards. As CEO tenures continue to shrink, organizations need to maintain and cultivate their leadership bench strength. What’s more, as technology, globalization, and demographics continue to dramatically change the nature of their organizations and workforces, the leaders of tomorrow will need a different mix of skills and attributes than those of today or the past.

Succession planning for CEOs and their leadership teams must be an ongoing responsibility of the board—in fact, many boards expect their CEOs to begin working with the board to plan their succession the day they step into their role. Leaders need to develop successors whose skills fit the new world; they need increased agility, greater collaboration, and a higher focus on developing talent capabilities. A growing number of boards expect their leaders to not only help identify, develop, and mentor in-house candidates to succeed them, but to also continuously monitor the outside talent so they also know the best external candidates.

An important consideration when developing leaders is their ability to create a work environment that engages all of the organization’s people since culture is defined by the tone at the top. Despite this, many organizations’ current leaders say they cannot define their organization’s culture, much less disseminate it throughout the company.⁹ Perhaps one reason for that is that organizations generally hold their leaders and leadership candidates accountable for business results and not for building strong and enduring cultures, listening to feedback, and engaging and retaining their teams.





Boards need to take a long-term focus, including their focus on talent. Managing people is the responsibility of management, but the board needs to ensure that the proper processes and practices are in place. They need to ensure that the organization is creating and nurturing a positive, engaging, and adaptive culture—call it the appropriate corporate ethic—that is sustainable and survives beyond a CEO’s tenure.

—Henri Vahdat

HR transformation

Although building and maintaining an inclusive culture should not be delegated solely to the organization’s human resources department, HR does have an important role to play in that process and in helping to manage the organization’s future talent needs. Unfortunately, helping their organizations build work environments of the future is an almost impossible task for HR departments that are themselves still rooted in the past.

Many traditional HR activities, such as performance management, should be automated and made self-serve, allowing HR to shift from administering personnel to providing insights to management. By making use of data analytics, HR functions could broaden their understanding of the current organization and talent pools to better prepare leaders, better support business strategy, and better understand where the organization will

find its workforce in future, while also more clearly identifying the risks to that workforce, in particular retention risk. Developing a mobile and social strategy for HR would also enable the function to work differently and more efficiently—for example, by leveraging social media to help build the organization’s brand both internally and externally.

The HR department—as well as management and the board—need to develop and maintain an outside-in perspective of what might disrupt the business, its medium- to long-term strategy, and its workforce. HR functions should play a role in helping CEOs and management understand how to solve business problems through innovative talent strategies, including the way jobs are designed, the type of jobs the organization will need in the future, and where those jobs will be located and performed.



The board's vision of organizational culture

The board's direct responsibilities around talent are to hire, manage, and supervise the CEO, while also ensuring that a leadership pipeline is in place for key executive positions (including an emergency succession plan if the CEO was suddenly unable to perform in that role), and to oversee the executive compensation system.

Given the importance of talent to the organization's ability to achieve its objectives, boards should also be satisfied that the organization puts in place the appropriate human resource policies, including building a culture that attracts, retains, and motivates top talent. Boards might also consider developing a Human Resources Appetite Statement that defines the board's expectations around the way the organization manages its talent and builds an appropriate organizational culture.



Questions for directors to ask

1. Does our organization monitor social media to learn about how our workplace is perceived? How does our workplace compare to those of our competitors? What do our employees say about our organization on social media?
2. How committed are our employees and how do we measure that? Do we only use formal engagement surveys? What other programs could we use to evaluate and assess organizational culture to understand its strengths, weaknesses, and how it really feels to workers? Do we act on the feedback we receive from employees? Do we benchmark our organization and strive for external recognition of efforts?
3. Are we “winning” in the talent marketplace? How does our turnover rate compare to our competitors?
4. Do our organization's leaders understand the importance of culture—in terms of attracting and retaining employees and its impact on corporate performance? Do we measure their actions in building an appropriate culture, including mentoring and coaching our people? Is the board satisfied that senior management sets and demonstrates the right tone at the top?
5. How well does the board understand the importance of organizational culture? Has the board made its expectations clear to management?

Jose Luis Prado



Jose Luis Prado

Jose Luis Prado is President, Prado Strategic Consulting, LLC and the former President, Quaker Foods North America, a division of PepsiCo, Inc. He is a member of the boards of The Northern Trust Corporation and Brinker International. Mr. Prado is also active in the community, serving on the boards of the Chicago Council on Global Affairs, Global Advisory Board of the Kellogg School of Business at Northwestern University, Chicago Symphony Orchestra, Lyric Opera and One Goal Chicago, GENYOUth and he co-chairs the Latino Corporate Directors Association.

What are some of the big challenges facing boards and organizations today?

There are several: cybersecurity, activist investors, risks and managing those risks, organizational culture, and there are more, but I think one of the biggest is the volatile, dynamic environment that organizations operate in. We're seeing a major shift in power in and around corporations. In the past, the organization controlled its own agenda. Now, it's more of a shared control—consumers and shareholders have tremendous power, and activist investors do too. Then there are disruptors, such as advanced technologies, that are changing the operating environment. What this means is that boards need to elevate their game. They need to work harder to ensure that the fundamentals are in place, while they also address the emerging trends and issues.

Has this shift in power disrupted organizations' ability to tell their story?

I think they're having trouble telling their story, and that's reflected in a loss of trust in companies and their leaders. For many years, the Edelman Trust Barometer¹⁰ has measured the confidence people have in large organizations around the globe, and each year those trust levels fall. We're in an environment where people are

losing trust in companies and politicians and what they say, and at the same time, they are paying greater attention to what a celebrity, their friends, or even what an unknown person says on social media and granting them their trust.

We're also getting fragmented pieces of information. Many groups focus on a single issue, such as taxes, proxy access, or executive compensation. When people are focused on a single issue, they don't see the big picture and organizations have a hard time communicating a coordinated message to them that puts everything in context. I believe companies need a strategic map around communications: who they will engage, the messages they will deliver, the communication channels they will use, and so on. They also have to pick their battles; they need to focus on what is essential to their success, and the better they understand what they are trying to do, the time it takes to do it, as well as the limits to what they can do, the more successful they will be at advancing engagement with stakeholders.

That also creates reputational risks for the organization, doesn't it?

When information is both in real time and fragmented, reputation is more fragile than ever before. Today, information is being democratized through social

media and other means, and we're only beginning to learn how to use that power responsibly. At the moment, people are using social media like a magic wand they can wave around and enjoy the sparks. Different pieces of information get out, in some cases unintentionally, and it can be difficult to put them all into balance and perspective—in the right way. So we have to learn how to operate in this new environment, which means becoming a lot more agile, a lot more savvy, and probably also a lot more open and accessible if we want to frame the discussion in a way that puts the issues into the proper context.

You mentioned that risk is a key concern.

Today, we have a high-risk environment. Just doing the same thing today that the organization did a few years ago now involves a greater level of risk.

Organizations need to carefully balance risks and rewards and ensure incentives are properly aligned to keep excessive risk-taking in check. And usually that's where the discussion is around risk: the dangers of taking on too much risk. But taking on too little risk is also dangerous, because organizations need to take risks if they are to evolve and innovate.

I think striking the balance between too much and too little risk can be a challenge for larger organizations because their scale makes it difficult to be nimble when addressing the challenges of disruption, the need to engage with different stakeholders, and the threats to their reputation. Large companies, particularly in the US, are very functional and silo-driven, with few people who see all the pieces together. Often smaller companies can adapt faster to bigger challenges, so boards need to consider creating a risk framework and corresponding appetite that coordinates the risks they need to take to move the organization to the next level.

How are boards responding to disruption risk?

We're seeing a huge level of transformation. I recently read a newspaper story that suggested that two-thirds of today's Fortune 500 companies won't exist 20 or 30 years from now.¹¹ Another story suggested that some companies are using their customers to lobby for them.¹² So they're moving from consumers to advocates, which might even have political implications.

Disruption is a fact of life. It's happening at ever faster speeds and it's creating big challenges for companies and their boards. When I look at the companies that appear to be managing this well, it has usually been ones that are willing to take some short-term heat in their core business by investing in a new generation of solutions. Culturally and structurally, that is very hard to do in a big business with long-established processes. Developing new approaches requires creativity, openness and providing support to a small group of entrepreneurs within the company who have the job of creating a disruptive solution and integrating the new solution with the company's traditional business. It can be done. For example, not too long ago companies thought the Internet would make brick-and-mortar stores obsolete. Today, most organizations have found a way for the Internet to complement their traditional businesses to create a new solution that is more convenient for consumers.

Jose Luis Prado

We are in a world of greater risk—reputational risk, risk of technological disruption, risk of international events that affect the global environment—so boards have to spend more and more time on those risks and challenges.

—Jose Luis Prado



Regulatory changes are another fact of life. Would it be easier if we had a global regulatory regime where the rules are the same across all jurisdictions?

A global regulatory regime would be a good aspiration, but it's something that I believe would be hard to build. Consider the proposals around genetically modified organisms: the US, Latin America and others accepted them, and then Europe opted out. We see that happening with other regulations where not every country adopts them. If there is ever to be a harmonization of international standards, I think it may come about through the increase in international trade agreements. Those agreements have played a huge role in eliminating disparities between different jurisdictions. But there is still more work to be done.

Is the market's demand for real-time information keeping companies focused on the short term?

Activist investors are targeting companies where they perceive an opportunity for them. They clearly have concerns about the way some companies have operated, especially when focusing on short-term opportunities. Companies have to be prepared to respond to and address the significant challenge of striking the right balance between short- and long-term objectives. When companies focus only on the long term,

they can lose accountability and they lose something like their adrenalin. Companies that focus too much on the short term don't invest for the long run. So, it's about balance and defining some points of reference so everybody knows where the organization stands. That's crucial in an organization with hundreds or thousands of employees who could very easily end up on a different page.

Is today's volatile environment making it harder for companies to find that balance?

In an environment where companies are pulled in every direction, it's important that they define their own strategy. Management and the board need to set the values and approach for the company. In this kind of environment with so much noise, you need very clear points of reference, values, goals, and principles. Fundamental things, like values and culture, become very important.

Years ago, I was a member of a group that was given the job of defining the values of the company I worked for. We surveyed the company and created a values framework, which was then adopted and deployed. The most important thing was the company leaders committed to living those principles and values, and that had a huge impact. Everyone clearly understood the values of the company, and it made decision making very clear; we knew

what the right choices were, based on the company's values. So I think organizational leaders need to have a set of values to guide their decisions; otherwise they'll end up getting pulled in every direction, never moving the needle forward on an initiative.

What opportunities do you see for organizations in 2016?

Diversity is a huge opportunity. In the US, diversity is about ethnic and gender diversity, and that's important because the role that immigrants play in the economy is huge. But diversity is more than ethnicity and gender. All of us are different in our socioeconomic levels, personalities, strengths, weaknesses, fears, ambitions, styles, education, and training. So there is a source of openness and solutions when you harness that diversity within a business.

Diversity is at the center of generating more risk-taking, a greater sense of entrepreneurship, and an attitude of renewal. Diversity also helps to eliminate the "not invented here" syndrome and drive innovation; build consumer and employer engagement; and attract, integrate, and get the most out of the right talent with their full commitment to and full engagement in the task at hand. Diversity is a hugely underutilized tool that will be absolutely essential for addressing the challenges we're facing.

Diversity also goes beyond corporate social responsibility. The real action and real leveraging of diversity to create solutions will come when companies and boards see a clear business case for diversity. That will come when diversity is converted from a "good thing to do" or the "right thing to do" into a business case around "what we need to do" to grow and evolve. Some companies are already doing that. They are coming to recognize diversity as a business strategic pillar.

A lot of what we've discussed impacts strategy. How well are boards keeping focused on strategy?

I'm concerned that boardroom discussions on strategy are suffering a lot in terms of the time the board can devote to this topic. We are in a world of greater risk—reputational risk, risk of technological disruption, risk of international events that affect the global environment—so boards have to spend more and more time on those risks and challenges. That's important, but it shouldn't come at the cost of time spent reflecting on, discussing, challenging, and testing the organization's long-term strategy. In a disruptive environment where people and events are trying to pull the organization in different directions, organizations need to have a clear long-term strategy that sets the long-term direction that keeps them focused.



Proactive engagement helps build shareholder loyalty



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Many companies are becoming increasingly proactive in engaging with their shareholders, which may be a result of a variety of factors including legislation giving shareholders a greater voice in companies' activities (such as "say on pay" in the US), quasi-regulatory initiatives like the European Union's Shareholder Rights Directive, and increasing activism.

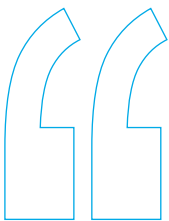
In 2015, just under three-quarters of CFOs of large North American companies said they had experienced some form of shareholder activism, often in the form of communication with management and the board, and sometimes in the form of proposals sent directly to shareholders. In addition, about half of the CFOs said they made at least one major business change specifically because of shareholder activism, including share repurchases, leadership changes or divestitures.¹³

Some activist campaigns are aggressive and public, including proxy contests and attempts to force a major company transformation or change the composition of the board or management. On the other hand, some activist hedge funds have taken more passive positions in companies, signalling to the market with their investment that they believe the company is already on the right track with its change of direction, while still being in a position to step in to get the company back on course if its redirection begins to falter.¹⁴

Many other activist interventions are extremely discrete. Often, activist approaches are friendly ones that do not get reported by the media, such as when a shareholder approaches a company with a point of view on how capital should be deployed or opportunities to enhance value.¹⁵

Companies that proactively engage with their shareholders can better ensure that shareholders have the information they need to build trust and credibility between the company and shareholders. Good engagement practices also provide the company and board with valuable feedback about shareholders' priorities and concerns.

Management, through the company's Investor Relations (IR) function, has traditionally provided "education" for shareholders on the company's performance, operating results, long-term strategies, principal business risks, competitive positioning, and other matters. However, the IR function might not be well positioned to engage with shareholders on governance issues. Some companies have implemented a governance function, often through the corporate secretary or general counsel, to lead engagement on governance matters, and boards are increasingly taking a heightened role in directly engaging shareholders, especially on topics such as executive compensation and board composition.

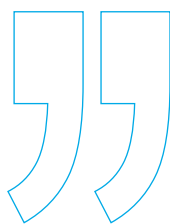


Today's investors are highly engaged. They have positions on the environment, diversity, remuneration, and more. They want their voices heard when they interact with or hold shares in a corporation and they want to see that the corporation shares their values.

—Christoph Schenk

In the UK, there is a separate board chair and CEO as well as a senior independent director, which gives shareholders three different routes to express their viewpoints. It also means the company has three leaders playing a proactive part to meet with and engage shareholders.

—Stephen Cahill



With the responsibility for shareholder engagement shared among different groups, it is important that these groups' activities are coordinated and supportive of each other so shareholders don't receive contradictory information about the company. Accordingly, boards may wish to create a shareholder engagement policy that provides a framework for discussion with shareholders, identifies who within the company should engage shareholders on a given topic, and sets out a process for addressing specific concerns. Such a policy may also set out the timing for engagement. Engaging shareholders outside the annual meeting season allows for better quality engagement, which helps to build mutual trust and respect.



Questions for directors to ask

1. What role does management and the board play in maintaining an ongoing dialog with the organization's largest shareholders? What are their primary concerns? Do we, as a board, consider and respond to those concerns appropriately?
2. How often does management brief the board on its monitoring of shareholder opinion and its outreach to key stakeholders? Does the board have a clear understanding of the opinions and concerns of our shareholders and other stakeholders concerning the organization, its strategies, and business activities?
3. Does the board understand the organization's vulnerabilities—the decisions and actions it has taken that are most likely to attract the attention of activist shareholders? Are we prepared to defend these decisions with a fact-based assessment of their value?

Opinion: Is it time to bring corporate reporting into the 21st century?



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By Stacey Nagle and Al Donald

Three years ago, Deloitte Canada started a comprehensive, ongoing review of the current corporate reporting framework and initiated discussions with board directors, analysts, institutional investors, and preparers. The initial reports in the series examined how public companies could be more effective in delivering useful information to the market and how they could better inform investors using the current reporting model. This article is based on the third report, published in late 2015, entitled “Is more less? Exploring a new world of corporate reporting. Part 3: Looking to the future.”

Today’s stakeholders crave information. They want to be able to clearly understand an organization’s governance policies, performance, business objectives, strategy, and key risks. They also want their voices heard and want to know that organizations share their views on environmental concerns, social responsibility, and management remuneration—among other matters.

Although information about companies, such as their performance, is included in regulatory disclosures, investors have often indicated that additional or refocused disclosures would be more useful. For example, a survey of 290 investment professionals by the CFA Society of the UK found that 60 percent of the respondents believe financial reports contain too much irrelevant information, while at the same time 55 percent stated that financial reports also omit important information.¹⁶

Perhaps one reason why corporate reporting doesn’t always meet shareholders’ needs is that the corporate reporting model is built on rules and regulations established in the aftermath of the 1929 stock market crash. While there have been new regulations

introduced since then, the legacy model is primarily rooted in making comprehensive and periodic disclosures to all stakeholders through the controlled distribution channels and delivery systems that were available over 80 years ago.

Perhaps the model would be improved if organizations were to use plain language (rather than legal jargon and boilerplate text), better prioritize the information they provide, standardize and define the non-GAAP measures that they utilize, and make better use of technology (such as searchable text, links, and tags).

A new model of corporate reporting

What if the legacy model and patchwork solutions were put aside and corporate reporting was redesigned? The aim of a good corporate reporting model should be to produce reports that communicate a clear, succinct story about how the organization is managing its resources to create value over time. Among the various worldwide initiatives to improve corporate reporting in recent years, the integrated reporting framework has gained the most traction because it’s being viewed as a step forward. Maybe we could go even further to effect fundamental change.

An ideal model might contain five key elements:

- **Integration**—Reporting should exhibit a strong connection of vision, strategy, and performance to value-creation activities and corporate responsibilities.
- **Proper balance between detail and frequency**—Reporting should be comprehensive at times with indicators of progress and performance released more frequently.
- **Standardized performance measures**—Reporting of key and relevant metrics for a particular industry segment would provide more transparency and usefulness to stakeholders if such measures had a standard definition and meaning within that industry.
- **Technology-enabled documents**—Embedding technology in the reporting framework—tagged text and links to relevant supporting information, for example—would allow report users to easily obtain and manipulate data as it suits their unique interests. Paper-based documents (e.g., PDFs) don't have this functionality.
- **Support long-term growth**—Reporting should emphasize long-term value creation through innovation and investment, and progress against these. This would reduce the focus on the achievement of short-term value realization.

The legacy corporate reporting model was suited to an era of slower change when past performance (value realization) was a strong indicator of future performance. That's still important for demonstrating how an organization realizes its opportunities. However, in today's economy, the past alone may no longer be the best indicator of future success. In an environment characterized by rapid change and disruption, other metrics and measures may provide better indicators of how a business is positioned for future success. These indicators relate to the organization's focus on, and ability to create, future value (value creation). Perhaps the best approach would be to measure and report both value-creation metrics and indicators as well as value-realization metrics to give stakeholders a more comprehensive picture of the organization's past performance and future prospects.

Corporate reporting is not only about the information that is shared, it's also when, how, and where that information is shared.

With stakeholders looking for more frequent, useful data, should companies begin sharing key value-creation metrics—just the indicators—on a more regular basis? That could give the organization the opportunity to more quickly correct any misinformation in the marketplace. And by including forward-looking metrics, they could avoid the impulse to chase short-term targets.

With such disclosures, the use of quarterly reports—which are often challenged as to their usefulness—could change. Quarterly reports tend to focus on short-term profit performance, which can distract from long-term revenue and earnings potential. Our research also indicated that interim reports take companies too long to prepare, while for stakeholders, they arrive too late to be of timely use.

Another consideration for organizations: bring the distribution of their financial news into the 21st century. For decades they have relied on news releases distributed over newswires to be picked up by traditional media. In today's world, social media is a faster and more efficient way to communicate with a greater number of people—and regulators recognize social media, such as Twitter and Facebook, as legitimate channels for conveying information to the public. Tweets might convey key news with a link to supplemental material, such as a press release or financial report in PDF form. Facebook updates could be longer and also link to additional documents.

Is it time to bring corporate reporting into the 21st century? We think so, but we also realize that changes to the corporate reporting model won't happen overnight. Hopefully, this article will provide some options for directors to consider for improving the quality and usefulness of their organization's disclosures.

Creating a sustainable tax strategy



Heather Evans

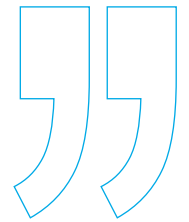
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The global reset around tax is a significant business issue for enterprises with multinational operations. Corporate tax affairs are very much in the spotlight, not just for tax authorities but also for investors, other stakeholders, some politicians, the media, and NGOs. The impacts will differ from one organization to another, and organizations must ensure that they are maintaining their competitiveness. Managing expectations may be a significant challenge since varying expectations can put pressure on the business.



–Heather Evans

Multinational organizations have been attracting a lot of critical public scrutiny in recent years, with concerns expressed that they are not paying their “fair share” of tax in all of the jurisdictions in which they operate. Business leaders have been called before government commissions in different countries in order to defend their tax strategies. Investors and other stakeholders have raised concerns about the reputational risks created by this negative publicity, and the resulting potential impact on the long-term success of their organizations.

In light of these and other concerns, in 2013 the G20 asked the Organisation for Economic Co-operation and Development (OECD) to create an Action Plan on Base Erosion and Profit Shifting (BEPS). This multilateral exercise to modernize what

is perceived as an outdated and complex international tax framework that is no longer suited to today’s global business economy represents the most significant change to international tax principles in a generation. BEPS is intended to eliminate tax mismatches, align profits to where value is created, and enhance transparency for tax authorities across the global landscape.

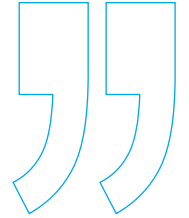
The OECD released the final reports for its 15-point BEPS Action Plan on October 5, 2015, outlining a series of policy reforms that cover, among others, transfer pricing, perceived tax treaty abuse, permanent establishments, and patent box regimes. Over the next few years, the G20 and other countries will begin adopting the BEPS reforms in their jurisdictions.

Some countries have already started implementing their own tax measures. Two pieces of legislation have been introduced in the United States Congress—the *Corporate Fair Share Tax Act* and the *Putting America First Corporate Act*—which would prevent corporations from using tax inversions to reduce their US tax burden. Several other countries, including Australia, Chile, China, France, and the United Kingdom, have enacted legislation to limit or prohibit certain tax activities in their jurisdictions. Country-by-country reporting on transfer pricing is expected to be implemented in many jurisdictions in 2016.

For organizations with multinational operations, the changing global tax landscape is much more than just a tax issue—it is a business issue with wide ramifications. The new rules and increased scrutiny by investors and the general public could potentially impact profitability, the effectiveness of business models, competitive positioning and, ultimately, share prices and brand. Since different organizations have different business models and operating structures, the BEPS rules may impact one organization more or less than another. This could be particularly important to the board, since there may be a greater impact on their organization's earnings per share relative to its competitors if it has taken greater advantage of tax planning opportunities, and that could potentially translate into a greater negative swing in its share price.



Boards need to consider their organization’s approach to tax strategy in the context of the organization’s stakeholders—shareholders, employees, suppliers, customers, and governments of the jurisdictions in which the organization operates—and their expectations.



—Piet Vandendriessche

The board’s role

Tax is an important issue for directors. A board must have a good understanding of its organization’s tax practices, including legacy practices, as well as the associated risks—for example, whether the organization’s current or past tax activities were audited by tax authorities and how that may be perceived by the organization’s stakeholders.

The board and the organization should also have an understanding of the developments occurring at the OECD and elsewhere. Having an advanced line of sight into these developments is important to give the organization sufficient time to adapt, if necessary, to new tax proposals—something that can be difficult for multinational organizations with complex structures to do in a short timeframe.

While an organization’s effective tax rate is an important consideration, the board must also consider the potential risk of reassessment and its associated costs, as disputes are increasing between jurisdictions over which one has the right to tax particular income streams. Reputational risk should also be considered and whether or not the organization’s tax strategies are consistent with its overall positioning and branding. Boards should consider the impact that the organization’s tax strategies have on its competitive position and be comfortable that the organization’s tax policy is sustainable.

Organizations may want to consider discussing tax as part of their investor relations programs.



Transparency is also an increasingly important consideration. The board should be involved in assessing voluntary disclosures about the organization's tax policies and practices, since such disclosures may enhance the organization's reputation and help build investor confidence. For example, a board may choose to make public the organization's structure and the general tax implications related to that structure, and the board's role in overseeing tax policy, including the way the board engages in that role, and the type of consultation it undertakes. Also, a board may choose to separately disclose all of the taxes that the organization pays beyond income tax to provide a better perspective on its total contribution to the governments and societies where it operates.

Questions for directors to ask

1. Do we understand our organization's tax position, both in our home jurisdiction and in other countries in which we operate? Are we comfortable with where the organization has positioned its tax practices?
2. In light of BEPS developments, should the reporting methodology employed by management in informing the board about the organization's tax practices and relevant tax developments be updated?
3. What changes to our tax policy and business model should we consider in order to be sure that our organization is aligned with BEPS initiatives and other new tax rules enacted in the jurisdictions in which our organization operates?
4. How will BEPS and other new tax developments impact our share price? How does this compare with our competitors?
5. Have we examined our legacy and current tax strategies in light of the way they may be perceived by our stakeholders? Is there a risk that they may be misunderstood and will have a negative impact on our reputation? If so, are we prepared to respond? Have we considered the potential financial impact of such reputational challenges?



Dr. Deenadayalen (Len) Konar



Dr. Deenadayalen (Len) Konar

Dr. Deenadayalen (Len) Konar has over 20 years' experience as a public company director in South Africa. He currently chairs the boards of directors of Steinhoff International Holdings Ltd., Exxaro Resources, and Old Mutual Investment Group. He is a member of the board of directors of Illovo Sugar, Sappi, and six other organizations. Dr. Konar is a member of the King Committee on Corporate Governance and the former professor and head of the Department of Accountancy at the University of Durban, Westville.

What are the big picture concerns of the boards you sit on?

The boards I sit on are generally concerned with company- and country-specific issues as well as externalities over which they do not have any influence, such as exchange rates or global economic issues. For example, South Africa has an export-based economy, and I sit on the boards of some commodity companies. For these companies, the slowdown in the Chinese economy and the drop in commodity prices is a major concern because we've got fixed costs of production and that creates some important issues to manage, such as bank covenants, the health of our balance sheets, and the need to husband our resources.

Are activist investors a concern?

Shareholder activism is certainly alive and kicking in South Africa, and it's not just hedge funds but also institutional shareholders that are looking for a balanced board, stable, ongoing earnings, sustainability, and cash flow by way of dividends. They are also scrutinizing the board, the leadership of the chair, and the governance practices—whether or not they meet best practices in terms of holding a regular number of meetings—that they are fit for purpose, that the board is sufficiently skilled, that the non-executive directors are independent, that they portray a cohesive story

around strategy, and that they have an appropriate focus on not just the short and long term but also the medium term.

People are looking to companies to generate value. They want to see that the entities that they invest in are responsible and that they take these issues to heart, while recognizing that they cannot be intimately involved with the day-to-day management of the entity. They do want to see a sufficient separation between the board and the executive management and that they are mindful of what their governance responsibilities are.

What impact have activists had on companies?

Activist investors provide the impetus for companies to move away from short-termism. For example, it takes a mining company seven to eight years to bring a mine into production; it takes about the same amount of time for an electricity utility to build and commission a power station. Companies need to measure and manage investors' expectations over that period of time and they need to provide credible information that stands the test of scrutiny. In the short term, companies need to convey the progress of the entity vis-à-vis their business plans; over the longer term, they need to deliver the results and show an accretion in total shareholder value as well as distributions from the entity.

How big a concern is reputational risk to your boards?

As Warren Buffett says, it takes 20 years to build up a reputation and five minutes to lose it. From a governance point of view, boards need to be aware of the top-line risks and how they can affect the organization's reputation. I chair three boards in South Africa, and reputational risk is a standing item on our agenda. We need to be aware of the things that could go wrong, for example a cyber attack or for a mining company, a fatality at a mine, and be assured that the investor relations department and other organizational leaders are in a position to respond to a crisis and manage any potential reputational damage professionally and in a timely manner.

Our boards also have media relations companies to provide us with their expertise, and our standing policy is that if a crisis situation occurs, we will tell the truth consistently, without any spin. For example, if there was an environmental problem, we would acknowledge that problem and outline the reparations and remediation that we would undertake.

Today, reputation management is a high-level item. Companies need to guard their reputations jealously because you don't want the company and the board to be in the position of having to react to something they didn't foresee.

Boards need to be aware of emerging risks and volatile situations, such as changing perceptions and regulations around taxes and transfer pricing. Boards need some awareness of potential "black swans." Boards and senior management should also receive training in managing a crisis and managing the organization's reputation from reputable agencies that have been established for that as well as for risk-specific purposes.

Many companies consider business model disruption to be their top strategic risk. What impact has it had on your boards?

Today, no industry is immune from disruption, which can be both a tremendous risk and a huge opportunity, and it is something that boards need to pay close attention to. The boards I sit on have all looked at the organization's business model to consider where it was vulnerable and where there were opportunities for us to innovate.

Let me give you an example. I'm a member of the board of Illovo Sugar, which is Africa's largest sugar producer. Because of the impact India, Thailand, and Brazil were having on sugar production and the taxes being imposed on sugar, we realized that our business was becoming disrupted and so we needed to diversify. Instead of being 100 percent reliant on sugar, we also started producing syrup, and we've diversified further still. We looked at molasses and started producing furfural and furfuryl alcohol. In Swaziland, we looked at the sugarcane bagasse (a by-product of the sugarcane industry) and we now put it into a boiler to generate electricity, which we upload to the system for a guaranteed minimum tariff per hour.¹⁷

Here's another example. I sit on the board of Sappi, which produces paper and pulp in North America, Europe, and Southern Africa.

We saw that its business was becoming disrupted because the paper industry is declining; with electronic communications, people are using less paper. The company needed to be repositioned, and now the majority of its business—60 percent—is in cellulose production, compared to 40 percent in paper and packaging.



Dr. Deenadayalen (Len) Konar

Cellulose has a wide variety of uses, from the garment industry, to automobile upholstery, packaging for fruit and vegetables, medicine boxes, and so on.

Boards and management need to spend time addressing disruption. From the board's perspective, it needs to be engaged with management, and directors should visit the company's business units to ensure they understand the business and its risks and opportunities. The boards I sit on spend three to five days each year visiting some part of the companies' operations, which we choose on an annual basis. The directors visit the business units and talk to the people working there. We also look at the industry and our competitors and what they are doing. When you serve on a board, you have to be alert, you have to be active, and you've got to stay ahead of the curve.

I've sat on boards where we've removed some directors because they were lethargic and they lacked passion. Directors need to be thinking about when and where the next wave is coming.

CEO tenures are becoming shorter and shorter. What should boards be looking at in this area?

The board is responsible for selecting and ensuring that the CEO is fit for purpose. Boards are also responsible for overseeing strategy, the organization's business plans, holding people to account and ensuring that there is compliance with laws and regulations, and managing the organization's reputation. I think boards need to look at all of these things together.

CEO tenures have become shorter because people are impatient and they want results quickly, and that leads to short-termism. But as a balance to that, the organization needs a well thought out strategy for the long term.

It's absolutely imperative that boards take time in looking at CEO selection as well as succession planning within the organization. If they get that right, and the company has a sustainable business plan (which may need to be modified tactically from time to time) and the company's executives are delivering on that plan, then the board should have a reasonable degree of certainty that the CEO will meet expectations and the company will withstand the disruptions that may shorten a CEO's tenure. Consider Apple, for example. Three years ago, when Steve Jobs died, how confident were people about Apple's future? Yet look what it has accomplished under Tim Cook's leadership—the iPhone 6, self-driving motorcars, AppleTVs and so on. A good CEO and a well thought out strategy is what organizations need to seize the opportunities and move forward.

The regulatory regime continues to increase. Is that having a negative impact?

I'm supportive of regulations because I think we need to have certain norms and standards. In the health care industry, for example, we need to ensure that the products released into the market are safe. I don't want to deal with people who are less than honest so something like FATCA really appeals to me. Sarbanes-Oxley required an enormous compliance expense, but now it's functioning and it's been embedded into risk management systems and internal controls.

But while I think regulations are highly desirable, they shouldn't act as a deterrent on the autonomy and the flexibility of business. Regulation needs to be managed. If we had global regulations as far as governments or foreign corrupt practices are concerned, I would buy in to that. And some jurisdictions may need to make it fit for purpose, but in international companies, what you do at head office should be

drilled down into all of the jurisdictions and territories in which you operate.

What will you and your boards be keeping an eye on in 2016?

There are a wide range of things that boards need to be aware of.

There is weather and climate change, and extreme weather in particular. Related to that is a concern about resources and, in particular, water. There are droughts in California and Texas, and a drought in South Africa, so water shortages are something we need to keep a close eye on. In a similar vein, I think we need to be concerned about food security and the provision of food, and we also need to be concerned about waste and how we're disposing of waste.

Energy and energy efficiency is also an important issue. Boards need to look at what the company is doing around energy efficiency, use of renewables, etc.

We need to consider the future of jobs and the way people work and where they work. Some companies want people to work in the office, but some people prefer to work remotely. Companies need to find the right workplace model. We also have to consider the impact of the Millennials and their expectations.

Another big issue for boards is health and wellness. South Africa is the third most obese nation in the world. As a director, I insist that the top leadership of the company have an annual health check because I need to know whether or not my executives are fit.

Another concern for me, which I'm raising at the board, is the aging population. What will be the impact of that on our markets, on social security systems, and on health care systems?

Safety and security is becoming an even greater concern than it has been since 9/11. We've seen what has happened in Paris, and we need to be mindful of that and from an entity-specific point of view.

Perhaps the most important issue for me is education, and specifically how do we, as individuals, retool ourselves? I believe in continuous education and learning so that I stay at the cutting edge of what I do.

I think all of these issues present both opportunities and challenges, and I think there are business cases to be made for each of them.



Today, no industry is immune from disruption, which can be both a tremendous risk and a huge opportunity, and it is something that boards need to pay close attention to.

—Dr. Deenadayalen (Len) Konar

How cyber savvy is your organization?



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It's no longer a matter of whether a cyber breach will occur; it's when it will occur if it hasn't already. Globally, in the first half of 2015, more than 245 million data records were stolen by cyber hackers every single day—or 16 records per second.¹⁸

Cyber attacks are becoming more sophisticated and harder to investigate and contain. Advanced Persistent Threats (APT), for example, are low-key attacks that slowly siphon off critical data and are difficult to detect using traditional methods.

Cyber attacks come in various forms:

- **Data breaches**—stealing an organization's data or manipulating it so the organization can no longer trust it.
- **Cyber crimes**—the theft of data, such as credit card information, that hackers use for their own financial benefit.
- **Acts of sabotage**—denial of service or other attacks that literally shut down the organization.
- **Espionage**—attacks on the industrial or economic security of the organization.

Cyber attacks are inevitable, and often the attackers are already inside the organization's network.



In addition to the immediate disruption created by a cyber crisis, a cyber attack often leads to drawn-out litigation, regulatory actions, ongoing operational disruptions, an impaired ability to execute strategy, and increased insurance liability—all of which diminish corporate value. It's not surprising, then, that cyber security is an increasingly important oversight responsibility for directors, and one with personal implications for members of the board. Following some cyber breaches, shareholders have called for the removal of directors or have filed derivative lawsuits against them. Class action lawsuits are also becoming more common following a cyber breach.

The bad news is that the problem is likely to become worse because every organization has a growing number of cyber risks. For example:

- Organizations are linked with others in their ecosystem through their supply chains that, to function effectively, require sharing of information among the ecosystem partners. Each of these links introduces vulnerabilities.

- Cyber espionage and data theft are becoming commonplace in mergers and acquisitions where hackers attempt to gain financial or operational intelligence to use as leverage in the negotiations or to devalue one of the organizations in the transaction.
- Employees often utilize their own personal digital devices to access an organization's data—an entry point whose security depends largely on the cyber awareness and care employees take with their devices both in and out of the workplace.
- A growing number of companies and individuals are taking advantage of the cost-effective and convenient alternative of cloud technologies—something that is equally convenient for cyber criminals and malicious actors.

Building a cyber secure organization

It has been said that an organization's cyber security is only as strong as its weakest employee, since cyber hackers look for naïve, uneducated, or untrained employees to provide them with an entry point into their employer's network.

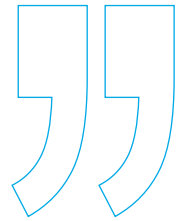
Boards need to assume that their organization's information network either has been, or soon will be compromised and they need to realize that cyber security isn't a zero tolerance issue—in other words, attacks will happen despite the organization's best efforts. The key is how quickly and effectively the organization responds to cyber threats and attacks. The board has a key role to play in ensuring that management is building a cyber savvy organization.



—Harry Raduege

In today's environment, with the widespread use of technologies, you can't be a responsible board member and not be concerned about cyber security. Boards need to inquire about the organization's cyber strategy, what information the organization exposes to third partners, and the security of the organization's ecosystem.

—Tse Gan Thio



Hackers will use bogus email accounts designed to look as if they were sent by a friend or co-worker, which, when opened, will upload malicious software (malware) to the organization's networks. Free gifts, such as thumb drives that are generously handed out at trade shows and other events, could also contain malware. Employees who use their digital devices to access unsecure WIFI could unknowingly be giving access to hackers.

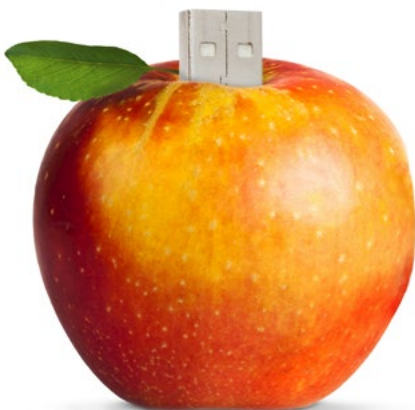
In this environment, organizations need to build a culture of data security—a process that should be led by the board and management and needs to involve more than just the IT department. Today, organizations need their entire workforce to be cyber savvy to ensure that they continuously operate in a secure, vigilant, and resilient environment.

Secure—Many organizations have spent significant amounts of time and money on traditional security controls and preventative measures, and most likely that investment will need to be increased in the future. Despite this, it is impossible to protect everything equally.

Organizations need to focus on their “crown jewels”—the mission critical data that they absolutely must protect. Organizations must also know the cyber hygiene of their partners and authorized connections—contractors, vendors, and suppliers—who may be security allies or liabilities. It's important to think in terms of the information supply chain, and decide who will or will not be allowed to access the information network.

Vigilant—Being vigilant means being cyber savvy. Awareness of cyber risks needs to be a priority for everyone within the organization, and for every one of its external partners. Cyber vigilant organizations build, maintain, proactively monitor, and test their cyber defense. When hackers attempt to gain entry or other suspicious events occur, the organization needs to respond appropriately to fend off the intrusion, and also learn from it so it can adjust its business and technology environment accordingly.

Resilient—Inevitably, some cyber intrusions will succeed so organizations need a crisis management strategy and cyber risk management plan that enables them to respond and recover quickly. (See the article on crisis management on page 32.)



Cyber security and the board

Boards of directors need to challenge management's assessment of the organization's cyber posture and critically review the cyber crisis management capabilities that management has put in place.

The board may also want to review its own processes for providing oversight of cyber security. For example, the board may want to expand the charter of the board-level committee responsible for overseeing cyber risk to include how the organization allocates resources in managing cyber risk. Another consideration may be to create a board cyber chair to oversee management's activities and ensure that senior management is appropriately focused on cyber security.

Boards may also want to establish a cyber risk process that defines cyber risk management priorities for the organization and outlines mechanisms of accountability. The board may also want to have access to its own cyber security experts.

Questions for directors to ask

1. What is our organization's cyber footprint? What information do we deliver? What channels do we use to deliver that information? What information do we share with third parties? Are we confident that our supply/information ecosystem is robust enough to protect information and data throughout the chain?
2. How well does the board understand cyber risk? Should the board engage outside experts to educate directors on cyber risk, how to mitigate it, and the signs that might signal a breach? How often does the board receive reports or updates from the people responsible for monitoring cyber risk?
3. What are our "crown jewels"—the critical information that, if compromised, would undermine our organization's ability to continue operations? How do we protect this information?
4. Does our organization have an overall enterprise cyber strategy and cyber risk management plan? Do they have both proactive and reactive components? Has management established working relationships with local law enforcement? Does our management team conduct regular cyber assessments and cyber security scenario planning exercises?
5. Is our organization able to detect a compromise early? What controls have been put in place? How do we know those controls are operating effectively? Have they been validated recently? How many actual breaches have we had, how well did we respond to them, and what did we learn from them?
6. In mitigating our risk, do we have cyber insurance? If so, what is the extent of our coverage?

Uncovering the unforeseen advantage in a crisis



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Four out of five business leaders expect that their companies will experience a crisis in the next year, yet barely half of them say they have a plan to deal with it.¹⁹

Most organizations are prepared to deal with higher probability events. It is when they encounter something blindsiding and unanticipated that they often flounder—usually in full view of the media. And, with the prevalence of social media and modern communication technologies, crisis situations can come about and escalate quickly. If the organization is without a disciplined crisis management plan and response capability, individuals will act independently, often complicating the crisis rather than helping to resolve it. On the other hand, organizations that do have a robust crisis management plan may be able to unlock unforeseen advantages created by the crisis, potentially emerging from it stronger than before.

While all organizations face operational challenges on a daily basis, a corporate crisis is something different, typically involving reputation, share price, major litigation, regulatory sanctions, or a threat to the organization's existence and the value of its brand. Sometimes, recognizing a corporate crisis is easy, particularly in the case of a rare, unexpected, catastrophic "black swan" event. At other times, recognizing when

operational issues end and a corporate crisis begins is more difficult, particularly when a rolling series of modest-sized operational issues cascade into a crisis—for example, a product failure harms an organization's reputation, which, in turn results in decreased sales that lead to reduced revenues and then greater financial problems.

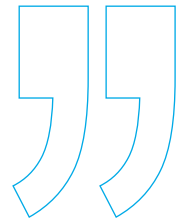
Preparing for the worst

The experience gained from addressing tough operational issues isn't sufficient when dealing with a crisis. When a crisis occurs, organizations need to be able to quickly shift information flows and decision making from the normal pace of everyday business to being able to make decisions at high speed while operating under a high degree of uncertainty and ambiguity.

The board should ensure that the organization has a crisis management plan that defines crisis management procedures, sets out key roles and responsibilities, identifies required information management processes, and defines decision-making protocols, communications, and coordination requirements. The plan should identify the individuals who will act locally—on the ground—and those who will be responsible for communicating with key stakeholders, such as suppliers, employees, shareholders, regulators, and other authorities.

The board needs to ensure that the organization and its leaders have the awareness and capability to deal with everything from operational interruption incidents to catastrophic value-killer events and that the right capabilities are in place—the systems, processes, and leadership training—to address the problem, and to ensure that the organization recovers from it.

—Graeme Newton



Boards must also ensure that the organization’s crisis management plan is well rehearsed and that the rehearsals address a variety of scenarios. It is particularly important that senior management—including the CEO—participate in the crisis management rehearsals since, in most cases, they will have the responsibility for managing the crisis, and will need to do so in the full spotlight of public and media attention. The board should also attend and observe the crisis management training sessions, both to satisfy itself from a governance perspective with the quality of the exercise and also to keep things on edge, ensuring that people do it right and that things don’t degenerate into a “check the box” exercise.



The key to crisis management planning and training is to focus on what matters to the business: the key enablers that allow it to deliver its business strategy—key people, leadership, technology, data, facilities, etc.—that, if compromised, would interrupt the organization’s ability to operate. Crisis management training should be based on scenarios that simulate compromises to these key enablers.

The purpose of crisis management training is to:

- Ensure that senior management and the board will quickly understand and

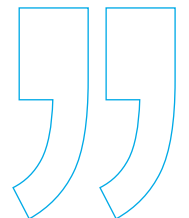
address the key challenges created by the crisis, including understanding the consequences of the crisis and how they will affect the organization’s business and its strategy going forward.

- Determine whether the organization can manage around these challenges and, if so, how.
- Decide on the messages the organization needs to deliver and to whom, as well as knowing what should and should not be said.



The board’s role isn’t to manage the crisis. Instead, its role is to support management with oversight and the strategic vision that focuses on the implications of the crisis in the near, mid and long term and how the organization will emerge from the crisis. And when a crisis does occur, the board should ensure that the organization learns from it and takes the opportunity for improvement to allow it to emerge stronger than it was in the past.

—Fernando Picatoste



The role of the board in a crisis

The board's primary responsibility in a crisis begins before a crisis occurs: ensuring that there is a full suite of awareness tools and capabilities within the organization to deal with interruption and emergency-type incidents, as well as unexpected catastrophic events, and that the right people, with the right training, will be in the right roles.

The CEO normally has the frontline responsibility for managing a crisis (in rare situations, for example, if the CEO is unable to act on behalf of the organization, the board chair may need to assume a more hands-on role in managing the crisis). The board's role is usually to provide counsel and support to management and to communicate with key stakeholders, such as employees, customers, suppliers, regulators, and other authorities. During a crisis, the board, an appointed board-level committee or a hybrid committee consisting of management and board members should oversee the CEO's crisis management activities and focus on the continuing operations of the organization. By focusing on "what recovery looks like," the board can help ensure that decisions taken in the short, mid, and long term all contribute to maintaining the long-term strength of the organization and its brand.

Questions for directors to ask

1. Does management have a robust crisis management plan for the organization? Does the plan cover the role the board will play in supporting executive leadership, the board's information needs, how the board will exercise governance and oversight during a crisis, and the support the board will require to carry out its responsibilities?
2. Is the organization's crisis management plan supported with adequate training that utilizes different crisis scenarios? Does senior management, including the CEO, attend the training? Does the board attend the training sessions? Is the board satisfied with the quality of the plan and training?
3. How confident is the board that the organization's leaders will be able to stand up to the pressure of the crisis and act effectively as leaders?
4. In the event of a crisis, does the board have a pre-populated crisis committee? Has the board identified directors with expertise in specific roles, such as legal, accounting, audit, public relations, or specific industry issues? Does the board have outside counsel and other third parties to provide crisis management support? Should the board seek director candidates with crisis experience when filling vacancies?
5. What processes have been put in place to ensure that the board receives timely, accurate information during a crisis? Have alternate information channels been pre-identified in the event that normal communication channels are disrupted by the crisis?

Jeffrey R. Williams



Jeffrey R. Williams

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What are some of the top concerns facing the boards you sit on?

Three big concerns come immediately to mind.

One is cybercrime. A lot of organizations think they don't have a cybercrime problem—until they do. When they hear about an incident, their reaction is "we're not like that company, so we'll be okay." The reality is everybody's at risk, and you can't predict the nature of the attack. Because this is moving so fast, having a truly productive conversation about cybercrime is difficult. Board members naturally are not cybercrime experts. Auditors have been helpful, but this is still a very large issue for companies to manage effectively.

A second issue is the broad question of risk. Like cybercrime, risk is terribly difficult to focus on before you see it, which makes categorizing and defining the risks facing an organization an ongoing yet difficult exercise. On a positive note, in financial institutions, the industry is now fairly well practiced at defining the different risk categories it faces. But, as the financial crisis showed, recognizing risk and managing it effectively are two different things.

The third is regulatory change. Here there are two main issues. First, when regulations change, this creates both

opportunities and challenges to the business. Second, and this is especially true in China, when there are many regulatory requirements, there's a danger of the board and management getting involved in form-filling instead of really thinking through business compliance issues. The more time the board spends on meeting regulatory requirements per se, the less time it has to focus on what really matters to the business.

Could you elaborate on the regulatory issues in China?

China is moving away from being a highly regulated economy to one that is more market-oriented, and that's a challenge for boards. It creates more freedom of decision for boards and management, which is something many boards will have to get used to. In the past, financial companies were highly constrained by regulation, but now more and more they have to learn how to make their own choices. It means focusing less on form and more on function.

You also mentioned risk. Today, risks seem to be escalating with serious potential to affect an organization's reputation.

Knowing the risks the organization faces and must manage is critical. Reputation risk has to be on that list, near the top. So the first question to ask is: does the board consider reputation risk, and how

specifically does the organization manage that risk? I think the answer to that comes down to values; you can't have a reputation if you don't know what your values are.

Today, I do feel that what is considered to be acceptable corporate behavior globally has deteriorated. I built my career in the financial industry, which of course is highly regulated. In recent years, I've seen many companies agree to settlements for a range of regulatory and legal violations, which 20 years ago would have led immediately to changes in senior management, and a great deal of soul searching by the board. Now, "gaming" the regulations seems to be just part of business as usual. I don't consider this progress.

Reputational risks are rising, and management and the board cannot be complacent. Boards have to start working with management to define the kind of organization they want to be and then stick to that. The way you know you're living up to your values is demonstrated in the way you behave when something bad happens.

There is also a lot of attention being paid to companies and their tax practices. Are they managing this issue well?

In the discussion about taxes and jurisdiction shopping the reality is: governments hold out tax incentives to attract investment and create jobs when a company locates in its jurisdiction. From the board's perspective, it has a fiduciary duty to act in the best interest of the shareholders, and if moving a headquarters to a tax advantaged jurisdiction would significantly benefit the shareholders, it's difficult to argue that the board shouldn't approve that.

I think companies need to do a better job of explaining the value they deliver to society, including why certain financial arrangements that benefit a company are worthwhile because of the other benefits that company can provide to society. Too often, though, companies are reactive and passive when these issues arise. Businesses need to make a better case for business and the capitalist system. In this debate, the discussion always seems to focus on the extractive nature of capitalism. What gets ignored are the constructive benefits of investment, innovation, growth, new products, new jobs, and new industries, all of which benefit society and which the capitalist system can deliver better than any other system.

Some say interim reports keep companies focused on the short term. Do you believe this is true?

Boards look at the interim numbers as a way of keeping tabs on the business. Once those reports are distributed around the boardroom, wider disclosure is inevitable and the company had better disclose them in a systematic fashion.

A large part of the investment community, pension funds for example, is long-term focused. But another big constituency in the investment community is very short-term focused; they trade in and out on these announcements. The concern about the balance between short and long term can, in part, be explained by the relative power of the players in the capital market and what they're emphasizing.

When boards put too much weight on short-term performance, and if the share price has a big impact on senior management's compensation, inevitably management will side with the short-term traders. So, to me, the villain isn't short-term reporting; the villain

Jeffrey R. Williams

is created by what you communicate to the market and how you set management's compensation.

Again, this comes back to how the company communicates to the market. Does it communicate what the interim figures mean relative to the long-term progress of the company?

One challenge to the longer-term prospects of many companies is the rate of disruption in the market today.

No matter what industry you are in, the Internet enables the creation of new business models that turn existing industries on their ear. If an Internet strategy is not at the very top of the agenda for management and for the board, you're going to have a problem because disruption is very real.

Disruption doesn't only result from technological change. In my experience in financial services, government makes reforms every year that both tighten the rules, and also liberalize the market by providing new licenses. That's also disruptive; if a new opportunity or area is opened up for the organization or its competitors, you have to run to capture that opportunity or fend off that competitive challenge, and those changes sometimes come with very little warning.

All organizations need to constantly ask: what could come into play to dramatically

change what we do? It is something that every industry has to think about.

With CEO tenures continuing to shrink, how should boards manage this?

Under normal circumstances, I'm not in favor of going outside the organization for a CEO. For middle management, yes, bring in new talent; it's helpful for the company to get new ideas if you get the right hires. At the top, however, I prefer transitions from within the company or from among people that are known. I'm personally skeptical of the ability of head hunters and search committees, even with a very rigorous process, to guarantee a fit. I believe you don't really know a person until you work with him or her, and the great advantage of having a leadership pipeline is that the qualities of potential successors are known. When you groom talent internally, you know who you have and what their qualities are before you make the decision to put them in charge. The one caveat to this is when there is a crisis; maybe then the best thing is a splash of cold water—getting somebody from the outside can be a good thing.

This is an area where Chinese companies can do a better job. They have a challenge because the larger state-owned companies have powers above the board who are also planning for succession and their choice often isn't communicated to the board until the time comes.



Boards and board members have limited time, so with society and regulators demanding that boards get involved in greater and greater detail against the chance that there might be a mistake or an accounting problem, we risk ending up with boards that don't have any time left to actually help develop the company.

—Jeffrey R. Williams

On the other hand, I recently experienced a CEO transition, which went extremely well, because the new CEO and chairman came from within the company, which meant a minimum of disruption to a successfully running business.

What do you see as being a major challenge facing boards in the years ahead?

An issue for all boards is the disconnect between what the media and public at large think the role of the board is, versus what boards actually can and should do. The public believes that boards act as a policeman, needing to watch management at all times. The board does have a role as a watchdog and to double-check, ensuring the audits are complete,

accounting policies are appropriate, and ethical standards are in place. But this is not the board's only role. The more important role is to guide the strategy, to coach the CEO in achieving that strategy, to ensure that succession plans are in place, to ensure that the management isn't only focused on short-term gains, and to think deeply about risk and the firm's long term development. Boards and board members have limited time, so with society and regulators demanding that boards get involved in greater and greater detail against the chance that there might be a mistake or an accounting problem, we risk ending up with boards that don't have any time left to actually help develop the company.



Appetite for success

As directors prepare for 2016 and set their priorities related to the governance issues facing their organizations, they should also consider allocating time to discussing the issues presented in this publication.

Governance issues continue to grow in number and complexity with many of them evolving rapidly, such as the growing threat of cyber attacks, the disruptive potential of new and emerging technologies, and the increasing proliferation of social media and other alternative communications channels. Even areas that have long been a focus of attention for boards of directors, such as the need to ensure that their organization has access to top talent, are changing. Meanwhile, the global regulatory environment is also changing, placing its own new demands on boards and organizations.

While the issues facing boards continue to grow, boards have a finite amount of time to address them. Boards, therefore, need to ensure that they continue to

allocate sufficient time to the areas where they can contribute the greatest value to the organization. In that regard, individual directors must devote greater time to preparing for board meetings and gaining a full understanding of the issues to be discussed. And, with the evolution of these issues, ongoing director education—which has always been a leading practice—is even more important.

As directors face the governance challenges of 2016, they may wish to consider some of the take-aways found earlier in this publication, some of which include:

- Ensuring that the organization has a robust program for engaging shareholders to understand shareholders' expectations.
- Reviewing the organization's tax practices for transparency and ensuring they appropriately balance the needs of stakeholders, including the communities in which the organization operates.

- Making cyber security a top issue for both the board and management to address. Cyber attacks are growing in number and sophistication, and organizations need to keep current with the latest developments to protect themselves.
- Being fully prepared to manage a crisis—many organizations have faced a crisis, sometimes with devastating results. Organizations that manage a crisis well, however, could emerge with a stronger brand and improved customer loyalty.
- Building the workplace of the future—today's employees are looking for a different kind of workplace experience and all organizations must compete for top talent, which means many may need to recruit from outside their traditional talent markets.
- Ensuring that the organization's strategy is agile and continues to be aligned with the market to keep the organization ahead of the curve.



Resources

Want to dig deeper? We've selected the following Deloitte Points of View to help you better identify potential risks and opportunities these issues present for your organization.

Corporate reporting

Is more less? Exploring a new world of corporate reporting (Deloitte Canada, 2015)

Crisis management

Around the Board Room: Connecting Insights on Digitally Driven Boards (Deloitte Netherlands, September 2015, in Dutch)

Crisis Leadership: Five Principles for Managing the Unexpected (Deloitte & Touche LLP in the US, July 2015)

Focus on: Building crisis-ready boards (Deloitte Global, August 2015)

The Future of Supervision (Deloitte Netherlands, August 2015)

Focus on: The board's-eye view of cyber crisis management (Deloitte Global, July 2015)

Cybersecurity

Cyber Security Survey: Increase your business security and resilience (Deloitte Canada, December 2015)

Cyber Risk: Getting the boardroom focus right (Deloitte UK, May 2015)

Cyber Security: everybody's imperative (Deloitte Canada, March 2015)

Cyber threats and the Board's role in curbing it (Deloitte India, April 2015)

Cyber Security: The changing role of audit committee and internal audit (Deloitte Singapore, September 2015)

Digital Directors: The board's role in the cyber world (Deloitte Singapore, August 2015)

Five essential steps to improve cybersecurity: Trekking toward a more secure, vigilant, and resilient organization (Deloitte Canada, April 2015)

Responding to cyber threats in the new reality: A shift in paradigm is vital (Deloitte Singapore, May 2015)

Innovation

Age of disruption. Are Canadian firms prepared? (Deloitte Canada, April 2015)

Case studies in funding innovation (Deloitte University Press, October 2015)

Directors' Cut Survey 2015: Board Effectiveness (Deloitte Australia, August 2015)

Deloitte on Disruption (Deloitte & Touche LLP in the US, June 2015)

Disruption in the mid-market: How technology is fueling growth (Deloitte LLP in the US, September 2015)

Responsible tax

Base Erosion and Profit Shifting: Is your organization ready for the global tax reset? (Deloitte Global, October 2015)

BEPS global survey: Base Erosion and Profit Shifting 2015 (Deloitte Global, May 2015)

Global Tax Reset: the changing world of tax (Deloitte Global, October 2015)

Shareholder engagement

Board Refreshment: Addressing Shareholder Concerns (Deloitte LLP in the US, January 2015)

CFO Insights: Activist Shareholders: How will you respond? (Deloitte LLP in the US, June 2015)

Proactive engagement: Opportunity to build stronger relationships (Deloitte Global, September 2015)

Strategy

Driving corporate growth through social impact: Four corporate archetypes to maximize your social impact (Deloitte Consulting LLP in the US, September 2015)

Risk Sensing: The (evolving) state of the art (Deloitte Global, October 2015)

Strategy, Risk Oversight Are Lead Areas of Board Room Focus (Deloitte & Touche LLP in the US, May 2015)

Talent

Global Human Capital trends 2015 (Deloitte University Press, April 2015)

Machines as talent (Deloitte University Press, February 2015)

Managing talent in the new world (Deloitte Global, June 2015)

Talento 2020. Un liderazgo que inspire (Deloitte Mexico, February 2014, in Spanish)

Which two heads are better than one? How diverse teams create breakthrough ideas and make smarter decisions (Deloitte Australia, December 2015)

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