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On the board's agenda | US

The 2020 boardroom agenda: More topics, more oversight

Introduction

The role of the board of directors and its committees is rapidly and constantly expanding. New matters seem to arise all the time, and the board is viewed, in the court of public opinion if not in courts of law, as being responsible for everything the company does or does not do. As both a result and an example of this perception of the board's role, it is not surprising that when anything negative happens to a company, the first question asked is often "Where was the board?"

There are many items that have been on the board's agenda for many years. These include oversight of risk, strategy, and executive compensation. At the same time, a number of items appearing on board agendas in recent years have taken up more of the board's time and attention. These include board composition, culture, and shareholder engagement. And the newest items that boards are grappling with include challenges such as the role and responsibilities of the company in society and sustainability, which itself includes topics ranging from environmental concerns to employee activism and more.

This edition of *On the board's agenda* discusses some of the matters expected to occupy much of the board's attention and time in 2020. This list is not all-inclusive, nor should it be, as there are many matters that will be the subject of board focus, as well as a wide range of new matters that will likely arise and command the board's attention.

Center *for* Board Effectiveness

Corporate social purpose, sustainability, and employee activism

Perhaps the most dramatic development—or, rather, series of developments—that boards may need to consider in 2020 is the intense focus on the role of the corporation in society. Starting in late 2017, companies have been urged to focus on and disclose more about their "social purpose" and their place in society. Several theories have been advanced as to the origins of and continuing pressure for corporate social purpose, including concerns about persistent economic inequality, climate change, and the availability and cost of healthcare, as well as concerns about the ability of governments to address these and other issues.[1] However, regardless of the reasons, investors, media, and other constituencies are asking companies to look beyond their bottom lines.

This trend gained significant traction in 2019, when the Business Roundtable published a "Statement on the Purpose of the Corporation,"[2] signed by the CEOs of more than 180 companies, committing to delivering value to customers, employees, suppliers, and communities—in addition to stockholders. The so-called "BRT Statement" has generated extensive comment, including opposition from some institutional investor groups who believe that stockholder value should be the "North Star"—and in some cases the only star—by which corporations should be evaluated. The departure from stockholder value may also be inconsistent with the corporate laws of many states, including Delaware, where so many companies are incorporated.

Despite these uncertainties, as well as arguments that companies create value for stockholders by addressing the needs of these other stakeholders, companies are feeling pressure from employees, customers, investors, and others to have a positive social profile.

In a related area, Environmental, Social, and Governance (ESG), sometimes included in the broader term "corporate sustainability," has also garnered the attention of investors and others, who are increasingly asking whether and how companies are affecting and affected by environmental and social developments. For example, in the environmental area, companies are being asked whether they are likely to be affected by carbon reduction and, if so, how? What about scarcity of water and other natural resources? What are they doing to address these and other matters? And social issues are no less prominent. Are companies providing their workers with safe and harassment-free workplaces? Do the employees have career paths? And what are they doing to retain valued employees in a period of nearly full employment, particularly when so many younger workers are espousing the "gig" economy, frequently switching jobs as new opportunities come along?

And investors are not the only ones expressing concerns. The rise of employee activism during 2019, with actions such as work stoppages and shareholder proposals, has increased the stakes in these and other areas.

Companies are being called upon by investors and others to provide disclosures concerning the ESG challenges they face and how they address those challenges. Some of that pressure has resulted from the rise of third parties—including so-called "rankers and raters"—who comment on companies' efforts in this area, making it important for companies to tell their stories rather than let someone else do so. Boards need to determine how best to exercise oversight of this area as well, including whether a committee (and, if so, which committee) or the full board should be responsible for this area.

The above and many other examples of social pressure constitute a major risk to corporations. However, the concerns associated with social pressure also present a great opportunity to companies. For example, a company with a strong positive reputation may find it easier to attract and retain employees, and higher degrees of customer loyalty, than one that raises negative perceptions in the minds of its stakeholders. In any case, in 2020 boards will almost certainly need to consider their corporations' actions in this new environment.[3]

1. See the 2019 Edelman Trust Barometer Global Report, at https://www.edelman.com/sites/g/files/aatuss191/files/2019-02/2019_Edelman_Trust_Barometer_Global_Report.pdf.
2. https://opportunity.businessroundtable.org/wp-content/uploads/2019/12/BRT-Statement-on-the-Purpose-of-a-Corporation-with-Signatures.pdf.
3. See "On the board's agenda—The board's role in corporate social purpose" at https://www2.deloitte.com/content/dam/Deloitte/us/Documents/finance/us-on-the-boards-agenda-industry-july.pdf

Technology

For the past several years, there has been a steady and growing drumbeat of concern with security and other risks created or exacerbated by technology. Just as noted previously with respect to sustainability and other "social purpose" matters, technology creates opportunities as well as risk. In fact, a company that shuns technology, whether due to concerns with its risk or otherwise, is likely to be disrupted or made obsolete. Consequently, technology is increasingly becoming the driver of many items on the board's agenda.

Some of the technologies that are driving board discussions are artificial intelligence (AI), which has the potential to handle a wide range of matters currently addressed by people; finance transformation, which will make financial information available in real time and enhance the predictive nature of financial statements; and the Internet of Things, or IoT—devices that handle tasks without the need for human intervention.

These and other technologies have the potential to disrupt every business enterprise, large and small. As a result, boards need to consider many aspects of technology:

- The technologies the company is using, and whether they are adequate for current and future performance
- New and emerging technologies that may be useful or even mission-critical or may provide others with the ability to disrupt the company or render it obsolete
- Ethical considerations associated with technology, such as unintentional bias arising from the use of algorithms and other forms of artificial intelligence
- The resources available to stay current with, and even ahead of, technological change, including the technological ability of the workforce

Technology can also be a critical factor in the success or failure of M&A transactions, as the acquisition of a company whose technology is incompatible with existing technologies can disrupt operations and create financial reporting and other compliance problems.

Technology is not only a driving factor in the board's oversight responsibility, but also a significant topic in terms of board composition.

Board composition

There is good news on the board diversity front: Statistics demonstrate that boards are becoming more diverse. For example, 26 percent of S&P 500 directors are women, up from 24 percent in 2018 and 16 percent 10 years ago, and more boards—92 percent of the S&P 500—now include two or more women.[4] Another milestone was achieved in mid-2019, when for the first time, all of the S&P 500 companies had at least one female director.[5]

However, while gender diversity has improved, some challenges remain. For example, the numbers for racial and ethnic diversity are generally lower those for gender diversity.[6] And there is evidence of so-called "recycling," which is the rate at which individuals serve on more than one board—meaning that a limited number of women and minority directors are joining additional boards. Higher recycle rates for women and minorities mean that while diversity may be increasing, the absolute number is lagging.[7]

Another major challenge is that "demographic" diversity is only part of the story. The right mix of skills is also critical. And the skills needed to guide a 21st-century corporation seem to keep increasing. Developing a comprehensive matrix of the skills needed on the board, aligning the board members' skills and experiences with those reflected in the matrix, and thoughtful self-evaluations and honesty in evaluating each board member's contribution to the company and the board can be helpful in achieving the right mix.

Given the ever-increasing role that technology plays as a source of both risk and opportunity, one area of particular concern is the need for "tech-savvy" directors—directors sufficiently conversant with technology to guide their companies through those risks and opportunities.[8] In 2019, bipartisan bills were introduced in both the House and the Senate directing the Securities and Exchange Commission to issue rules requiring public companies to disclose which board member has expertise or experience in cybersecurity, or if no member has such expertise or experience, to describe what other company cybersecurity aspects were taken into account by the board for identifying and evaluating nominees for the board.[9] However, there may be valid reasons for not having a tech "expert" on the board, including concerns that an expert in one field might not have the broader business sense and experience needed for board service.[10]

4. 2019 Spencer Stuart Board Index.
5. https://www.wsj.com/articles/the-last-all-male-board-on-the-s-p-500-is-no-longer-11564003203
6. Source: Missing Pieces Report: The 2018 Board Diversity Census of Women and Minorities on Fortune 500 Boards, published on January 16, 2019 by the Alliance for Board Diversity and Deloitte.
7. Ibid
8. See "On the board's agenda—The tech-savvy board—a director's perspective" at https://www2.deloitte.com/content/dam/Deloitte/us/Documents/center-for-board-effectiveness/us-center-for-board-effectiveness-on-the-boards-agenda-the%20tech-savvy%20board.pdf and "Deloitte Insights—The tech-savvy board" at https://www2.deloitte.com/content/dam/insights/us/articles/5194_the-tech-savvy-board/DI_Technology-and-the-boardroom.pdf. Also see the discussion below.
9. https://www.govtrack.us/congress/bills/116/s592 and https://www.govtrack.us/congress/bills/116/hr1731
10. See the related discussion in "On the board's agenda—The tech-savvy board—a director's perspective" cited in note 8.

Board composition is not likely to diminish as an area of focus for boards and their nominating/governance committees, in part due to pressure from investors, whose voting policies increasingly call for votes against members of nominating/governance committees and even all directors when board composition does not comply with those policies. In addition to factors such as diversity and skill mix that focus on the board as a whole, investors are focusing on factors impacting individual directors, such cases where a director serves on multiple boards, and whether such "overboarded" directors have the time and capacity to do their jobs. Possibly because of these and other factors, voting results continue to show declines in votes in favor of board candidates; according to *The Wall Street Journal,* 478 public company directors failed to win the support of a majority of voted shares in 2019, up 39 percent from 2015.[11]

Regulation, politics, and geopolitics

While regulation and political and geopolitical matters have long been factors in the matters considered by the board, they seem to be moving closer to the forefront of board focus. For example, boards of agricultural and manufacturing companies, among others, are addressing the impact of tariffs and other global trade issues; international political uncertainty can have great impact on cross-border M&A transactions and geographical expansion; and domestic political uncertainty can have a significant effect upon capital allocation and other major areas of board oversight.

For US companies, politics can have a more direct impact in terms of regulation, ranging from tax to disclosure. In the latter regard, public company boards may need to recalibrate their actions if recent proposals by the Securities and Exchange Commission are enacted. In August 2019, the SEC proposed to require companies provide disclosure about strategy—a topic never previously addressed in SEC disclosure rules—and human capital management.[12] Among other things, companies may need to consider their policies in these and other areas given the exposure they would receive as a result of enhanced disclosure. Similarly, the SEC has issued interpretive guidance and proposed new rules that would effect changes in dealings with proxy advisory firms and shareholder proposals; boards may need to decide how these policies and rules, if adopted, might change their companies' dealings with those firms and proposals.

Other areas

As noted at the outset, the topics discussed above are just a few of the many issues with which boards of directors may need to tackle in 2020. Some others include:

- **Corporate culture:** The emergence of corporate social purpose as a major issue in 2019 does not mean that corporate culture is no longer a matter of interest to boards, investors, and other corporate constituencies. In fact, some investors are seeking somewhat granular information regarding how the board (or its committees) can best oversee culture. One particular area of concentration in this regard is the culture of the boardroom itself; do directors treat each other with respect? Are all board members contributing to the conversation? Is full and free discussion encouraged within the boardroom, or is there a tendency to "shoot the messenger" when problematic issues are raised? Is the board's culture aligned with the company's culture?
- **"Bread-and-butter" governance issues:** Boards and investors have been discussing, and in some cases debating, a number of structural governance issues for a very long time. These include board leadership—for example, whether the positions of board chair and CEO should (or must) be separated and whether the board chair should (or must) be independent. These long-term discussions, however, have not resulted in a consensus; as a result, shareholder proposals on the topic continue to be submitted and continue to receive substantial favorable votes, even when they are not approved. More recently, boards and investors, particularly of startup companies, have questioned the advisability of so-called "dual-class" structures, in which founders or other early-stage investors should be able to perpetuate voting control, to the exclusion of public investors.

Conclusion: Increased board effectiveness and strategic oversight

The abundance, or possibly overabundance, of issues that the modern board needs to address, a few of which are discussed above, is itself a topic of discussion in the boardroom and is likely to loom larger in 2020. Given the limited time that boards have to address issues old, new, and emerging, they are increasing the scrutiny of their own procedures and practices in order to be as efficient and effective as possible. Traditional board assessments, often perfunctory, are increasingly becoming substantive deep dives into how the board does its work, the optimal allocation of responsibility as between the board and its committees, and the suitability of each director to effectively execute his/her responsibilities, among other areas. And boards are also acting on the results of these self-assessments, changing the way they do things, ranging from developing more user-friendly agendas and pre-reads to replacing less relevant board skills with the skills needed today and tomorrow.

Another byproduct of the breadth and depth of board responsibilities is a heightened degree of oversight of corporate strategy and risk. The era of the annual board retreat followed by little or no oversight of strategy is being replaced with more active oversight, where strategy and risk are discussed at every meeting and, where necessary, boards are seeking or supporting changes in strategic plans and the ways in which they are implemented.

These and other actions speak to the increased commitment of many boards and are positive signs for board effectiveness and efficiency in 2020 and beyond. At the same time, the topics referred to in this piece demonstrate that new risks, and new aspects of existing risks, are emerging all the time. Consequently, boards need to be vigilant, staying informed in order to remain effective.

11. See https://www.wsj.com/articles/corporate-board-elections-getting-a-little-less-cozy-11570532400.
12. See https://www.sec.gov/news/press-release/2019-148.

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