



On the 2022 board agenda

KPMG Board Leadership Centre



As organisations focus on reopening and repositioning for the future, it is increasingly clear that resilience – of strategy, the organisation, and operating muscle – is proving to be the great differentiator of the pandemic era. From pivoting to “remote everything” and focusing on workforce well-being to deepening digital engagement with customers and recalibrating supply chains, the ability to quickly adapt to dramatic disruptions and dislocations has defined the survivors and thrivers.

The unprecedented events of the past two years have clearly put corporate governance processes, including board oversight, to the test. Demands for action on ESG performance, including climate risk, increased cybersecurity risks (including ransomware attacks), economic and supply chain challenges, a fast-changing regulatory landscape, and other factors impacting the global risk environment will continue to challenge even those boards at the top of their game.

In short, boards are at a pivotal moment. As one director recently observed, the need for today’s boards to help their company “reimagine, rethink, and reset is probably a once-in-a-generation opportunity.”

Drawing on insights from our latest survey work and interactions with directors and business leaders, we highlight eight issues here for boards to keep in mind as they consider and carry out their 2022 agendas.

Deepen the board’s engagement in strategy and in envisioning the future

Given the volatile and fluid business environment ahead – managing remote workforces, employee activism, digital transformations and other accelerating megatrends, building more-resilient supply chains and strengthening connections with customers whose behaviors, preferences and expectations are changing – take time to reassess the board’s engagement in strategy. Review the alignment of corporate purpose, culture, values, and strategy. And identify specific practices to drive quality boardroom discussions about strategy and the future.

A fundamental question for every board is whether boardroom conversations are, in fact, conversations. Does the board allocate sufficient agenda time to meaningful, *two-way* discussions between management and the board about forward-looking issues – challenging assumptions and considering scenarios (likely and unlikely) – versus reviewing historical, compliance-related information which, while essential, can crowd-out valuable agenda time.

Effective engagement in strategy discussions (which investors expect) increasingly calls for a collaborative mindset: How can the board help management think-through the implications of pressing and potentially existential strategic questions and decisions? And is management helping to set the context, providing meaningful materials to the board to prepare directors for those critical conversations and maximise the board’s contribution?

In our discussions with experienced directors over the past year, a number of elements and practices were highlighted that may be helpful:

- Encourage management to revisit the strategic planning process. Is the process adequate in light of the speed and impact of megatrends – and does it capture the risks and potential disruptions on the horizon? Does the process challenge the validity of key assumptions that the company’s strategy and business model are based on? Is it an iterative process – with milestones and opportunities to recalibrate – and does it bring in perspectives from throughout organisation, beyond the inner team?
- Develop a vivid picture of the future. This is never an easy undertaking, and it’s particularly challenging today, given the level of uncertainty and transformational changes underway. Where are the company’s industry and competition (both industry competitors and those in adjacent industries) headed? What might the business look and feel like in two, five, or ten years? Make time for the board to have meaningful “what-if” discussions in a focused and urgent way – including devoting time to less-likely scenarios (without getting overly theoretical). Risks and scenarios related to climate, ESG, human capital, and supply chain should be front and centre.

- Make resilience part of the strategy discussion. *Full resilience* is not only the ability to bounce back when something goes wrong; it's also the ability to stand back up with viable strategic options for staying competitive and on the offense.
- Understand the value of the board's lens. Management is immersed in running the business, looking around the corner and staying competitive – as they should be. Board members are likely picking up broader perspectives and signals from their activities – and may be seeing and hearing things differently than management.

Embed ESG, including climate risk and diversity, equality and inclusion (DEI) issues, into risk and strategy discussions

How companies address climate change, DEI issues, and other ESG risks is now viewed – by investors, research and ratings firms, activists, employees, customers, and regulators – as fundamental to the business and critical to long-term sustainability and value creation. Expect the intense regulatory focus on these issues to continue in 2022.

The clamor for attention to climate change as a financial risk has become more urgent, driven by a confluence of factors, the most visible of which is the accelerating physical impact of climate change – including the frequency and severity of floods, wildfires, rising sea levels, and droughts – as well as concern by many experts that the window for preventing more dire long-term consequences is rapidly closing. Related to climate risk are the “transition risks” that companies face as they work – in conjunction with countries, regulators, and other stakeholders – to reduce reliance on carbon and the impact on the climate. The Task Force on Climate-related Financial Disclosures (TCFD) defines these transition risks as “risks associated with the transition to a lower-carbon economy, the most common of which relate to policy, tax, and legal actions, technology changes, market responses, and reputational considerations.” A challenge for boards is to help ensure that these transition risks are properly addressed by management – together with other climate change risks.

Monitoring the rapidly changing legal and regulatory developments regarding climate change is critical as regulators and policy makers globally are placing greater demands on companies to take action – as evidenced by the recent COP26 summit which brought parties together to accelerate action towards the goals of the Paris Agreement and the UN Framework Convention on Climate Change.

Investors are looking to boards to address diversity and inclusion too. It has been widely reported that last year Legal and General Investment Management (LGIM) wrote to FTSE100 nominations committee chairs to put them on notice that they will vote against their reappointment “if they fail to meet expectations on ethnic diversity”.

Several fundamental questions should be front-and-center in boardroom conversations about the company's ESG journey. After determining which ESG issues are of strategic significance. How is the company embedding them into core business activities (strategy, operations, risk management, incentives, and corporate culture) to drive long-term performance? Is there a clear commitment and strong leadership from the top, and enterprise-wide buy-in?

Oversight of these risks and opportunities is a significant challenge, involving the full board and potentially multiple board committees. For example, elements of climate, ESG, and DEI oversight likely reside with the audit and remuneration committees – and other committees, like an ESG or sustainability committee, may have responsibilities as well. Overlap is to be expected, but this puts a premium on information sharing and communication and coordination among committees. It also requires that committees have the expertise to oversee the issues delegated to them.

Engage proactively with shareholders, activists, and other stakeholders

Given the intense investor and stakeholder focus on climate risk, ESG, and DEI, particularly in the context of long-term value creation, engagement with shareholders *and* stakeholders should be a priority. Institutional investors and other stakeholders are increasingly holding boards accountable for company performance and are continuing to demand greater transparency, including direct engagement with independent directors on big-picture issues like strategy and ESG. Indeed, transparency, authenticity, and trust are not only important to investors, but increasingly to employees, customers, suppliers, and communities – all of whom are holding companies and boards to account.

To best understand the views of its key stakeholders, the board should request periodic updates from management as to the effectiveness of the company's engagement activities:

- Does the company engage with, and understand, the priorities of its largest shareholders and key stakeholders?
- Are the right people engaging with these shareholders and stakeholders – and how is the investor relations (IR) role changing (if at all)?
- What is the board's position on meeting with investors and stakeholders? Which independent directors should be involved?

In short: Is the company providing investors and other stakeholders with a clear, current picture of its performance, challenges, and long-term vision – free of “greenwashing”? (Investors, other stakeholders, and regulators are increasingly calling-out companies and boards on ESG-related claims and commitments that fall short – and all indications are that they will continue to do so.)

Strategy, executive remuneration, management performance, climate risk, other ESG initiatives, DEI and human capital management, and board composition and performance will remain squarely on investors’ radar during the 2022 AGM season. We can also expect investors and stakeholders to focus on how companies are adapting their strategies to address the economic and geopolitical uncertainties and dynamics shaping the business and risk environment in 2022.

Having an “activist mind-set” is as important as ever – particularly given the new form of shareholder activism seen with the success of Engine No. 1, a small activist hedge fund, against a major oil company in Summer 2021. By linking climate and environmental issues to profits and long-term value creation, Engine No. 1 won the support of the major institutional investors in winning three board seats and influencing the strategic direction of the company. It remains to be seen whether this will inspire a wave of ESG campaigns in the future, but many are speculating that it will.

Make talent, human capital management, and CEO succession a priority

The events of 2020-2021 further highlighted the strategic importance of human capital management (HCM) issues – including those employee and supply chain health and safety issues that are critical to the company’s performance and reputation.

Institutional investors have been increasingly vocal about the importance of human capital and talent development programs and their link to strategy – including calling for more-engaged board oversight and enhanced disclosure of HCM-related metrics.

Consider management’s processes for developing HCM-related metrics and the controls for ensuring data quality – and help ensure that the disclosures demonstrate the company’s commitment to critical human resources issues.

In 2022, we can expect continued scrutiny of how companies are adjusting their talent development strategies. The challenges of finding, developing, and retaining talent, amid a labor constrained market has created a war for talent. Does the board have a good understanding of the company’s talent strategy and its alignment with the company’s broader strategy and forecast needs for the short and long-term? Which roles throughout the organisation are mission critical, and what are the challenges keeping those roles filled with engaged employees? Which talent categories are in short supply and how will the company successfully compete for this talent? Does the talent strategy reflect a commitment to DEI at all levels?

More broadly, as millennials and younger employees – who increasingly choose employers based on alignment with their own values – join the workforce in large numbers and talent pools become globally diverse, is the company positioned to attract, develop, and retain top talent at all levels?

Pivotal to all of this is having the right CEO in place to drive culture and strategy, navigate risk, and create long-term value for the enterprise. The board should ensure that the company is prepared for a CEO change – whether planned or unplanned, on an emergency interim basis or permanent. CEO succession planning is a dynamic and ongoing process, and the board should always be focused on developing a pipeline of potential CEO candidates as well as all other C-suite positions. Succession planning should start the day a new CEO is named.

How robust are the board’s succession planning processes and activities? Is the nomination committee reviewing the plans at least once per year – but likely more often in these uncertain times? Are succession plans in place for other key executives? How does the board get to know the high-potential leaders two or three levels below the C-suite – especially in a work-from-home environment when office visits and board-executive in person meetings may not be feasible?

Approach cybersecurity and data privacy holistically as data governance

The rapid shifts that companies have made during the pandemic to keep their businesses up and running – remote work arrangements, supply-chain adjustments, and increased reliance on online platforms – have been a boon to organised crime, hacktivists, and nation-states. Cyberattacks of all types proliferated during the pandemic, highlighting the far-reaching implications for supply chains and operations, as well as the ongoing cybersecurity challenge facing companies.

Boards have made strides in monitoring management’s cybersecurity effectiveness – for example, with greater IT expertise on the board and relevant committees, company-specific dashboard reporting to show critical risks, and more robust conversations with management. Despite these efforts, the acceleration of digital strategies, remote work and hybrid work models, increased regulatory scrutiny of data privacy, and the growing sophistication of cyber attackers all point to the continued cybersecurity challenge ahead.

As we’ve noted, data governance overlaps with cybersecurity, but it’s broader. Data governance includes compliance with industry-specific privacy laws and regulations, as well as privacy laws and regulations that govern how personal data – from customers, employees, or vendors – is processed, stored, collected, and used. Data governance also includes the company’s policies and protocols regarding data ethics – in particular, managing the tension between how the company may use customer data in a legally permissible way and customer expectations as to how their data will be used.

Managing this tension poses significant reputation and trust risks for companies and represents a critical challenge for leadership.

To oversee cybersecurity and data governance more holistically:

- Insist on a robust data governance framework that makes clear how and what data is being collected, stored, managed, and used, and who makes decisions regarding these issues.
- Clarify which business leaders are responsible for data governance across the enterprise – including the roles of the chief information officer, chief information security officer, and chief compliance officer.
- Reassess how the board – through its committee structure – assigns and coordinates oversight responsibility for both the company’s cybersecurity and data governance frameworks, including privacy, ethics, and hygiene.

Reassess the company’s crisis prevention and readiness efforts

The litany and severity of crises that companies have found themselves facing in recent years looms large, with crisis prevention and readiness now featuring more prominently than ever in boardroom conversations. Crisis prevention goes hand-in-hand with good risk management – identifying and anticipating risks, and putting in place a system of reporting and controls to help prevent or mitigate the impact of such risk events.

We’re clearly seeing an increased focus by boards on cultural risks as well as key operational risks across the extended global organisation – e.g., supply chain and outsourcing risks, information technology and data security risks, etc. Does the company understand its critical operational risks, including “mission critical” company and industry risks?

What’s changed in the operating environment? Has the company experienced any control failures, and if so, what were the root causes? Is management sensitive to early warning signs regarding safety, product quality and compliance?

Periodically reassess the clarity and appropriateness of risk oversight responsibilities among the board’s committees – being mindful to not overload the audit committee’s agenda and recognising the importance of good communication and coordination among committees, as certain risks likely touch multiple committees.

Help ensure that management is weighing a broad spectrum of what-if scenarios – from supply chains and the financial health of vendors to geopolitical risks, natural disasters, terrorist acts, and cyber threats.

Is the company’s crisis response plan robust and ready to go? Is the plan actively tested or war-gamed – and updated as needed? Does it take into account the loss of critical infrastructure – e.g., telecommunications networks, financial systems, transportation, and water and energy supplies? Are there communications protocols to keep the board apprised of events and the company’s response? Even the best-prepared companies will experience a crisis; but companies that respond quickly and effectively – and with a robust communication strategy – tend to weather crises better.

A final, important reminder from the COVID-19 pandemic experience: While management should keep the board apprised throughout a crisis, the board should avoid information requests that unduly add to management’s workload and potentially distract the CEO and management team from mission-critical activities.

Help set the tone and closely monitor the culture of the organisation

The events of 2020-2021 have increased the risk of ethics and compliance failures, particularly given the increased fraud risk due to employee financial hardship and the pressure on management to meet financial targets. Closely monitor the tone at the top and culture throughout the organisation with a sharp focus on behaviors (not just results) and yellow flags. Is senior management sensitive to human resource issues, particularly the pressures on employees (both in the office and at home), employee health, safety and well-being, productivity, engagement and morale, and normalising work-from-home arrangements? Does the company make it safe for people to do the right thing?

Headlines of sexual harassment, price gouging, aggressive sales practices, and other wrongdoing continue to put corporate culture, leadership, and incentives front and center. With the near-instantaneous speed of social media, corporate crises (particularly when self-inflicted) are hitting corporate reputations fast and hard, with investors, regulators, and others increasingly asking, “Where was the board?”

Given the critical role that corporate culture plays in driving a company’s performance and reputation, we see boards taking a more proactive approach to understanding, shaping, and assessing corporate culture. Have a laser focus on the tone set by senior management and zero tolerance for conduct that is inconsistent with the company’s values and ethical standards, including any “code of silence” around such conduct. Be sensitive to early warning signs, and verify that the company has robust whistle-blower and other reporting mechanisms in place, and that employees are not afraid to use them. Closely monitor the reporting systems to understand how claims are addressed and resolved, and identify trends. If the company has a sizeable workforce and few or no claims, the board should dig deeper.

Understand the company's *actual* culture (the unwritten rules versus those values employees are supposed to adhere to); use all the tools available – surveys, internal audit, hotlines, social media, virtual town halls as well as walking the floors, and visiting facilities – to monitor the culture and see it in action. Recognise that the tone at the top is easier to gauge than the mood in the middle and the buzz at the bottom. How does the board gain visibility into the middle and bottom levels of the organisation? Make sure that incentive structures align with culture and strategy and encourage the right behaviors. Take a hard look at the board's own culture for signs of groupthink or discussions that lack independence or contrarian voices. Focus not only on results, but the behaviors driving results.

Think strategically about talent and diversity in the boardroom

Boards, investors, regulators, and other stakeholders are increasingly focused on the alignment of board composition with the company's strategy – with diversity front-and-center.

Indeed, the increased level of investor engagement on this issue highlights investor frustration over the relatively slow pace of change in boardrooms, and points to the central challenge with board composition: a changing business and risk landscape. Addressing competitive threats and business model disruption, technological innovation and digital changes, climate and ESG risks, cyber risk, and global volatility requires a proactive approach to board-building and board diversity – of skills, experience, thinking, gender, and race/ethnicity.

Notably, 69% of the directors we surveyed in Ireland recently said their board's composition would be (moderately or completely) different if they were able to rebuild it to best meet the company's needs for today and the future. And more than 50 percent expressed concern that a lack of diverse views in the boardroom "hampers insightful discussions or identification of blind spots and issues important to the company's future."

Thanks to initiatives like the FTSE Women Leaders Review – some progress has been made in terms of women on boards. However, corporate Britain has not made enough progress in other areas to take a more holistic approach to equality including women in

Expect continued legislative and regulatory action on board composition and diversity. For example, commenting on its 2021 research into board ethnic diversity, the FRC declared "most UK companies' approach to board ethnic diversity is unsatisfactory". The FRC found that over half of FTSE 250 companies fail to mention ethnicity in their board diversity policy, with most of the FTSE 350 failing to set measurable ethnicity targets. Just 14 percent of FTSE 100 companies set similar measurable objectives for their boards.

Board composition, diversity, and renewal should remain a key area of board focus in 2022, as a topic for communications with the company's institutional investors and other stakeholders, enhanced disclosure in the company's annual report, and most fundamentally positioning the board strategically for the future.

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