KPMG

On the 2021 private company board agenda

KPMG Board Leadership Center

COVID-19, recession, extreme weather events, deep-seated social unrest, and an increasingly polarized global community all paint a picture of a daunting and opaque business and risk environment for the year ahead. Global volatility – driven by trade and geopolitical tensions, resurging debt, technology and business model disruption, elevated cyber risk, regulatory scrutiny, and political gridlock – will add to the challenge. The pressure on employees, management, boards, and governance will be significant.

Along with the business, boards will continue to operate against a backdrop of tremendous uncertainty, an uneven economic recovery, and heightened expectations of all stakeholders – investors, employees, customers, suppliers, and communities. Moreover, shifting trends in capital markets, including surging growth in private debt and expanding options for raising public equity – by merging with a special- purpose acquisition company, exploring a traditional initial public offering (IPO), or even listing directly on a public exchange – have expanded and challenged private company management and boards to consider how to adequately finance and operate the company into the future.

Indeed, private company boards may see 2021 as an opportunity to fine-tune strategy and corporate governance, with demands for greater attention to corporate purpose and stakeholder views, corporate culture and incentives, diversity and inclusion, the richness of boardroom dialogue and debate, and the company's (and board's) readiness for the risks and opportunities ahead.

Drawing on insights from KPMG in the US firm's latest survey work and interactions with directors and business leaders, we highlight nine issues for private company boards to keep in mind as they consider and carry out their 2021 agendas:

- Maintain focus on management's response to COVID-19, while keeping sight of the bigger picture.
- Build the talent in the boardroom around the company's strategy and future needs.
- Make human capital management and CEO succession a priority.
- Ask whether the company is doing enough to make real and lasting changes to combat systemic bias and racism.
- Reevaluate the company's focus on ESG and corporate purpose.
- Help set the tone and monitor the culture throughout the organization.
- Reassess whether crisis readiness and resilience plans are effectively linked to the company's key risks.
- Approach cybersecurity and data privacy holistically as data governance.
- Engage with shareholders to understand their ownership governance and dynamics.

Maintain focus on management's response to COVID-19, while keeping sight of the bigger picture.

COVID-19 will continue to redefine business as usual for nearly all companies – and their boards – regardless of industry, size, or geography. All leaders will face significant disruption and uncertainty – grappling with when and how to reopen, the implications of managing remote workforces, accelerating digital transformation, building more resilient supply chains, and strengthening connections with customers in the months to come. At the same time, some companies are finding new opportunities and growth in this uncertain environment.

Navigating the uncertainty will require a sharp focus on people, liquidity, operational risks, and contingencies while keeping sight of the bigger picture: strategy, risk, and resilience. With information about COVID-19 and the economy changing frequently, companies should expect to recalibrate their responses – and potentially reframe their thinking about how the COVID-19 crisis is impacting the business. As COVID-19 vaccines become widely available, consumer demand and jobs growth return, and the new reality takes shape, it will be critical to stay nimble and have a strategy for operating effectively, staying competitive, and eventually thriving.

Perhaps most important will be the continued attention to human resource issues, particularly reopening plans, employee safety, engagement, and morale, as well as normalizing work-from-home arrangements – while focusing on diversity and equity in the workplace. Companies may need to rethink how work is carried out and reassess the operational and policy implications of working remotely. Is management considering more flexible work-from-home policies longer term and the implications for workflow, efficiency, performance, talent development, and culture?

Leadership and communication regarding the company's reopening plans and strategy will be critical to retaining the trust and confidence of employees, customers, and investors. Understanding and compassion have become more important than ever: As many have emphasized, the company's stakeholders will remember how they were treated during COVID-19.

Build the talent in the boardroom around the company's strategy and future needs.

Boards are increasingly focused on aligning board composition with the company's strategy, today and for the longer term. Talent and diversity in the boardroom are also top of mind for investors, regulators, and other stakeholders. That said, it's clear that the world is changing markedly faster than boards.

Even before the pandemic, institutional investors in private equity in particular were encouraging private investment firms to focus on diversity and inclusion within investment teams as well as on portfolio company boards.[1] Similar pressure is being placed upon venture-capital investors and the companies they back. For 2021, at least one prominent Wall Street bank declared that it will no longer underwrite initial public offerings for companies without at least two diverse board directors, and one of the world's largest private equity investors mandated that a third of board seats for its U.S. and European controlled companies be filled by diverse candidates within a year of its investment.[2]

The increased level of stakeholder engagement on this topic highlights the urgency that many in the private company ecosystem see as a central challenge linked to board composition: a changing business and risk landscape. Addressing competitive threats and business model disruption, technology and digital innovation, cyber risk, and global volatility requires a proactive approach to board-building and board diversity – of skills, experience, gender, race/ethnicity, and sexual orientation.

As a result, board composition and diversity should remain a key area of board focus in 2021, as a topic for communications with the company's owners and investors and to help position the board strategically for the future.

Make human capital management and CEO succession a priority.

COVID-19 and social unrest have amplified the critical importance of human capital management (HCM) to a company's performance and reputation. To gain better oversight of HCM, many boards are charging the compensation committee (or another board committee) with oversight of talent development and related HCM issues and changing the name of the committee and its charter to reflect these additional responsibilities.

Does management's talent plan align with its strategy and forecast needs for the short and long term? Has management considered whether reskilling of certain categories of employees makes sense? Which talent categories are in short supply and how will the company successfully compete for this talent? More broadly, as millennials and younger employees 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?

For its part in HCM, the board should help ensure that the company is well prepared for a CEO change. Are succession plans (including emergency succession plans) for the CEO and other C-suite roles formalized and reviewed at least annually (if not more often), and which board committee is responsible? In considering potential CEO successors, the board should ensure that if the business and strategy have changed as a result of the impact of COVID-19, then the desired profile of a new CEO has been updated accordingly. The numerous crises of 2020 may require other changes in the succession pipeline, with some skills becoming more important and some executives having stepped up with steady leadership in the face of tremendous uncertainty. How does the board get to know senior executives in the leadership pipeline – particularly given the limitations of a remote work environment?

[1] "ILPA publishes a diversity and inclusion roadmap for the private equity industry" (USA) February 24, 2020, Institutional Limited Partners Association (ILPA).

[2] "Blackstone casts a wider net in diversity push," WSJ Pro Private Equity, October, 22, 2020.

Ask whether the company is doing enough to make real and lasting changes to combat systemic bias and racism.

The disproportionate impact of COVID-19 on communities of color and the social unrest following the death of George Floyd and others are driving a critical dialogue about systemic racism and inequities. Are companies doing enough – using their financial resources, advocating for public policies, engaging in public/private partnerships, and leading by example ("walking the walk") – to make real and lasting changes to combat systemic bias and racism?

Listening to and acknowledging the injustices that communities of color have long suffered is imperative, and speaking out with statements of concern and support is important. Yet, communities, employees, customers, and investors are calling on companies to drive lasting change – to back up their words with action, and to show measurable progress.

On a KPMG in the US Board Leadership Center webcast, speakers highlighted a number of considerations for more robust conversations about diversity and inclusion, including clearly committing to building the company's pipeline of diverse employees at all levels and among its board members, defining diversity and considering setting aggressive goals at all levels, measuring progress and holding the CEO and leadership team accountable, considering vendors' diversity practices, and telling the company's diversity story. How the company addresses these issues may affect its reputation, ability to attract and retain talent, and the views of customers.

Reevaluate the company's focus on ESG and corporate purpose.

Corporate growth and shareholder return still require the essentials – managing key risks, innovating, capitalizing on new opportunities, and executing on strategy – but the context for corporate performance is changing quickly and COVID-19 is accelerating that change. The ongoing challenges of stagnant wages, income inequality, climate and environmental issues, health and safety, and diversity and inclusion – with limited government solutions – continue to spotlight a corporation's role: What is the company's responsibility to society and the stakeholders it relies on for growth?

Even for private companies and their shareholders, there are increasing demands for an open discussion on how the company is addressing ESG risks and opportunities – particularly climate change and diversity. Which ESG issues are of strategic significance – i.e., key to the company's long-term performance and value creation? How is the company embedding ESG into its core business activities (strategy, operations, risk management, incentives, and corporate culture)? Is there a clear commitment and strong leadership from the top as well as enterprise-wide buy-in?

Help set the tone and monitor the culture throughout the organization.

COVID-19 has increased the risk of ethics and compliance failures, particularly given heightened 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 organization with a sharp focus on behaviors (not just results) and yellow flags. Is senior management sensitive to the human resource issues stemming from COVID-19, particularly the pressures on employees (in the office and at home), employee health and safety, productivity, engagement and morale, and normalizing work-from-home arrangements? Does the company make it safe for people to do the right thing? Headlines of lax data privacy protections, aggressive sales practices, and other lapses continue to put corporate culture front and center for companies, shareholders, regulators, employees, and customers. Boards themselves are also making headlines – particularly in cases of self-inflicted corporate crises – with investors, regulators, and others 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-like 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. Verify the company has robust whistle-blower and other reporting mechanisms in place and that employees are using them without fear of retaliation.

Understand the company's actual culture (how things get done versus the rules posted on the breakroom wall); use all the tools available – surveys, internal audit, hotlines, social media, walking the halls, and visiting facilities – to monitor the culture and see it in action. Recognize 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 organization? Make sure that incentive structures align with strategy and encourage the right behaviors, and take a hard look the board's own culture for signs of groupthink or discussions that lack independence or contrarian voices. Culture and strategy are inextricably linked. The company's strategy has changed as a result of COVID-19 and related impacts, carefully consider what changes to the culture may be necessary to support the new strategy.

Conflicts of interest, including related-party transactions, can pose a significant challenge for private company boards, whose directors often represent third parties such as private equity or venture capital firms, investment funds, or family councils. While the interests of the private company and the third-party entity that a director represents are aligned in most cases, conflicts can arise – in the form of management fees, debt and equity financing terms, dividends and distributions, timing or exit strategies, or ownership transitions, etc. Be vigilant to identify early on any potential conflicts, and work with legal counsel to develop an appropriate course of action to surface and resolve any conflicts.

Reassess whether crisis readiness and resilience plans are effectively linked to the company's key risks.

COVID-19 is a stark reminder of the need to have robust enterprise risk management (ERM) processes that are closely linked to crisis preparedness and resilience. Are the company's risk governance processes keeping pace with its changing risk profile? Does the board understand who owns key risks at the management level, and would an empowered chief risk officer help create a more unified approach to risk? The events and crises of 2020 suggest several fundamental questions for boards and management teams to reassess the company's risks and readiness, including:

Do we have a complete inventory of the company's critical risks? COVID-19 has surfaced a range of heightened risks to manage, from employee and customer health and safety and managing remote workforces to the acceleration of digital transformation, changing customer demands, and vulnerable supply chains. Extreme weather events – droughts, wildfires, hurricanes, flooding, rising sea levels – illustrate the risks that climate change poses to companies, supply chains, and customers. (A majority of directors and investors surveyed recognize climate severity as a risk that is impacting the company today.[3]) COVID-19 and social unrest have cast a bright light on a host of ESG risks that should be front and center for business leaders – including employee well-being, pay equity, racial and gender diversity, and human rights, and how companies are meeting their commitments to stakeholders. Management will need to regularly reassess the risk landscape considering the dynamic operating environment and the interrelationship among risks.

Are crisis readiness plans closely linked to risk management – and are we prepared for a worstcase scenario? Even the best ERM isn't going to prevent every crisis. Companies need crisis response plans with a focus on agility, resilience, and values – maintaining operations and company reputation in the face of a disaster and learning from past crises. Identifying likely crisis scenarios and practicing responses using tabletop exercises is critical. Prepare for the worst-case scenarios – e.g., extended periods of supply chain disruption, substantial sustained reduction in sales and revenue, and the loss of key personnel – and consider having the board participate in these exercises.

Does the board's committee structure bring the right focus and attention to the company's critical risks and its crisis readiness and resilience? Are the risk oversight responsibilities of each committee clear? Does that allocation of responsibilities still make sense – particularly in light of the changing risk environment? While boards may be reluctant to establish an additional committee, considering whether a finance, technology, risk, sustainability, or other committee would improve the board's effectiveness can be a healthy part of the risk oversight discussion. Also consider whether risks should be reallocated among committees, and whether committees have directors with the necessary skills to oversee the risks their committees have been assigned.

Approach cybersecurity and data privacy holistically as data governance.

The accelerated shift to digital that many companies are experiencing underscores a trend: the importance of taking a holistic approach to data governance – the processes and protocols in place around the integrity, protection, availability, and use of data.

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 of key risks, and more robust conversations with management focusing on operational resilience and the strategies and capabilities that management has deployed to minimize the duration and impact of a serious cyber breach. Despite these efforts, given the growing sophistication of cyber attackers, the shifts to remote work and online customer engagement, cybersecurity will continue to be a key challenge.

The broader challenge is data governance, encompassing compliance with industry-specific privacy laws and regulations, as well as new privacy laws and regulations that govern how personal data – from customers, employees or vendors – is processed, stored, collected, and used. It 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

[3] Kristin Bresnahan et al., "Global Investor-Director Survey on Climate Risk Management", Ira M. Millstein Center for Global Markets and Corporate Ownership at Columbia Law School, LeaderXXchange, October 13, 2020.

way with customer expectations. Managing this tension poses significant reputation and trust risks for companies and represents a critical challenge for leadership. To help develop a more rigorous approach around oversight of data governance:

- 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.

Engage with shareholders to understand their ownership governance and dynamics.

Building on the amplification of corporate purpose as a result of COVID-19, it is important for boards to consider communication lines to all stakeholders and that they have a clear understanding of the stakeholders' definition of success, including their non-financial metrics such as community involvement, reputation and in the case of family businesses, elements tied to generational succession or family employment.

As part of stakeholder management, boards should consider these measures of success as part of the strategic direction of the business and that management has built these metrics into their short- and long-term plans. For companies where shareholders are active at the board level and within senior management this may happen organically, however, with an increasing desire for greater independence and diversity at the board table this needs to be on the agenda.

Appreciating the dynamics at the shareholder level also helps boards understand how shareholders will measure the success of the board. Are shareholders looking for generational growth? Is there a short-term return and exit plan? Do they have strong views around specific investments or initiatives within the company? The board should be engaging with its shareholders at a cadence that both parties are comfortable with, and depending on the level of concentration of the shareholding and the level of overlap between the two groups, this may be required more often than once a year at the annual general meeting.

Let's do this.

Contact

Mary Jo Fedy
National Enterprise Leader
KPMG in Canada
519-747-8875
mfedy@kpmg.ca

Daniel Trimarchi
Director, Family Business Advisory Services and Director of KPMG Enterprise Global Centre of Excellence for Family Business
KPMG in Canada
416-777-3816
danieltrimarchi@kpmg.ca