PART 1

Governance Practices in the Digital Age

CHAPTER 1

Ensuring Value Creation (Despite Volatility)

Most companies have growth periods and value periods. You grow and then you harvest.[1]

– Margaret Whelan, Corporate Director of TopBuild and Mattamy Homes

What is value creation in the digital age? It's a home-building company actively reallocating its capital to the markets with the most need and the least competition. It's a medical IT company[2] developing products that respond to pain points in customers' daily workflows. It's a mail-order provider of DVDs adjusting to changing consumer behavior to become a world leader in scripted programming.

Value creation is different from growth. Growth is about short-term returns and capital expansion, with less focus on longer-term consequences. Value creation, by contrast, is a long-term strategy that takes into account how companies invest in innovation and sustainability.

Importantly for corporate boards of directors, value creation today goes beyond immediate decisions on dividends and investment strategies to maintaining a durable and sustainable business model. Think of it as building a strong company as well as a strong stock – a dual mission that's more challenging than ever in today's global landscape of technological complexity. And think about it as staying ahead of risks and opportunities. At any moment, a new innovation like blockchain or artificial intelligence, or virtual reality can irrevocably upend business as usual, even for the most entrenched global leader.

Stakeholders agree that boards need to play a more involved role in making their corporations valuable to customers, investors, and the overall marketplace. BlackRock, State Street Global Advisors, Vanguard, and others have been pressing for governance practices that support long-term, sustainable value creation.[3] Evolutions in these practices have included mandatory sustainability reports for publicly traded companies in Singapore and proxy statements in the United States that have evolved from check-the-box compliance statements to rich windows into a company's strategy, performance, compensation, and culture.[4]

Board members already make pivotal decisions on acquisitions, investments, marketplace expansions, executive hires, and more. But in an environment of constant and often cataclysmic change, they must replace the caretaker model through which they traditionally view such decisions with what consulting firm Bain describes as a "private equity" approach.[5] They must look at decisions with the sharp, opportunity-focused eye of an investor, as well as the caution of a steward.

The right board leadership can steer a $500 million company into becoming a $10 billion leader, while ineffectual guidance holds a similar power in the opposite direction. Or, to paraphrase the famous words attributed to Intel's Andy Grove, only the value creators survive.

How can a forward-thinking board make the shift from cautious steward to innovation catalyst? Even the most time-efficient director possesses only 24 hours in each day. And board processes, steeped in decades of tradition, may not be agile enough to respond to the heady demands of value creation.

We believe quick wins in this complex area can be achieved. First, focus on operational engagement, specifically implementing fresh tactics for collaboration, shaping board structures (especially committees) for the value creation mission, and using technology to stay in touch with what's going on inside and outside of the organization. Then examine your Board Behavioral Profile. Which traits does your board currently exhibit? Consider how your profile might need to shift for greater value creation.

Embrace New Ways of Working Together

Becoming a value-focused board doesn't happen instantly, with one epiphany at an alpine board retreat. It happens over time, with incremental changes to business as usual. In a November/December 2017 *Harvard Business Review* article about the "new innovation imperative," former Mastercard CEO Robert Selander emphasized that big ideas typically don't spark transformative change.[6] It usually takes several ongoing discussions about several ideas, good and bad.

Cambia Health Solutions CEO Mark Ganz put this premise to work by turning its PowerPoint–driven board meetings to open discussions.[7] Through encouraging thought-provoking questions, his board improved their partnership with management and increased the value delivered by individual members.

Boards are recognizing the need to solicit new and different viewpoints in order to stay relevant. Board diversity is key to board resilience, an area that will be explored further in the next chapter. Specific to value creation, many directors and other governance professionals are finding that bringing in a broader range of perspectives can keep a board more closely in touch with change and better equipped to talk about it. Onboarding new directors can also change board dynamics for richer, deeper conversations and faster, sharper decision making.

"They say that if you have at least two or three women on a board, it really changes the way a board processes things. The same study has been done with digital directors," said Betsy Atkins, CEO and founder of Baja Corporation, who serves as a director on the boards of directors of Cognizant, Wynn Resorts, SL Green Realty, Schneider Electric, and Volvo Cars. "You need, at minimum, two digitally savvy directors to understand the rate of change, technology, and how to use technology to bring costs down, take friction and steps out of the customer journey, and truly understand future differentiated business models."[8]

How important are these broad-ranging perspectives? Allstate CEO Tom Wilson cited valuable insights into customer behavior from a board member experienced in "connected car" startups and the manufacturing/OEM space.[9] And imagine the fate of Netflix if someone hadn't flagged changing habits in TV and movie consumption as a game-changing trend.

According to Ralph Loura, who's been an executive with Rodan + Fields, Clorox, and HP, boards can change their value-creation outcomes by becoming more digitally focused. "Like a lot of things that have happened around IT in the past, supply chain automation, financial consolidation, this was at first thought of as 'Oh, this is just an IT project.' But then something like 70 percent of all CRM implementations were considered failing at some level, and people realized they were treating these implementations like an IT project, instead of business projects."[10]

Disruption in the Entertainment Industry Inspires a "Fashionable" Startup

Sometimes the best way to sense that a business model is changing is to see it in action. StitchFix founder and CEO Katrina Lake was studying Blockbuster and Netflix in her previous role as a venture capitalist when she realized the way people were consuming movies was evolving toward a subscription model.[11] She sensed that similar changes might be happening in retail and built a $977 million company on that insight.

Bringing on members with fresh perspectives on value creation is only part of the battle, however. Boards must be able to draw out their insights and maximize their contributions.

Education, engagement, and encouragement are places to start. Nelson Chan, who serves as Chairman of the Board of Adesto Technologies and is a corporate director of Deckers Outdoor Corp., believes that

"We carve out the time to ask these big questions. It's as important – more important – than dealing with audit or comp."[12]

For example, "We might carve out a half day to work with an expert or go outside and see what's happening on the bleeding age of tech for transforming the marketplace. We visited companies that do that like Google or investment firms focusing on tech startups, and we asked them to show us what they are up to as a way to educate the board."

Checklist for Cultivating and Maintaining Value-Focused Collaboration

Making new methods of collaboration stick can be a challenging proposition – especially for a time-strapped board with entrenched ways of working together. Here are a few suggestions for getting started:

- Foster a boardroom culture of respectful disagreement, curiosity, candor, and open debate. Make the boardroom a space where constructive criticism is welcomed by directors and senior managers alike as an important ingredient in growth.
- Expose board members to new ideas. This could be through meeting with experts from different and/or related industries and reading broadly on current issues.
- Get the board out of the boardroom periodically. Visit your company's primary operations, research and development (R&D) department, and other key divisions. Meet with key customers and investors to ensure relevance.
- Expand the diversity of backgrounds, skillsets, and leadership styles represented in the boardroom. More unique perspectives can lead to better outcomes.
- Remember that trust is an essential component to a collaborative mind-set. People share more ideas, with greater candor, when they don't fear condemnation for their contributions.

Take Value Creation to Committee(s)

Value creation is too important – and the circumstances driving it too volatile – to address only six to nine times a year. Many boards enlist their audit or risk committee to conduct research on investment, risk, and industry trends and actively participate in strategic planning. Ideally, committees will be monitoring and evaluating progress toward the company's strategic goals and regularly updating the full board on progress.

In this past decade of digital transformation, some boards are upping the ante by making structural adjustments specifically for innovation – a key component of (and some might say synonym for) value creation. In 2012, French tire manufacturer Michelin established an "innovation governance system" led by a Corporate Innovation Board.[13] Members include product line managers, the corporate development manager, an external member, and the manager for research, development, and innovation. This board's mission is to define innovation strategy, ensure a dynamic innovation ecosystem (which includes customer and market feedback), and to make decisions in areas such as innovation investment and research direction.

At Rolls-Royce, a company that Pamela Coles, Company Secretary, praises for its focus on innovation, the board pairs up directors with different backgrounds for site visits. "They'll see things differently," she said. "They'll ask different questions."[14]

But just establishing a special committee or initiative for value creation is not enough. Such a committee needs to make an impact on value creation and be recognized by stakeholders for its role in doing so.

A recent situation with Procter & Gamble provided an interesting and powerful example.[15] P&G has an Innovation and Technology Committee tasked to oversee the acquisition, implementation, and tracking of technical and commercial innovation. Yet in early 2018, activist investor Nelson Peltz, who oversees roughly $3 billion in P&G stock, joined the board positing that P&G hasn't created an important brand in two decades. He referred to corporate R&D as "a hobby" and has called for cuts.

Companies, including their boards, need to champion technological innovation and make it an overarching priority. Laurie Yoler, who was a founding member of Tesla's board of directors, and now serves on the boards of Church & Dwight, Zoox, Bose Corporation, and Noon Home, explains, "The issues a company faces, like cyber, are so broad in their impact that you need to determine what the full board should review vs. what the tech committee should handle. How will the full board get comfortable with tech terms and issues if they are relegated to a single committee?"[16]

A Global Take on Board Tech Literacy[17]

Anastassia Lauterbach, PhD, a technology strategist, is founder and CEO of 1AU-Ventures Ltd. She serves as a director on the boards of directors of Dun & Bradstreet, Wirecard, and Censhare, and she serves as a senior advisor to McKinsey and Company. Dr. Lauterbach is also the author of a new book, *The Artificial Intelligence Imperative: A Practical Roadmap for Business*.

What level of tech literacy do you see in your work with boards?

Even though IT is one of the top drivers of competitiveness today, IT is a new field for most directors, especially in Europe. On German boards, for example, even cybersecurity is considered to be a novelty. Most directors did not study computer science or technology. There are soft factors at work, too. Many directors don't want to admit that they lack IT understanding or struggle to dedicate time to self-study. Technologists often aren't helpful either. They speak in jargon, use a lot of abbreviations, and don't translate their visions for "normal executives."

Why don't boards recruit directors with more IT knowledge?

Because of fit issues. If CISOs (Chief Information Security Officers) and risk managers go through the interview process and speak candidly with leadership, you might hear, "This is a great opportunity but not a great cultural fit."

Furthermore, most of my peers working in technology are not used to the culture in the boardroom, which is overwhelmingly white, male, and "gray." In my experience speaking with board members who are age 65-plus, these directors are very interested in what you have to say and are amazed at what's happening in technology, but then they don't move forward because of that cultural fit. There might be a bit of an unconscious bias. People love the familiar. We love having people who are just like us in our companies. But boards need to recruit people who think differently or have a different area of expertise and need to give them encouragement. Often it comes down to the chairman's ability to establish a culture of respect and curiosity.

This comfort level builds with time and familiarity. When I was the only technologist on the board and I would ask questions of the CIO, all the other directors would check out. Now that there is a second technologist on our board, there's more engagement. The directors are more

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active in asking questions. Technology matters can't be outsourced just to directors with strong IT backgrounds. Everyone should be involved.

What specific board practices have you seen change because of the rapidly increasing speed of information?

Directors are spending more time with technology teams. They're facilitating exchanges with other companies within their networks, and they want to see technical people at every strategic and operational discussion. Directors are sharing information from conferences and what they're reading.

Governance is more or less a historical concept, and our current frameworks are backwards-looking in a time when we need them to be more forward-thinking. Boards need to know what they don't know, which requires a lot of courage. Directors need to be able to ask questions and be honest about what they don't understand, or they won't be able to provide the level of oversight and insight required today.

Track the Right Metrics and Trends

How can directors keep tabs of external market trends and how their corporations need to react to create and maintain value?

A perfect solution might look a little like the classic television show *Star Trek*. Directors would be able to create a "Vulcan mind meld" with every important internal and external stakeholder – think department heads, heads of startups and key competitors, pivotal activists, and investors – importing the latest intel on R&D, risk, market opportunity, and more into their brains. They would use the logic of Mr. Spock to distill the salient points into an actionable view of the technological, commercial, and financial landscape. And like Captain Kirk, they would be able to dive headfirst into the unknown because they trusted their crew to come up with creative and innovative solutions to any obstacles they might encounter.

Until such sci-fi capabilities become reality, however, boards will have to make do with available tools and processes. This includes meetings and events with customers and shareholders and IT applications like dashboards, which are emerging and evolving in sophistication with today's overall wave of digital transformation.

One straightforward way to find out what's going on with employees and customers: get out of the boardroom and interact with them. When Chip Bergh began as Levi's CEO and joined the company's board, one of the first things he did to investigate its falling sales was embark on a month-long "listening tour" to meet with 60 top executives.[18] In his second month on the job, his in-depth interview with a customer in Bangalore yielded a new tagline: "Live in Levi's."

Corporate director Laurie Yoler spoke of her own experiences as a board member. "We just did a tour of our R&D center to learn how the company handles innovation and development and the full board received such value from the visit."[19]

But the speed of digital transformation inherently presents challenges to boards striving to stay educated, she added. "The tech consultants that come into the boardroom tend to be one-off speakers, which isn't the same level of engagement and longevity that you have with your auditors, outside counsel, or compensation consultants. For example, if you're in a manufacturing firm, you might focus on specific robotic systems, but those might only be the most important 'right now' and change in six months."

When such “feet on the ground” approaches are impractical, a digital dashboard can give board members a reading of the landscape. Innovations in data collection and analytics have made an unprecedented amount of data available for decision making, increasingly with real-time availability. The trick, with dashboards and with overall governance, is in keeping board members out of the weeds.

How involved should a board be in company operations? What should the members know – when and at what level of detail? At what point does informed oversight cross the line into information overload and micromanaging? The answers will vary across companies and evolve with the digital age. Based on our conversations with directors across industries and around the world, we believe boards can start by:

- **Keeping abreast of macro trends**, which today might include blockchain, virtual reality, augmented reality, artificial intelligence, and robotics.
- **Narrowing your focus to what really matters.** Out of all the thousands of trends you could be tracking in the external environment, identify the ones that are most relevant to your organization. Track the metrics that most accurately reflect the performance and health of each department. Then synthesize this into potential opportunities (or risks) to corporate value.
- **Asking provocative questions**, like does your current reporting structure enable success? Are tech budgets reflecting strategic priorities? How does your brand and business model compare with peers (including new entrants)? Does either need a refresh to be more contemporary?
- **Measuring success** with quantitative measurements and analysis and making sure management rewards, incentives, and promotions push innovation, rather than take the safer road.

- **Leading by example,** with directors who embrace tech trends, actively integrate them into strategy, and clearly communicate investment decisions.

Certain areas will always feed into value creation, no matter what your geographic region, industry focus, or company size. These include risk management, corporate citizenship, and the ability to inform strategy with perfectly timed insights. These areas will be discussed in greater detail later in this chapter. Up next, however, we'll discuss one of the most important components of successful value creation: the people you put on your board and the structures and processes you give them to do their best work.

Key Takeaways on Value Creation

- **Change up board dynamics.** Board diversity is key to both value creation and resilience. Bringing in new perspectives leads to richer, deeper conversations and sharper decision making.
- **Expand board education outside the boardroom.** Visit other companies, work with experts, and encourage fellow board members to ask big questions.
- **Get comfortable with technology.** Relegating tech to a single committee leaves much of the board out of decisions that could have a broad impact on the company.
- **Don't forget employees and customers.** Learn how your corporation needs to react to create and maintain value by interacting with employees and customers.
- **Examine your Board Behavioral Profile.** What are the traits of your board profile and how might it need to shift for greater value creation? (See Chapter 7 for more details.)

Building Value through the Right Practices and People[20]

Margaret Whelan is a real estate industry executive and founder and CEO of Whelan Advisory. She also serves on the boards of directors of TopBuild, Mattamy Homes, John Burns Real Estate Consulting, and the Housing Innovation Alliance, along with four other nonprofit boards.

What overall practices are having the biggest impact in terms of financial success?

It's important to set the right tone and standards from the top, establish a growth plan through the CEO, have a board that is engaged and continuously refreshed to bring new energy and ideas into the room, and create an innovation strategy to think about things outside the box. The board's primary role, in my view, is to help the CEO to anticipate what's around the corner. That's easier said than done these days, as digitization is accelerating the rate of change and adoption rates for new products and services.

Another positive trend is quality over quantity. There is a link between board size and action. Look at the size of the Wells Fargo or GE boards and what happened in those companies. There were many smart people, but with GE there was atrophy in the business model, and at Wells Fargo the culture facilitated some poor judgment. Ultimately, having a large number of directors didn't help the shareholders.

For the right people, should you look for former CEOs or for board members with other skillsets, like next-gen directors with digital experience?

When you look at putting in next-generation directors, it reminds me of five years ago when I was looking to join my first corporate board. The message was, "We need a woman on the board. We're not looking at your resume, your skills, your capabilities, or your achievement. We just need a woman." I avoided those positions. More recently the focus has been on attracting younger directors because they can bring such a diverse and valuable perspective.

Today boards are saying, "We need someone who's a little younger, they have so much value to add as they work, live, and communicate in different and often more efficient ways." I'm a Gen Xer, working with a lot of Baby Boomers, wondering what the Millennials are thinking. Why not give them a seat at the table? In a lot of cases, their fresh perspective, even if they have yet to achieve their full professional potential, can still bring a lot of value add to a room that's populated with aging Boomers that aren't always fully engaged. PwC just published results of their director survey, and for the second year in a row half of the participants believe that at least one of their fellow board members is not adding any value. A young person with a fresh perspective is a big improvement versus someone who's disengaged. Maybe we need to think about board composition differently and be open to busy younger directors joining for a term or two, versus retired executives who stay too long.

On the other side, if everyone in the boardroom is putting on their superhero capes because they've all been CEOs, CFOs, or had other senior executive roles, they are often used to having all the opinions, all the influence. They're not always used to voting, and they can have strong personalities or opinions that less assertive directors can hide behind. Those directors don't speak up or challenge others because they're afraid they'll be replaced. When a board runs well, each person has a seat at the table, an even vote, and an informed opinion to share.

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How are you seeing companies become more diverse?

I'm in housing and construction, which is a very male-dominated industry. I work with a female CEO who is also chairman of a publicly traded housing company; more than half of her direct reports are female. That board recently announced two new female directors, so they now have a majority female board in an industry where half the boards don't even have one woman director. How was she able to find talented female directors when other companies are saying that they can't find any qualified female candidates? She brought in two very different candidates, including one with a retail background.

Notes

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17. Excerpts from telephone interview with Anastassia Lauterbach, PhD, 15 Aug. 2018.
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