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BOARD PERSPECTIVES: Risk Oversight

SETTING SIGHTS ON DIGITAL TRANSFORMATION AND INNOVATION

With the sudden onset of a worldwide pandemic, companies have had to accelerate their efforts to transform themselves digitally. How can boards and their companies best leverage digital transformation to compete and thrive in a brave new world?

At a recent NACD Master Class program for active directors, one session contrasted the expected churn in the S&P 500 today versus 50 years ago.¹ Disruption is continuing at a faster pace than any time previously, with the big lesson from the pandemic being that more digitally advanced organizations have proved to be the most resilient.

The various stages of the digital maturity journey were discussed. Digital leadership is a state of mind. Digital skeptics are reactive and risk-averse. Digital beginners embrace change by piloting and trying new things, but often implement a collection of point solutions rather than a well-thought-out strategy. Both digital skeptics and beginners need to advance past

the point of viewing digital channels as a threat and start viewing technology as an opportunity to out-innovate, secure competitive advantage and grow market share.

Digital followers move in this direction by engaging in more coherent efforts with a clearer vision and direction, and they are reasonably effective in delivering change. But they are still reacting to digital advances by competitors. Digitally advanced players achieve higher automation levels that translate to a lower cost base and a hyperscalable business model, making them more agile and less people-dependent. Finally, digital leaders (e.g., Amazon and Airbnb) are highly innovative and industry-disruptive.

¹ This session, "Digital Transformation and Innovation in a New Era," was facilitated on August 20, 2020, by Scott Lenet, founder and president of Touchdown Ventures, and Protiviti Managing Director Jonathan Wyatt.

This “journey” presents a continuum — starting with skeptics and beginners, progressing to followers and more advanced experts, and ultimately, for some companies, industry leaders. It offers directors a context for evaluating where their respective organizations stand, with the point being that digital transformation prepares businesses to be more resilient when market disruptions arise.

With that context, the participating directors at the NACD event offered several insights:

There is a distinction between the impact of technology on the business model and its impact on other enterprise threats. Digital technologies can transform business models but can also create new risks, such as different kinds of cyber threats. With respect to transformation, one breakout group consisted of directors serving banking, real estate and other related companies that were principally digital followers in an industry undergoing significant disruption. In these sectors, innovation is critical to the business model remaining viable. The group recognized that organizations like Apple, Amazon.com, Alibaba Group Holdings, Samsung and PayPal Holdings (which are not small startups that can be bought out) may be, with their digital wallet offerings, the real financial technology, or fintech, companies.

With respect to creating new enterprise threats, corporate leaders may be focusing more on keeping employees and customers safe and sustaining the business, given the health complexities of COVID-19, through a virtual workplace. However, as new technologies are implemented to accomplish these objectives, they may require different information security measures to ward off novel threats created by these advances.

Companies accelerated their innovation cycle during the pandemic. Several examples of rapid mobilization to enable working from home were shared:

- A homebuilder of multi-unit buildings accelerated implementation of digital locks

for apartment units to facilitate contactless security measures.

- An event support company highly dependent on brick-and-mortar events pivoted rapidly to support virtual events with a digital platform that had been under development for four years.
- A flooring company, striving for contactless customer service and delivery, achieved rapid innovation by implementing visualization software that enabled customers to see samples very clearly on their computers and envision how their selections would appear in their homes. The company’s management believes that the fast-track innovation process they deployed could be a blueprint for future advancements.

These and other examples are inspiring, but are they representative of true digital transformation? They certainly demonstrate that companies can make quick decisions, get things done out of necessity and trust their people to work from home. But if reinvention ceases post-pandemic, it won’t be enough.

Demographics are a factor when implementing new technologies over a compressed time period.

A healthcare system accelerated innovation by shifting 80% of its patient visits to a telehealth model as the pandemic limited mobility. However, when lockdowns were lifted, only 10% of health visits remained virtual, as older people were less comfortable with them.

When implementing new technologies over a short period of time, it is essential to consider the demographics of users of a company’s products and services and their evolving preferences and changing needs. It may also be necessary to educate segments of the market about the advantages of virtual options (such as the telehealth option for older patients).

Look for alterations in supply chains to reduce risk. To learn a major lesson from the pandemic, look to its effect on global supply chains, which has forced businesses to build resilience into

procurement processes. Such restructuring focuses more on speed in a digital world and could ultimately entail shifting the attention of traditional procurement processes to reducing life-cycle costs, managing operational risk factors, and achieving enduring business partnerships (rather than relying on the vendor model in which the relationship ends when the transaction is completed) as part of a high-performance procurement ecosystem.

A strategic mindset not only solves current supply chain issues but also helps mitigate potential future challenges.

Many companies may not be well-prepared for the next disruptive scenario. COVID-19's health complexities are not fully understood or realized yet, so unexpected effects will likely still play out. For example, education delays, stay-at-home learning mandates, ineffective online training, and sporadic interruptions to in-person education programs will have an economic impact over the near and long term.

Disruption comes from unexpected developments; for example, when two regulators merge, they set new expectations for the organizations they regulate. But the velocity of disruption can vary. Disruptive innovation can take a long time to generate returns, hampering profitability. For instance, the consumer preferences of millennials and Generation Z are expected to drive dramatic market shifts. This shift in preferences is coming, but the lag time between initial digital innovation investments to prepare for those shifts and ultimate profitability could be significant, creating a dilemma for boards and their management teams to consider.

Not every company needs to be a digital leader.

From a risk and reward standpoint, many companies may prefer to watch others take risks, assess what works in the market based on the outcomes of taking on those risks, and adopt best practices as they evolve, but do so in an agile manner. Ultimately, companies do not necessarily need to be leaders to succeed. Agile followers can also succeed when they focus on the market and continuously

assess new ways to reach customers with a keen, watchful eye on leading competitors. The counterpoint, however, is that digital leaders may pull further ahead. The quest is all about finding ways to be better in rapidly changing markets. That may require companies to become disruptive themselves as they enhance the customer experience.

A team with a proven track record of disruption and digital innovation should devise the optimal strategy — and ask the right questions. Most

businesses are people businesses; thus, technology innovations should be driven by people. Companies should assign a diverse, multidisciplinary team to focus on digital disruption and innovation. That team should formulate a coherent strategy and the most cost-effective means to implement it considering the nature of the business and answers to the appropriate questions. *What do our customers need? What are our competitors doing? As for needed innovation, do we buy it? Do we build it? When?* Engaging younger generations in decision-making processes can support digital thinking.

Use data to drive decision-making for the business. Regardless of where the business stands on the digital maturity continuum, there is an opportunity to use data and information for insights around how to better reach and serve the company's customers and improve operational efficiency.

In summary, the NACD Master Class discussion illustrates that many companies have implemented new ideas in a matter of days and weeks, not months and years, during the COVID-19 pandemic. They have taken risks out of necessity. And in doing so, they have discovered for themselves the power of digital transformation and an innovative culture.

Going forward, the lesson with respect to digital disruption is that directors should be cognizant that the biggest risk with regard to digital disruption comes from not acting, being slow or overly methodical, failing to focus on being agile, and engaging in broad and lengthy debates that frustrate the imperative of being an early mover in rapidly changing markets.

Questions for Boards

Following are some suggested questions that boards of directors may consider, based on the risks inherent in the entity's operations:

- Does the board have access to the expertise and experience needed to evaluate how management approaches digital transformation and innovation? Is management thinking and acting digitally and nurturing an innovation culture that facilitates attracting and retaining the talent needed to effect necessary change?
- Has executive management assessed the organization's digital readiness and identified the strengths and limitations across the business in the context of a clearly articulated digital vision, mission and strategy? If not, has the board discussed with management the need to conduct such an assessment?
- How does the board assess the resiliency of the company during the COVID-19 pandemic compared to its peer competitors? What are the lessons learned?
- Are there barriers to innovation and digital transformation that exist within the organization that require the board's attention from a change management standpoint? Are steps being taken to eliminate these barriers and track progress over time?

How Protiviti Can Help

Protiviti's digitalization offerings focus on:

- Exploring new ways to build strong relationships with customers.
- Launching new, enhanced products and exploring new business models.
- Enhancing the information available to enable timely and effective data-driven decision-making and improve digital propositions.

- Creatively using technology to improve processes and underlying performance.

We invite interested parties to use our free online, proprietary **digital assessment tool** to identify issues that may undermine their digital strategy as well as opportunities to advance their digital maturity and measure progress over time. Multiple people can complete the assessment independently, yielding a consolidated summary of results.

Protiviti (www.protiviti.com) is a global consulting firm that delivers deep expertise, objective insights, a tailored approach and unparalleled collaboration to help leaders confidently face the future. Protiviti and our independent and locally owned Member Firms provide clients with consulting and managed solutions in finance, technology, operations, data, analytics, governance, risk and internal audit through our network of more than 85 offices in over 25 countries.

Named to the **2020 Fortune 100 Best Companies to Work For**® list, Protiviti has served more than 60% of *Fortune* 1000 and 35% of *Fortune* Global 500 companies. The firm also works with smaller, growing companies, including those looking to go public, as well as with government agencies. Protiviti is a wholly owned subsidiary of Robert Half (NYSE: RHI). Founded in 1948, Robert Half is a member of the S&P 500 index.

Protiviti partners with the National Association of Corporate Directors (NACD) to publish articles of interest to boardroom executives related to effective or emerging practices on the many aspects of risk oversight. As of January 2013, NACD has been publishing online contributed articles from Protiviti, with the content featured on <https://blog.nacdonline.org/authors/42/>. Twice per year, the six most recent issues of *Board Perspectives: Risk Oversight* are consolidated into a printed booklet that is co-branded with NACD. Protiviti also posts these articles at protiviti.com.