



ISSUE 155

BOARD PERSPECTIVES

ADVANCING THE BOARD'S ROLE IN DIGITAL TRANSFORMATION

Boards and their companies operate in an increasingly digital world. Every director should have sufficient digital understanding to engage in strategic conversations with the CEO, other company leaders and other members of the board.

Embracing digital capabilities indicates a way of thinking about business both now and in the future. It is a mindset that emphasizes agility and continued innovation. Digital discipline and focus represent a commitment to adapt continuously in the face of change and respond to customers' increased desire for products and services that meet their evolving needs. As markets continue to evolve, is the value contributed by the board keeping pace? Is board composition refreshed to reflect the times? Do the board's experience, skill sets and capabilities enable it to

engage meaningfully with the CEO and management team?

One of the top trends that will have the greatest effect on companies over the next 12 months — as noted in a recent survey of public company corporate directors issued by the National Association of Corporate Directors (NACD) — is the increasing pace of digital transformation.¹ The digital era is fostering an environment in which each director should be knowledgeable about the enabling technologies that will impact the industry over the long term,

¹ 2022 NACD Public Company Board Practices and Oversight Survey, NACD, June 30, 2022: www.nacdonline.org/insights/publications.cfm?ItemNumber=73754.

resulting in new business models, transforming customer experiences, and driving operational efficiencies and innovation. A sufficient digital understanding enables directors to contribute to capital allocation and strategic conversations around digital initiatives and thinking.

There are several imperatives that boards should consider to advance their role in digital transformation:

Allocate more board agenda time to discuss digital matters. Another NACD report² notes three areas of board oversight requiring increased attention: human capital, cybersecurity and digital transformation.³ These topics are interrelated.

Managing the evolving digital landscape and implementing complex digital strategies require the best and brightest talent. The old cliché “talent wins” applies especially in the digital game. Also, the CEO faces the challenge of aligning the executive team in formulating and executing the transformation road map. As digital transformation introduces new infrastructure and capabilities, fresh cyber threats are spawned, requiring new proactive and reactive countermeasures.

Boards should devote more time to discussing these matters as they impact capital allocation decisions.

Transition the board to embrace more directors with experience in the digital evolution. Mere understanding of the importance of digital and the notion of altering the board’s culture to embrace it has become very “yesterday.” To compete and win in today’s markets, the CEO needs advisers with a currency of understanding to navigate the

digital seas. The NACD survey noted three areas needing the most improvement in board operations: board succession planning, diversity of voices in the boardroom and director education.⁴ All three areas have digital underpinnings.

The nominating/governance committee’s mindset, criteria and expectations should reflect the board’s most immediate needs. Boards needing to elevate their game in recognizing the impact of disruptive technologies on business models and growth strategies, as well as the security implications of implementing those technologies, should make it a strategic imperative to evaluate board composition. To that end, the nominating/governance committee should seek the CEO’s input on the specific capabilities and skill sets that the board needs to add value to strategic conversations in the boardroom.

Digital understanding and experience require nontraditional skill sets and thus provide a compelling need for diversity in the boardroom. While “fit” has been a long-standing criterion when evaluating board candidates, the nominating/governance committee should not permit “fit” to function as a cover for unconscious bias or other barriers to the participation of otherwise qualified candidates, particularly on the digital front.

A company’s circumstances will change over time, but the need for digital thinking and diversity of thought will not. Continuing director education should tap into digital experience with an objective to increase the digital savviness of all board members. Boards with deficiencies in this area should look to independent advisers to help bridge the gap.

² “Governance Challenges 2021-2022: Digital Transformation Oversight,” NACD, November 9, 2021: www.nacdonline.org/insights/publications.cfm?ItemNumber=72849.

³ Ibid.

⁴ Ibid.

Understand how artificial intelligence (AI) is a bridge connecting company offerings with the customer experience. Whether it's technology, healthcare, financial services, consumer products or industrials, organizations across all sectors are adopting intelligent automation and advanced analytics to enhance the customer experience, drive new business opportunities and increase competitive advantage.

AI is a key element to companies' progress toward digital transformation, leading to more informed decisions, empowered employees, accelerated innovation, and improved compliance and third-party risk management. Board members should contribute to the integration of AI initiatives with capital allocation and strategic spending decisions as well as ethical discussions around such issues as transparency, fairness, trust, responsibility and privacy.

Be aware of regulatory developments spotlighting boardroom composition. The Securities and Exchange Commission (SEC) in the United States recently proposed a rule requiring annual reporting or certain proxy disclosures about the board of directors' cybersecurity expertise, if any.⁵ The proposal doesn't define what constitutes this area of expertise, only offering examples. It doesn't include an "if not, why not" provision, making it unclear how investors might interpret a company's lack of disclosure of a board-level "cybersecurity expert." (For example, might they reach the mistaken conclusion that a company and its board are not concerned with cybersecurity?) Parties commenting on this proposal have reported various concerns regarding its implementation.

Directors serving public companies listed in U.S. capital markets should appraise how the board organizes its oversight of cybersecurity risk. Given cyber threats are a moving target, this risk merits consideration on a periodic basis regardless of what the SEC does.

Be mindful of legislative developments affecting digital business models. The European Union's (EU's) recent landmark legislative initiatives⁶ to upgrade digital services and digital markets rules will likely have ripple effects across the globe as digital borders are less defined than physical ones. With many digital platforms being global in nature and utilized by global companies, the impact of the EU's initiatives on the digital landscape will likely be far-reaching from large tech and platform providers to smaller digital software and marketplace startups as their requirements around algorithmic transparency and restricted data harvesting for profiling are put into practice.

While the full effects may not be known for some time, the significant footprint of affected services includes not only very large online platforms but also online marketplaces, app stores, collaborative economy platforms and social media platforms, not to mention intermediary services and hosting services such as cloud services. This latest EU legislation is likely to be a trendsetter for other countries to follow, as was the EU's landmark General Data Protection Regulation (GDPR) legislation, adding yet another component to the compliance table stakes for doing business on a global basis. It also may spawn legislation affecting other aspects pertaining to digital capabilities. Accordingly, the board should expect management to monitor developments in this space.

⁵ "Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure," SEC, March 9, 2022: www.sec.gov/rules/proposed/2022/33-11038.pdf.

⁶ "The Digital Services Act Package," EU, April 23, 2022: <https://digital-strategy.ec.europa.eu/en/policies/digital-services-act-package>.

Understand that technology is a key underpinning of both sustainability and profitability.

Digital technologies are powerful enablers of increased productivity, innovative strategies and cost savings. They're also an integral part of solutions to reduce product waste and conserve scarce resources. They offer more powerful ways to analyze data and measure and track progress in minimizing environmental impacts. They can streamline supply chains and facilitate problem-solving. Most important, digital technologies can enhance reputation and brand image, opening doors to customers valuing relationships built on sustainable business practices and trust.

Last year, finance ministers and central bank governors from G7 countries agreed to mandate climate-related financial reporting aligned with the recommendations of the Taskforce on Climate-related Financial Disclosures.⁷ The SEC's recent climate disclosure proposals⁸ signaled that an explicit climate change rule in one form or another will soon become a reality for U.S. capital markets. With the increased frequency of shareholder environmental and safety proposals gaining traction in forcing votes at annual meetings, directors should focus on their company's preparations. This may entail elevating the boardroom conversation above discussions centered on the presumed dichotomy between sustainability and profit.

Market expectations are such that superior financial results are not enough and that issuers should convey responsible environmental stewardship. If sustainability initiatives impact

short-term profits, a compelling narrative to shareholders and different performance incentives may be necessary to balance the executive team's focus. The board can set the tone in this conversation.

Consider reviewing reporting to the street. While still high, support levels in director elections continued to decline in the U.S. through the 2021 proxy season.⁹ Communicating through traditional reporting protocols on an annual basis may be "too little, too late," emboldening proxy access groups that lack the full picture with respect to the company's progress on the aforementioned topics. More frequent updates may prove useful as a preemptive measure. Accordingly, the board should consider the company's strategic communications to the market and determine whether a conversation with the CEO and other management is warranted.

In summary, advancing the board's digital transformation requires smart, strategic and engaged thinking and recognizing technology as a strategic driver rather than a mere enabler for fostering disruptive innovation. It's about the board's composition and processes for refreshment, as well as the board's continuous education. It's also about allocating sufficient time to discuss the digital agenda in the boardroom. It entails remaining abreast of relevant legislative and regulatory developments and viewing digital initiatives with a broad lens that considers sustainability matters. Finally, it raises the question of how best and frequently to communicate with investors about the company's and board's progress on the digital front.

⁷ "G7 nations agree on mandatory climate-related disclosure," by Graham Caswell, Green Central Banking, June 8, 2021: <https://greencentralbanking.com/2021/06/08/g7-nations-mandatory-climate-related-disclosure/>.

⁸ "The Enhancement and Standardization of Climate-Related Disclosures for Investors," SEC, March 21, 2022: www.sec.gov/rules/proposed/2022/33-11042.pdf.

⁹ "Proxy Season 2022 May Be Even More Challenging," The Conference Board, February 15, 2022: www.conference-board.org/press/proxy-season-2022.

How Protiviti Can Help

Protiviti helps organizations think digital-first. From digital strategy and innovation to solutions and services across marketing, sales and customer success, we help companies redefine how they reach and engage customers, innovate business models, create digital products and channels, and orchestrate the skills and agility required to unlock growth and compete in today's marketplace.

We partner with companies to drive profitable growth at the nexus of human-centered digital connections and enterprise operational change. Approaching every engagement with the vision of a startup founder, the precision of a watchmaker,

the collaboration of a trusted adviser and the creativity of an artist, our focus is on orchestrating the intersection of strategy, design, technology and assurance.

Protiviti uses human-centered design and strategies to stay rooted in purpose while elevating experiences past the point of simple utility to create lasting relationships and loyalty. Our approach is grounded in empathy for understanding and agile thinking for rapid action and focus on those the company serves. We partner with best-in-class technology providers to bring leading thinking and capabilities to our clients.

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 its independent and locally owned Member Firms provide clients with consulting and managed solutions in finance, technology, operations, data, digital, legal, governance, risk and internal audit through its network of more than 85 offices in over 25 countries.

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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* are consolidated into a printed booklet that is co-branded with NACD. Protiviti also posts these articles at protiviti.com.