



## Oversight of Digital Transformation: Insights from Active Directors

*Below is the full summary, including key takeaways, of a discussion among active directors facilitated by Protiviti during a dinner roundtable at an August 2018 National Association of Corporate Directors event. An abbreviated summary of this roundtable is provided in Issue 110 of Board Perspectives: Risk Oversight (available at [www.protiviti.com/US-en/insights/bpro110](http://www.protiviti.com/US-en/insights/bpro110)) and on NACD|BoardTalk (see blog at <https://blog.nacdonline.org/posts/oversight-digital-active-directors>).*

***Disruptive innovation has a clear impact on the half-life of companies' business models. Industry disruption and digital transformation present a new frontier of opportunity and risk that is shaping – and speeding up – business model changes.***

Disruptive change has been present throughout recorded history. But the contemporary notion of disruptive change really came into vogue just over 20 years ago, when former Intel CEO Andy Grove published his outstanding book, *Only the Paranoid Survive*. In it, Grove coined the term “strategic inflection point,” defining it as “a time in the life of a business when its fundamentals are about to change.” That a company can be both the subject *and* the cause of a strategic inflection point is a sobering market reality that cannot be taken lightly.

Now, 20 years later, Grove’s premise is especially prescient. As he so eloquently observed, “The ability to recognize that the winds have shifted and to take appropriate action before you wreck your boat is crucial to the future of an enterprise.” Today, there is greater awareness that companies that are not agile, resilient and adaptive enough to recognize market opportunities and emerging risks — and deploy the tools of the digital age to address them on a timely basis — are at risk of being swept aside by a tidal wave of disruption.

## Key Considerations

A recent global survey of board members and C-suite executives cited the inability to compete with “born digital” competitors, resistance to change and disruptive change to the business model as top risks for 2019.<sup>1</sup> These risks were not at the forefront of many senior executives’ and board members’ minds just a few years ago. But with the onslaught of emerging digital technologies — robotic process automation (RPA), machine learning, natural language processing (NLP), big data analytics and other components of artificial intelligence (AI) — just about every industry is facing the challenge of transforming customer engagement, offering new products and services, facilitating more informed and higher-velocity decision-making processes, and improving operational performance. Companies that are laggards or behave like ostriches with their heads buried in the sand won’t survive in this fluid environment.

To gain perspective on this important area of board oversight, Protiviti met with 20 active directors during a dinner roundtable at an August 2018 National Association of Corporate Directors (NACD) event to discuss the board’s oversight of industry disruption and digital transformation. Below are some of the important points covered, including key takeaways, during that discussion.

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**Evaluate digital readiness.** To set the context for the roundtable discussion, Protiviti’s research and experience indicate that few organizations are taking the steps necessary to become truly digital in nature. Across the spectrum, corporate executives and their boards are saying they need to focus on the “digital channel” and, specifically, on the technologies and talent to drive that channel. The outcome of these efforts is often a digital veneer. From the standpoint of digital advancement, the organization may appear to outsiders as if it is making progress. But beneath the veneer, true change at the organization’s core is minimal.

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<sup>1</sup> *Executive Perspectives on Top Risks 2019*, Protiviti and North Carolina State University’s ERM Initiative, December 2018, available at [www.protiviti.com/US-en/insights/protiviti-top-risks-survey](http://www.protiviti.com/US-en/insights/protiviti-top-risks-survey).

It is not about how much money is spent. Many organizations may invest heavily in new technologies and digital initiatives, but the changes they may achieve are not transforming how the organization *thinks* and *acts* at its core. Digital transformation is about transforming the organization — its culture, people and processes — to think and act more broadly. For example, organizations should have four areas of focus centered not on specific technologies, but rather on goals and desired outcomes.

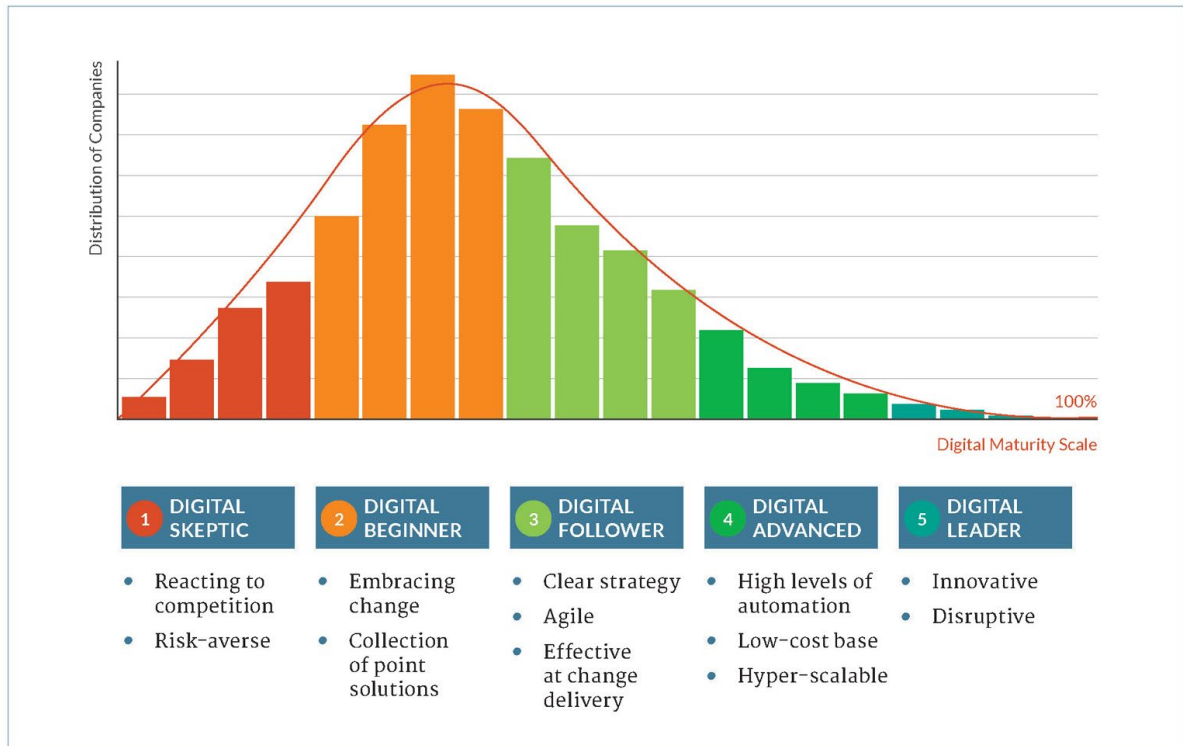
- **Better customer engagement** — **Ask yourself:** *How can we get closer to customers and end consumers?*
- **New business models** — **Ask yourself:** *Do we consider new operating models to strengthen our competitive position?*
- **Better decision-making** — **Ask yourself:** *How can we make better, more timely decisions given the huge volumes of data and information we have?*
- **Operational performance** — **Ask yourself:** *How can we do things more efficiently and effectively?*

To become digital leaders, our research indicates that organizations need to excel and differentiate themselves across 36 separate attributes at which we believe digital leaders excel. Using these attributes, Protiviti has created an interactive thought leadership piece — a Digital Maturity Assessment Model<sup>2</sup> — that has been designed not only to educate companies and their boards on what it takes to be effective in the digital age but also to enable them to benchmark themselves against leaders and peers as they complete the assessment. Clarity on organizational strengths and areas of weakness enables the enterprise to embark on its journey to digital maturity with confidence and ensure it has the best possible chance of prospering in the digital age. We offer access to our assessment tool to the market to help organizations conduct their assessment.

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<sup>2</sup> Go to <https://landing.protiviti.com/digital> to complete the digital maturity assessment to discover how your organization measures up against digital leaders, and identify barriers that will prevent your business from achieving its strategic goals over time.

Regarding digital maturity, we have identified five levels for gauging the current and desired future states of an organization in the graph below.



It is our experience that most organizations are still at relatively low levels of maturity. When it comes to digital transformation, an organization ultimately measures success depending on where it wants to go – which may not involve being a digital leader. Positioning as a digital follower is okay as long as the company is agile, has a clear strategy and is adept at change. The key is understanding where the company is now and where it wants to go. With that perspective, the organization establishes a structure and approach to measure progress toward reaching its goals.

**The key takeaway for boards:** Digital leadership requires a certain state of mind. It is about changing the way an organization acts and thinks in everything it does. To be successful, executive management must prepare the organization to compete in the digital age. Management can have the best possible strategy, but the organization can't execute it if the business is not digital-ready. It is also difficult to formulate a viable strategy if the organization is not digital-ready or does not possess the requisite digital know-how.

If the organization is a digital beginner or a skeptic, the board must encourage management to advance its digital maturity so that it is either a digital follower or a leader. Management should identify and act on strengths and weaknesses across the business in the context of the digital vision, mission and strategy. Using the above framework to benchmark itself against the 36 competencies at which digital leaders excel helps an organization better understand the pathway toward achieving digital readiness.

**Understand what transformation entails.** There have been disruptive revolutions in business before, from the Industrial Revolution to the introduction of computers. Digital is just the latest. However, one could argue that today's transformations are more pronounced than in the past.

As they consider the changes their organizations are undergoing, some directors use “transforming the business” or “business optimization” over “digital transformation” to, in their view, more accurately describe their journey. For example, born-digital companies and startups don't talk about digital transformation. They do not need to transform digitally because digital is already ingrained in their culture and operations. Thus, there really isn't a single digital transformation that takes place, but a series of transformations — a continuum of sustained progress and milestones. Digital-native companies don't talk about “digital transformation” as if it were a one-time event or a unique, monolithic thing. Transformation, for them, is an ongoing process.

Digital leaders roll up their sleeves to understand innovations and new technologies like machine learning, NLP, advanced data analytics and other components of AI. They do this across the organization in all aspects of the business rather than delegate to research and development (or other functions). Board members can enhance their oversight effectiveness by becoming more familiar with new technologies to improve their education and ensure that their executive teams do so as well.

Digital cannot be led or governed from afar. One director at the recent roundtable noted that embracing technology outside of the work environment can be a good way of becoming “digitally literate.” For example, converting one's home into a “smart home” and learning how to use different tools can facilitate a director's education. One director offered an example about using an artificial intelligence assistant (such as used in smartphones) to improve performance in the home.

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*Just as true digitalization starts at the core, so must the board transform itself before it can offer effective oversight of the organization's journey to digital readiness.*

Digital familiarity and literacy are vital to probing and asking management the right questions regarding the company's advancement as a digital entity, particularly when augmented by digital-savvy experience. How else can board members connect with management to perform governance around digital initiatives and a digital strategy when the board itself is neither digitally literate nor tech-savvy? How else can the board validate the path management is taking?

One option may be to form an innovation committee, with technology, digital and transformation experts either as members or advisers. Another is to include directors with the requisite technology expertise on the board to complement the directors who grew up in the analog age. Yet another option is to engage outside advisers to inform the board with relevant perspectives.

Whether through an innovation committee or otherwise, the board must become educated and well-informed in the digital space, thus improving its ability to ask focused questions and challenge

assumptions. Management should welcome this, as it helps them to look at the situation and the related transformation opportunities differently.

**The key takeaway for boards:** True digitalization starts at the core. The board, therefore, must transform itself before it can offer effective oversight of the organization's journey to digital readiness. Just as a strategy that attempts to layer technology on an analog business does not work, neither can a board consisting solely of directors who grew up in the analog age contribute effective oversight without substantive steps taken toward digital literacy and digital savviness.

**Focus on resiliency and agility.** In the digital era, good governance may need to be different than even five years ago. For example, boards need to sharpen their focus on innovation initiatives and on changing the organization's mindset concerning digital initiatives. People and culture are vital to the success of a digital transformation. If an organization has effective digital leadership, enhances the digital capabilities of its people, and creates a corporate culture that incents and empowers creativity and innovation, it will become a truly digital organization. Changing the mindset also requires a compelling narrative regarding the company's focus on digital transformation and the need for change. That narrative must be communicated by management effectively. Without all of these elements, change is hard, if not impossible.

How does the board contribute value-added oversight? That is where a technology committee — a smaller, focused board group working with management on long-term digital and innovation strategy — can be useful. It might also mean recruiting younger and technology-savvy directors to bring more knowledge of new technologies and innovation cultures into the boardroom, including a broader, more diverse perspective with respect to digital and how an organization embraces digital. The board should work with management to understand the road map to the desired digital maturity (e.g., the Digital Maturity Assessment Model discussed earlier helps organizations focus on the necessary attributes and formulate a customized plan for moving forward).

Another core role for the board is risk oversight. How does the board know that management's innovation process is making progress in taking the organization where it needs to go with respect to achieving its growth and digital transformation objectives? More specifically, how can board members look beyond management's word on the organization's progress and approach to digital? A dashboard report may be useful in focusing the board's questions regarding the organization's resiliency. Such questions might include:

- Do we understand how digital is changing the economics of our business and the competitive landscape in the industry? Are *we* thinking “out of the box” about our business model, how we serve our customers, and how the market may be different five years from now? Are our digital strategy and the way that we are executing it enabling our organization to stay ahead of or keep pace with market developments?

- What fundamental assumptions have we made in formulating our strategy that could be impacted adversely by future events? Are any of our markets or operations at risk?
- How can we address any deficiencies or plan for any contingencies, and how fast can that be accomplished?

The point was made at the NACD roundtable that board members should disrupt themselves, their approach to oversight and how they govern. They need to encourage management to rethink the business and industry and assess how the digital economy is disrupting them. In addition, the board needs to move faster, even though many boards may not like to move fast.

**The key takeaway for boards:** The board can play an important role in fostering a resilient and agile mindset. This requires constructive engagement of management with digitally literate and digitally savvy directors having broader, more diverse perspectives regarding how the organization should embrace digital opportunities. The dialogue should be supported with appropriate innovation-specific metrics that tell the full story of how the strategy is performing, what the return on investment is, and how effective the company's innovation culture and capabilities have become.

**Keep an eye on the customer experience and competitive advantage.** From the board's perspective, there is an important overriding question: How is the change the organization is undergoing, or expects to undergo, affecting the customer experience? Boards need to work with management to ascertain how the company can get, and stay, ahead of its customers and competitors. This is not solely about technology; it is more about the business model. Technology is merely a tool or vehicle for achieving the company's goals for delivering exceptional products and services to customers and establishing a sustainable competitive advantage.

The ultimate question for boards is this: How can directors ensure that management has its act together, has the right team and competencies in place, and is taking the organization down the right path? When it comes to transformation, however, organizations have different levels of needs. Some things to address are more basic; for example, a need to get closer to the customer (e.g., know our customers better, obtain more information about our customers, or talk directly with them). Once change initiatives are planned or underway, customer experience and satisfaction are critical areas the board must ensure that management is watching proactively.

**The key takeaway for boards:** A customer-centric approach to digital strategy breeds confidence that the organization is making the right moves. Success in executing on digital initiatives is about knowing the company's limitations and avoiding procrastination on making the difficult decisions to address those limitations. A strong focus on the customer is a powerful driver for moving forward. For example, data strategy and legacy infrastructure issues (e.g., technical debt) are examples of difficult problems that are often ignored. But with a commitment

to enhancing the customer experience and commanding customer loyalty, companies can overcome this inertia and do what it takes to remain competitive.

**Ensure there is a compelling plan that fits market realities.** The board needs to ensure that management formulates a viable plan for managing business disruption and transformation and executes that plan. This is not easy given the uncertainty in determining the appropriate technologies to embrace, new products and services to offer, third-party ecosystem supplier and distribution channel partners to engage with, and the changes to make in the business. There is also the need to make decisions in a timely manner to position the organization as an early mover.

Transformation should never be attempted in a vacuum. Accordingly, directors may want to bring in external consultants and experts to identify market opportunities and emerging risks to help frame the big picture. Given the stakes, the board should exercise a healthy skepticism and be ready and willing to push back on management's assumptions regarding any transformation plan. A healthy challenge culture and a robust process for testing and piloting the plan will only make it better.

Benchmarking information and data can provide insights to the board as to how the organization is doing. Considering the success of digital companies, it may make sense to ask provocative questions around what Amazon or Google would do with the information the organization has on its customers. Is the company leveraging its available data and information on customers and the market with the same rigor and sophistication as those organizations, which have grown exponentially over the past decade?

A formidable issue, or roadblock, for organizations is that often there are competing interests, both internal and external, for disruption and transformation. Delivering acceptable short-term financial results to shareholders remains a high priority even when the organization proceeds to transform itself. Accordingly, management faces a challenge where it cannot simply transform the company, digitally or otherwise, and sacrifice near-term profitability.

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*Few organizations effect change if they do not have a mechanism for measuring and monitoring progress in addressing areas in need of improvement.*

It was pointed out during the NACD roundtable that there is a “maddening difference” in Wall Street's treatment of digital-native companies with little or no profitability or positive cash flow compared with established incumbents facing immutable expectations to sustain existing cash flow and earnings. That makes a complex transformation process or multiple significant innovation initiatives especially difficult to carry out, as they often require investments of time and resources that could impact financial performance over the short term.



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*Amid ongoing transformation and the rapid speed of innovation, board members have a high level of concern regarding the organization's people — specifically, their potential dislocation and displacement.*

This apparent discriminatory market view handicaps legacy companies, as digital-native brands require less startup funding to grow fast and organically compared to, say, five or more years ago. Legacy incumbents may not be “Wall Street darlings,” but the reality they face is clear. They need to figure out how to walk the line between doing the things they're good at while addressing the need to innovate, change and adapt, and sell the message to the street.

**The key takeaway for boards:** Directors need to ensure that management formulates a viable plan for managing business disruption and transformation. Under the auspices of the board, management must monitor progress in executing the plan. Our Digital Maturity Assessment Model can help with this by clarifying the organization's strengths and weaknesses so that management knows where to focus on its journey to digital maturity. Few organizations effect change if they do not have a mechanism for measuring and monitoring progress in addressing areas in need of improvement.

With respect to investor expectations, it is important that boards and their management teams look forward, not backward, as many companies have announced significant digital investments. With the world changing rapidly, sustaining the status quo presenting significant risk, and digital investments needed to forge the way forward, it is important for the board to take the long-term view in creating a platform for sustainable growth even at the risk of a short-term drop in share price. The alternative is a steady decline over time that management is powerless to correct. Directors should be mindful that investor sentiment can shift quickly as digital capabilities become essential to compete. Our perspective is that increasingly there is an expectation that these types of investments are being made and, over time, investors will be looking for CEOs to articulate a compelling digital vision and plan. No one should be waiting until it's too late to act.

**Consider human(e) digital transformation.** Amid ongoing transformation and the rapid speed of innovation, board members have a high level of concern regarding the organization's people — specifically, their potential dislocation and displacement. The predictions regarding job disruption vary, but some directors cited projections as high as 50 to 60 percent of employees being dislocated in some organizations due to digital transformation. If such predictions hold up, companies need to have a human capital strategy. Granted, computers were thought to be something that would displace jobs, and this did not occur. Further, there are arguments that today's transformational efforts could result in the same outcome. However, many believe the digital transformation phenomenon underway now is not the same as the mere introduction of more computing power into the workplace. The scale is much larger and more disruptive. While there likely will be growth in jobs resulting from digital transformation efforts, this growth is likely going to take a longer time to develop.

The questions are daunting. How do companies reskill their people as part of digital transformation initiatives? More broadly, how does the corporate environment redeploy hundreds of thousands of workers? And even more broadly, how do the public sector and higher and secondary education partner with the private sector to deal with this oncoming social challenge?

**The key takeaway for boards:** A clear and coherent strategy is needed to address worker dislocation and displacement. That was a critical issue in the room during the NACD event, which no one took lightly. In fact, it was a matter of such concern to board members that several participants continued to discuss it after the roundtable concluded. Currently, the answers are elusive.

## 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 understand how digital disruption can affect the organization and its business model so that it can oversee the effectiveness of management's incorporation of digital thinking into the strategy-setting process and corporate culture?
- Does the board understand where the organization stands and is headed on the digital maturity continuum? Is it a follower or a leader? If the company is a beginner or a skeptic, does the board encourage management to advance its digital maturity by identifying and acting upon the strengths and weaknesses across the business in the context of the digital vision, mission and strategy?
- Is the board satisfied that management has a deep understanding of and is immersed in digital business concepts, building digital ecosystems and the potential of digital hyper-scaling platforms that are ready to facilitate growth? Are there barriers to innovation and digital transformation that exist within the organization that require the board's and executive management's attention from a change management standpoint? Are steps being taken to eliminate these barriers?

- Does the company have a digital transformation program in place that is well-defined and positioned to succeed?
  - Is the program focused on changing the way that the organization acts and thinks, introducing a digital mindset across the organization? Or is it focused on introducing new technology into the organization to solve narrow problems?
  - Are adequate resources allocated to support its execution?
  - Is there a compelling customer-centric vision and an accompanying strategy driving it?
  - Are there issues or weaknesses (e.g., data strategy and legacy infrastructure) holding the organization back? If so, is there a plan in place to address these matters?
  - Is there timely decision-making within the organization on whether or how to embrace emerging technologies?
  - Is the board satisfied that there are effective processes for challenging and vetting new ideas and “testing and learning” to ensure they will work?
- Does the board agenda allocate time for discussing the company’s innovation strategy and culture and encouraging open discussion on direction and progress? Is this dialogue supported with appropriate innovation-specific metrics that tell the full story of how the strategy is performing, what the return on investment is, and how effective the company’s innovation culture and capabilities have become?
- Do management and the board have access to enough intelligence to inform decision-makers as to the nature and extent of change that is occurring (e.g., changes in competitors, customers, suppliers, new technologies, regulators and other relevant external forces)? Is the velocity of the organization’s decision-making sufficient to manage the business at the speed of change?

## How Protiviti Can Help

Digital transformations generally seek to accomplish one or more key objectives: exploring and creating new ways to build strong relations with customers; the digitization of products or services, which involves launching new, enhancing existing, or exploring innovative business models for products or services; enhancing business analytics and decision science to improve decision-making; or creatively using technology to improve operational performance. We have experience collaborating closely with clients to help them achieve their business objectives in a variety of ways. Since each transformation is unique, we tailor the following competencies to fit your organization's strengths and needs:

- **Digital transformation, governance, strategy and execution** — Ensuring that transformation programs are established, well defined, set up for success and supporting execution.
- **Functional transformation and improvement** — Using technology to reinvent finance, information technology, business operations, procurement, risk management and audit.
- **Enabling an innovation culture** — Ensuring that the unnecessary barriers to innovation and change that exist within organizations are eliminated.
- **New technologies assessment and implementation** — Supporting organizations with decision-making as they consider whether to embrace new or emerging technologies.
- **Business analytics and decision science** — Helping organizations manage increasingly complex data architectures and transform data into information.

## About Protiviti

Protiviti 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 independently owned Member Firms provide consulting solutions in finance, technology, operations, data, analytics, governance, risk and internal audit to our clients through our network of more than 70 offices in over 20 countries.

We have served more than 60 percent of *Fortune* 1000® and 35 percent of *Fortune* Global 500® companies. We also work 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.

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