Nasdaq Boardvantage®

Achieving Excellence in a **New Era of Corporate Governance**

*Team @ Nasdaq Governance Solutions

Our modern world relies on organizations to deliver products and services necessary to the daily lives of the people they serve, whether they are local non-profits providing services to the community, manufacturing companies providing Personal Protective Equipment (PPE) for front-line pandemic workers, or critical infrastructure technology enterprises. Throughout 2020, the world faced uncertainty and previously inconceivable complexity. As a result, organizations were tasked with responding to such uncertainty and pivoting strategies to meet their stakeholders' needs.

Corporate governance is the foundation that enables organizations to thrive and serve their stakeholders. In an era of change, organizations that have excelled can point to healthy and robust corporate governance. Moreover, organizations with a sharpened focus on environmental, social, and governance (ESG) matters demonstrate an understanding of the importance of such matters to organizational, stakeholder, and shareholder success.

Boards that exhibited strong engagement and played an active role in driving focus on long-term strategy—while adapting appropriately to new short-term, pandemic-, economic-, and socially-driven challenges—are effectively stewarding their organizations into this new era.

In their efforts to achieve governance excellence, organizations should consider focusing on seven key areas:

1. Stakeholder-Oriented Governance
2. Board and Management Alignment
3. Board Composition
4. Board Performance
5. Environmental, Social, and Governance Matters
6. Crisis Preparedness
7. Return to Long-Term Growth

Stakeholder-Oriented Governance

A stakeholder-oriented governance structure provides clarity of purpose and focuses strategy on common values and goals that go beyond those of the shareholder. An organization should focus on delivering value to its essential stakeholders, including:

- The employees and contract workers on which it depends.
- The customers it serves.
- The communities it touches.
- The suppliers, partners, and vendors with which it works.
- The environment it impacts.
- The shareholders for whom it provides financial returns.
- The organization itself.

Governance excellence embodies the essence of these stakeholders working in an almost symphonic role orientation that delivers success and value to all. Boards that embrace ideals for excellence should consider driving strategies and risk mitigation in a consistent and innovative manner to serve all stakeholders.

Board and Management Alignment

High-performing CEOs and managers deserve qualified, high-performing board members. As the ancient proverb goes, “Iron sharpens iron, so one person sharpens another.” Over the years, the individuals who comprise a board have changed, and a more holistic, value-oriented assessment of board composition emerged that understands the benefits of diversity of thought. With this value-oriented diversity came essential constructs of board effectiveness, such as credible challenge and constructive dissent, to the benefit and augmentation of board and management alignment.

The importance of healthy dynamics between the board and management team, agreed upon risk thresholds, and a shared understanding of how an effective decision-making process functions were showcased throughout 2020. From assessing whether to furlough or lay off workers to managing debt, or from raising capital to approving mergers, ineffective boards and management teams risked becoming the next corporate governance failure and a case study for generations to come. Conversely, effective boards and management teams keenly understood the benefit of having people in the room who could candidly raise diverse perspectives and thoroughly vet issues, and, as a result, found both solutions and opportunities.

Board Composition

Beyond gender diversity, focus has expanded to disclosing ethnic and racial diversity on boards. Moreover, a well-balanced and diverse board incorporates multiple perspectives, allowing the board to better provide full and effective oversight and value to the organization.

While organizations must comply with regulatory requirements and investor demands for improving board diversity or potentially face negative consequences, sophisticated boards understand that diversity can be a strategic differentiator for board effectiveness, especially when facing complex circumstances. Varied perspectives and experiences will allow for more robust discussions and thorough analyses of possible downside risk or upside potential. This requires that diversity not be defined by only considerations of gender or race. Diversity in its most comprehensive and impactful definition incorporates the many facets of cognitive diversity, or diversity of thought.

Based on the Nasdaq Governance Solutions board engagement team's work with clients, the team found that certain boards consider a multiplicity of factors, including gender, race, age, national and geographic origin, experience (including prior board and leadership experience), and expertise. Additionally, when vetting candidates, certain boards consider personality and alignment to board culture and corporate values to understand how each would impact the boardroom environment, cultivate relationships with other directors and management, and represent the organization. Comprehensive board succession plans, along with thorough director recruitment, onboarding, and evaluation processes, has helped certain boards evolve to meet the challenges of an ever-changing marketplace and provide oversight.

Board Performance

The current climate has raised challenges to traditional perceptions of “good” board performance. Previously, directors may not have had the expertise and perspectives needed to represent the interest of stakeholders, or to provide effective corporate oversight. Governance is critical to corporate success and sustainability, deviating from twentieth century views of corporate governance as a byproduct of corporate structure and legal requirements.

Due to a variety of factors, including the pandemic and geopolitical and economic changes in 2020, boards are expected to protect the interests of the organization's key stakeholders. Investors are calling for more board participation and engagement. Directors must ask insightful questions and support management in addressing challenges, mitigating risks, and realizing opportunities.

To better understand corporate strategy and alignment between the board and management team, it is beneficial if directors have intimate knowledge of the organization. Whether that takes the form of factory site visits, test-driving the cars, or shopping at the local stores, this practice helps directors put themselves in the position of the stakeholder and understand the gaps to successfully execute on strategy. Gaining this kind of first-hand perspective has been difficult with pandemic-related safety restrictions, including limitations and restrictions on face-to-face board meetings, lasting more than a year.

In today's mostly virtual environment, boards and management teams have adapted their practices and endeavored to maintain engagement. As virtual circumstances are likely to continue, the following considerations may allow them to effectively engage in strategy meetings in the short-term and long-term:

- In advance of strategy sessions, the board should consider reviewing materials, such as analysis of performance, competitive landscape, changing regulatory requirements, and potential upside opportunity and downside risk.
- Breaking strategic planning sessions into shorter segments over multiple days and smaller groups may help maintain engagement, improve discussion quality, and prevent fatigue.
- Finally, the board chair, CEO, and other leaders may consider sharpening their facilitation skills, which may require them to read the room with both their eyes and their ears. Doing so in virtual meetings may require more concerted efforts to ensure that topics receive input from all directors and are given appropriate consideration before reaching a resolution. These leaders may find it beneficial to schedule one-on-one follow-ups with directors after the meetings to resolve any outstanding issues and better plan for subsequent sessions.

Directors and executive teams are rightfully eager to resume in-person interactions. But there is an opportunity to turn short-term adaptations into long-term techniques to promote deeper engagement and more effective, regular oversight on a go-forward basis.

ESG Matters, Including Human Capital Management

Another growing part of the board's fiduciary duty is to understand stakeholders' ESG concerns and priorities. ESG concerns reflect broad societal matters impacting organizations and people around the world.

The pandemic and social justice movements in 2020 have heightened the focus on human capital management (HCM). The importance of HCM continues to be a focus for investors. Corporations are pressed to disclose workforce safety, welfare, and equality in their annual proxy statements.

In addition, investors are signaling that boards will be held accountable for progress toward ESG and how those factors correlate to business performance and risk reduction. Boards should consider disclosing this information to showcase transparency and progress toward the organization's ESG goals.

An effective, forward-looking board will evaluate ESG matters through an approach that brings together strategy, risk, and governance with co-equal cross-disciplinary responsibilities for the board and management team. The board should consider working closely with the management team in assessing what environmental and social matters are material to the organization and its stakeholders—which will be specific to each organization based on several factors. It is then the board's responsibility to ensure the stakeholders' environmental and social priorities are built into the strategy and culture through the lens of risks to be managed and opportunities to be developed in three core areas:

1. Boards may consider assessing how they will provide effective oversight of ESG matters through either specific committees or the board, with regular and meaningful data.
2. Boards may consider how they will foster accountability for performance, which may be through KPIs in the strategic plan and financially material metrics built into executive compensation.
3. Boards may consider taking a growth mindset as they look to understand changing trends and standards for ESG matters, schedule educational opportunities on these topics, and be comfortable with setting goals that will likely evolve.

ESG matters, including HCM, will likely be key drivers in changing the way organizations—and their boards—function in the future.

Crisis Preparedness

The pandemic highlighted weaknesses in boards' understanding of crisis preparedness. Organizations have been prompted to reevaluate board performance with respect to risk oversight responsibilities. Many scrambled to work closely alongside their management teams, having daily meetings in some instances, to address the disrupted and rapidly evolving environment. Boards moved quickly to help management teams swiftly respond to changing and unfamiliar circumstances, ensuring employees could work remotely, protecting workforce health and safety, and developing actionable plans in response to social unrest. The events of 2020 provided boards a reason to reflect upon the lessons learned, including:

1. Assessing the adequacy of management's crisis preparedness plans and responses.
2. Evaluating the effectiveness of the board's oversight of crisis response.
3. Understanding enterprise risk management framework maturity.
4. Regularly reviewing corporate risks and delegating oversight responsibilities.

Through the Nasdaq Governance Solutions board engagement team's work with clients in their board evaluation processes, the team has helped boards realize the value of “table-top” and “black swan event” exercises. Those that used such exercises had a deep understanding of each director's relevant experience and leveraged that experience to provide examples to their management teams about actual crisis response practices from other organizations. These organizations were able to succinctly respond and message continuity plans to stakeholders. These strategies can be used to better prepare organizations and their boards and management teams for the next crisis.

Return to Long-Term Growth

Crisis situations necessitate an immediate focus. For example, organizations may have recently pivoted strategies to focus on transitioning to a virtual environment, reducing costs, allocating capital, or managing debt, among other issues aimed at keeping their doors open and workforces and customers safe.

While the 2020 pandemic and social justice events presented organizations—and their boards—with challenges, the “new normal” also presented opportunities for improvement and innovation. Boards should be evaluating the current competitive landscape and refining their strategies to expand reach, drive efficiency, and disrupt their industries. Boards should also consider helping management teams make the transition from short-term stopgaps to long-term strategies for sustainability, efficiencies, cost reductions, and improved stakeholder value. Therefore, not planning for “a return to normal,” but imagining a new future built on reinvigorated strategies with more dynamic practices, agile workforces, and sophisticated leaders.

The Journey to Excellence

Today, organizations are responding to the issues addressed above, delivering value to stakeholders, and showcasing excellence. Gone is the notion that effectiveness inhibits return. To prepare for the future, organizations should consider focusing on fostering an engaged and diverse board that prioritizes opportunity, risk management, and ESG matters critical to all stakeholders and sustainable business success.

An effective board is one that adds value by looking down the road to where the business is going while peripherally assessing the risks that may be approaching from “around the corner.” Such boards may gain strategic alignment with management, adding value by elevating discussions and making inquiries. Organizations now have the new tools of governance and the opportunity to reach a new level of excellence. ■

The article has been authored for ***Nasdaq Governance Solutions*** *by their internal team.*

****Nasdaq Governance Solutions*** *supports organizations worldwide with innovative corporate governance and compliance solutions. Ranging from board portal technology to board engagement services to expert insights; these solutions are designed to help boards, leadership teams, corporate secretaries, and general counsel optimize their collaboration activities and drive governance excellence. Nasdaq's board portal software - Nasdaq Boardvantage®, helps enhance the effectiveness of virtual meetings, collaboration, and decision-making processes to drive business forward for your organization.*