2020 Outlook: The State of Modern Boardrooms

Diligent | CGLytics

Introduction

As we close the chapter on another year, the corporate governance landscape of 2020 looks both promising and complex. Culture, social purpose, stakeholder activism, political uncertainty—these were among the key themes of 2019 that have set the stage for the new year. What's on the road ahead for US boardrooms? Which landmark events, regulations, and crises have set the tone for 2020?

In the first report of our 2020 Modern Governance Series, Diligent has partnered with CGLytics, the leading global provider of governance data and executive compensation tools, to examine the current landscape and look ahead.

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Diligent

Diligent is the pioneer in modern governance. Our trusted, cloud-based applications streamline the day-to-day work of board management and committees, support secure collaboration, manage subsidiary and entity data, and deliver insights that empower company leaders to make better decisions in today's complex landscape. With the largest global network of corporate directors and executives, Diligent is relied on by more than 16,000 organizations and 650,000 leaders in over 90 countries. With award-winning customer service across the globe, Diligent serves more than 50% of the Fortune 1000, 70% of the FTSE 100, and 65% of the ASX.

Learn more about:

- Board & Committee Management
- Entity Management
- Insights & Analytics

CGLytics

CGLytics is transforming the way corporate governance decisions are made for effective oversight and competitive edge. Combining the broadest governance and executive compensation dataset in the market with powerful analytics tools, CGLytics enables organizations to make better informed, data-driven decisions. CGLytics provides real-time data for an independent analysis of companies' governance practices including peer benchmarking. CGLytics is the source of global compensation data and analytics for Glass Lewis' voting recommendations.

Learn more about:

- Executive Compensation Benchmarking
- Corporate Governance Risk Monitoring
- Glass Lewis Partnership

Diligent Institute

The Diligent Institute provides publicly available, industry-leading research and programs on corporate governance practices with a global perspective. The Institute's research is derived from real experience across sectors and geographies, utilizing quantitative surveys, case studies, and interviews with leading professionals.

Learn more about:

- Diligent Institute & Recent Reports
- "Ask a Director" Series

About the Modern Governance Series

The world is spinning faster. In ten years, half of current S&P 500 companies will be replaced—a sobering (and perhaps motivating) statistic reflecting the immense pressure on companies to innovate or be left behind. As investors and market pressures drive organizations to become more digital, more global, and more sustainable, boards and management teams are facing a new set of challenges and responsibilities.

Governance has failed to keep pace. Too many organizations are without the insights, tools, and practices they need to thrive. Too many boards lack the skills to oversee digital transformation. And too many companies are left exposed by flaws in their cyber defense, their corporate culture, or their talent development strategy. In times of flux, good governance should be the backbone.

We're curating best practices. Diligent's network of board members, executives, and governance professionals is among the largest in the world. We've launched the Modern Governance Series to tap into those experiences:

- What governance practices and tools do today's most successful companies have in place?
- How is the role of board members, executives, and governance professionals evolving to meet the demands of the digital age?
- How are transformative companies shaping and measuring culture, talent, sustainability, and leadership?
- How can boards, executives, and governance professionals acquire the skills they need to see around the corner?

Throughout the year, we'll be partnering with industry leaders including Spencer Stuart, Merryck & Co., Unqork, and many more, to explore these topics with a digital lens. We can't promise we'll arrive at all the answers. However, we can promise you'll be joining a community dedicated to finding them.

Subscribe to the Modern Governance Series for free.
Visit **diligent.com/modern-governance-series** for more information.

2019 Review

Reflecting on 2019, we recognize a series of events and regulations that are shaping the agenda in 2020.

1 The **Business Roundtable Statement**, signed in August 2019 by nearly 200 public-company CEOs, offered a new definition for "corporate purpose"—one that elevates the interests of employees, customers, and communities to the level of company shareholders. Conversations around social purpose (popularized by the World Economic Forum and institutional investors like BlackRock and State Street Global Advisors) will continue in 2020. Yet, some governance experts expect to see this philosophy tested with the next economic downturn.

2 Unprecedented for establishing the first gender diversity quotas in US boardrooms, the state of **California's SB-826 law** reached its first deadline on December 31, 2019. According to CGLytics data, 26 California-based companies failed to meet the state's requirement for adding one female board member. California corporations will need to add another 1,000 female board members by the end of 2021. Will other states (or even the federal government) consider implementing similar quotas? Or will organizations demonstrate more proactive efforts towards board diversity in 2020?

3 At the federal level, the Securities and Exchange Commission (SEC) is proposing a set of guidelines designed to regulate proxy advisors and address other "proxy plumbing" issues. If approved, the **proposed SEC rules amendment** (issued November 2019) would allow corporations to review proxy voting recommendations and provide feedback prior to publishing. For many corporate issuers, the SEC rules amendment represents an overdue "reining in" of proxy advisors; yet, investors are pushing back. The SEC is still gathering commentary with a vote expected in early 2020.

4 The **Delaware Supreme Court's 2019 ruling on Blue Bell Creameries, Inc.** served as a reminder of the board's important role in risk oversight. Following a listeria outbreak in Blue Bell's ice cream that killed three people, the company's board of directors was sued for breach of fiduciary duty. The Delaware Supreme Court (overturning a decision by the Court of Chancery) ruled that the board failed to implement a reasonable oversight process articulated in the landmark Caremark case. The importance? Directors must ensure they've identified all the risks that are truly critical to their company. And it's not sufficient to merely have risk oversight processes in place; these processes must be followed with vigor.

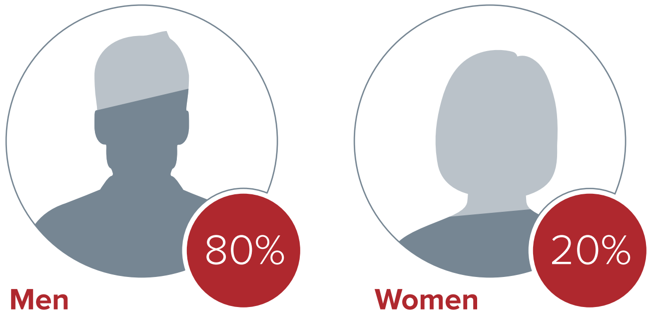
5 In 2019, the flurry of **crises related to organizational culture** persisted. Blunders by Boeing, WeWork, and Nissan reflect a range of cultural flaws extending from poor tone at the top to prioritizing profits at all costs. Over the last two years, culture has climbed to the top of board agendas. Yet, its complex nature continues to present a challenge for boards.

Together, these governance events and milestones make for quite a cocktail in 2020. Let's take a look at the data.

2019 Snapshot: The Governance Landscape

Russell 3000 Index

Board Composition



Average tenure of board members

7.4 years

350 Overboarded directors

Board Effectiveness Health Score

Top 10 companies

1. Sterling Constuction Company, Inc.
2. Schlumberger Limited
3. The AES Corporation
4. HP Inc.
5. S&P Global, Inc.
6. Tiffany & Co.
7. Domtar Corporation
8. Pfenex Inc.
9. Stericycle, Inc.
10. DSP Group, Inc.

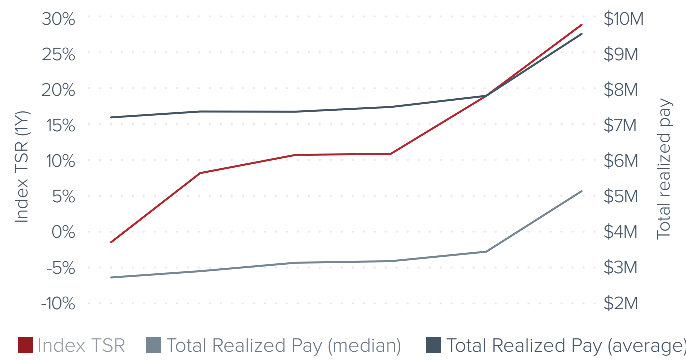
How we calculate

The Board Effectiveness Health Score is calculated using 13 effectiveness attributes including Director Interlocks, Overboarding, Gender Equality, Age Dispersion, Nationality Dispersion, and Board Independence. Criteria are based on the New York Stock Exchange Corporate Governance Rules.

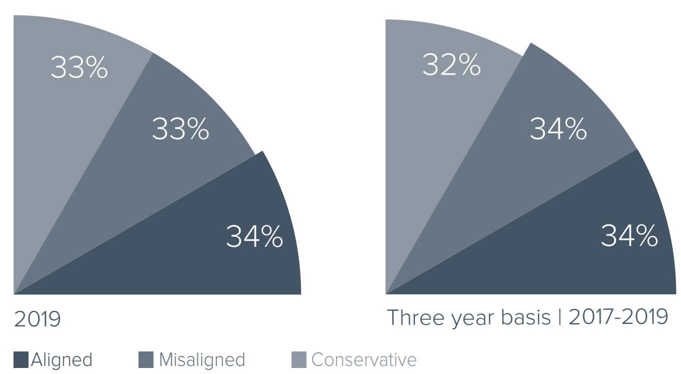
How does your organization stack up?
Click here to learn more.

Pay Landscape

Index TSR vs. CEO Pay



Pay for performance[1]



Top paid CEOs (2018)[2]

Elon Musk	Tesla, Inc.	$2,284,044,884
Patrick Smith	Axon Enterprise Inc.	$246,026,710
David Zaslav	Discovery Inc.	$129,499,005
Nikesh Arora	Palo Alto Networks Inc.	$125,068,836
Jay Levine	OneMain Holdings Inc.	$71,532,583

[1]The P4P alignment is based on granted compensation in 2019 for the year of 2018.
[2]The top paid CEOs is based on granted compensation in 2019 for the year of 2018.

Powered by CGLytics

The Road Ahead: Predictions for 2020

1 | ESG Moves Beyond An Acronym

The Environmental, Social & Governance (ESG) narrative has been looming for a while. Uptake in the US has been slow for a few reasons. First, a general lack of ESG disclosure guidelines has left many organizations wondering what to report on—and how to report it. Even on the investor side, a lack of standardization has made it difficult to compare one company to the next. We sense this is changing.

In 2020, we foresee more clarity and action around the board's role in ESG. According to CGLytics CEO Aniel Mahabier, more than $30 trillion of global assets are now assigned to ESG strategies—a total that has grown by more than 30 percent in the past two years and is expected to increase by another 17 percent in the next two years.

From a board oversight perspective, the scorecard component of ESG has helped to both define ESG and offer a system for benchmarking. Overboarding, greenhouse gas emissions, board composition, and human rights violations are just a few of the sustainability metrics investors are using to assess the long-term health of their portfolios. A key theme for 2020 will be ESG integration—that is, the thoughtful integration of these ESG factors into board reporting, shareholder engagements, strategic discussions, and even CEO pay.

We expect to see more boards performing "health checks" to ensure their organizations are fit for purpose and meeting investor expectations.

"In a world where activist investors are becoming more emboldened, issuers simply cannot drift into AGMs with blindspots in their governance performance. Corporate issuers must invest in data and analytics capabilities to stay ahead of the curve, especially when issues like executive pay can lead to big headlines with damaging effects."

– **Aniel Mahabier**, CEO of CGLytics

Advice for 2020: Take Inventory & Tell Your Story

If you're unsure where to start, step back and use an ESG lens to look at the initiatives the organization is already driving. How are employee engagement efforts or health safety programs contributing to the organization's long-term sustainability? Focus on telling that story more effectively—especially in the proxy statement. Boards should leverage frameworks from organizations like the Sustainability Accounting Standards Board (SASB) or Global Reporting Initiative (GRI) to identify gaps and outline an ESG action plan for the next three, five, and ten years.

2 | Conversations Around Board Composition Will Evolve

Discussions of board composition are evolving. While gender and racial diversity remain critical board issues, the discourse around board diversity is expanding rapidly—and out of necessity.

At Diligent's 2019 Directors' Experience event in Napa Valley, a group of 45 corporate directors characterized the shift towards board resilience (i.e., what is the unique mix of board skills that will carry the organization through its long-term strategy?). The focus is moving away from individual skills and criteria to a much bigger picture—one that also considers soft skills, interpersonal dynamics, and how these things come together in the boardroom.

As boardroom challenges become more global, digital, and nuanced, the skills matrix approach to assessing gaps becomes dangerously insufficient. In other words, a checkmark for "Technology" fails to capture the distinction between cybersecurity and digital marketing expertise, and it fails to capture the importance of those skills related to company strategy.

In 2020, we predict that board composition and diversity will continue to be a top priority for institutional investors. Yet, we believe they will increasingly look to boards for more context: "Why is this the right group of people—and the right set of skills—to tackle the organization's challenges ahead?"

"[Boards must think] about diversity as more than simply a taxonomy. [They must] think about the kinds of diversity that are really going to push forward the strategic thinking of their organization and its ability to grow and thrive into the future...What regions do you have expertise in?...What kind of a thinker are you? Are you someone who asks a lot of questions...? What kind of network do you have access to? What was your career path?"

– **Jennifer Chapman**, Professor at the Haas School of Business at UC Berkeley and Independent Director at Simpson Manufacturing (via The Corporate Director Podcast)

Advice for 2020: Distinguish Between Digital Skill Sets

The complexity of board composition is increasingly tied back to today's digital-era business challenges. Yet, "digital" is not a monolith. Information security, data analytics, digital marketing, and e-commerce are just a few distinct concentrations or career paths under the digital umbrella. Without an understanding of these skill sets and how they differ, boards will have trouble identifying gaps in their composition or determining what kind of expertise they need. Make it a goal in 2020 to get all board members up to speed on the digital landscape. (Heads-up: we'll be tackling this topic later this year as part of the Modern Governance Series.)

3 | Company Purpose Becomes Non-Negotiable

Why does your organization exist? How does it positively impact its employees, shareholders, customers, and communities? Organizations that don't have good answers to these questions could find themselves in a compromising position this year.

Institutional investors (notably BlackRock's CEO Larry Fink) have challenged companies to think about value creation more holistically. For many companies, this message finally hit home with the August 2019 Business Roundtable Statement, a pledge signed by nearly 200 CEOs that offered a new definition for corporate purpose. Among the endorsers were Amazon CEO Jeff Bezos and JP Morgan Chase CEO Jamie Dimon, all commiting to "lead their companies for the benefit of all stakeholders" (i.e., customers, employees, suppliers, communities, and shareholders). Not only did the Business Roundtable Statement garner significant publicity, but it has queued up conversations in 2020 around the board's role in company purpose.

Effective boards are recognizing that company purpose is more than a feel-good exercise. When approached strategically, company purpose should power everything from executive compensation (are we incentivizing the right behaviors?) to company culture (what values, practices, and people will ultimately lead us to achieve our long-term goals?).

"What's the role of a modern CEO today? It's to achieve long-term profitability by prioritizing stakeholder interests in the present. The challenge comes with connecting the dots. Today's board of directors, given their longer tenures, can be a grounding force and a strategic asset on the road to long-term value."

– **Brian Stafford**, CEO of Diligent

Advice for 2020: Focus on Impact

Companies with a clear purpose will find it easier to engage with their employees and with the wider public. Boards and governance professionals should be prepared to discuss the purpose-driven initiatives and policies at their organization, but they should also focus on impact. How have these initiatives—or how will these initiatives—positively impact organizational stakeholders while building shareholder value over time?

4 | Poor Company Culture Will Remain the Gateway to Crisis

Peel back the layers of any 2019 crisis, and you'll typically find flaws in company culture. The root of poor culture can be many things: tone at the top, poorly designed incentives, lack of stakeholder empathy, or systemic discrimination. Unfortunately, we predict that this trend of culture-powered crises will continue in 2020. However, we also predict that boards will devote significant time and attention to the topic this year.

Culture is tricky. For the same reasons culture is difficult to define, it's difficult to monitor and influence. From the board's perspective, cultural factors are woven into the fabric of every major board committee and governance function—from risk management to CEO succession to compensation and incentives.

Overseeing culture requires directors to look beyond the board materials. "I never settle for the highlights of the employee engagement survey," said board member Jan Babiak in an interview for a Diligent article on culture. "I always ask to read the full report with the results filtered by gender, tenure, geography, and job function."

Whether it's reading reviews on Glassdoor or spending time with members of the management team, board members must leverage emotional intelligence alongside key risk indicators like employee turnover or whistleblower complaints. Culture may be challenging, but there are always clues for directors who know where to look.

"From a governance standpoint, culture is rather ethereal. It's not like other areas of oversight where boards can say, 'We beat our earnings per share by X.' You can't measure culture in that way, because culture is both positive and negative–and every culture has both good and bad within it."

– **Jan Babiak**, Corporate Director (multiple boards)

Advice for 2020: Don't Ignore Board Culture

Boards must not overlook the relationship between company culture and board culture. Boardrooms that don't encourage tough questions or alternative viewpoints will likely never arrive at the conversations most likely to influence culture. Boards lacking cognitive and demographic diversity are simply more likely to miss red flags.

5 | New Information Models Will Arrive in the Boardroom

In decades past, boards conducted their business within the four walls of the boardroom. Quarterly board meetings allowed time for deliberation and the board materials provided enough information for directors to fulfill their basic fiduciary obligations.

Fast forward to today, and the landscape has entirely shifted. Digitalization, globalization, and connectivity have driven welcomed advances in today's business world. Yet, these trends also expose organizations to a world of new risks. Social media, cyber threats, and activists are always "on." And boards can no longer rely on management-prepared materials as the sole source of board intelligence.

In a recent study on board meeting preparation, the Diligent Institute found that 71% of public company directors gather independent information about the company in preparation for board meetings.

In 2020, we expect this environmental scanning function to become a more formal part of the board information process. We expect to see more boards leveraging data and even artificial intelligence in ways that improve both visibility and speed.

"Like all facets of business, boardrooms are not going to be immune to change. There's a…mismatch between the pace at which boards operate and the pace at which the world is operating—and [a mismatch in] the expectations of shareholders and employees relative to our agility and responsiveness."

– **Dr. Anita Sands**, Board Member for ServiceNow, Symantec, and Pure Storage (via The Corporate Director Podcast)

"It's about getting alternate data points. So whether I'm talking to customers or suppliers or attending…investor conferences, I try to correlate lots of different data points… Having data from multiple sources—especially contrary, independent opinion from management—allows me to ask much better questions."

– **Nora Denzel,** Board Member at AMD, Talend Software, and Ericsson (via The Corporate Director Podcast)

Advice for (Governance Professionals in) 2020: Embrace the Change

Board information needs are changing—and no one is better positioned to drive these changes than the corporate secretary. The most effective governance professionals will be the ones who can anticipate board member needs and enhance visibility in ways that power better decision-making. The demand for a trusted advisor has never been so high. Governance professionals should feel empowered to fill that gap.

The New Imperative: Modern Governance

As these trends come together in the boardroom, organizations face a series of challenging questions. How does our company positively impact the world around it? Do we have the right talent and culture for growth? Do our current practices hinder agility? Do our existing systems and processes open the door to cyber threats? Which risks are we willing to take?

The costs of poor governance are simply too great. In a 2019 report, the Diligent Institute examined the financial consequences of a governance-related crisis. The Institute looked at 14 companies that had recently undergone a governance mishap ranging from a cyber breach to financial fraud. The findings? One year after the incident, these 14 companies had lost a total of $490 billion in shareholder value—a deficit these companies are still working to regain. However, the Diligent Institute report also delivered a bit of good news.

Good governance can be a competitive advantage. The same report found that companies with strong governance (top 20%) financially outperformed their low-ranking peers by 15 percent over a two-year period. In other words, good governance yields a return on the investment. But what does modern governance look like? Where should boards focus their time? What are the best practices among today's leading organizations? This is exactly what our Modern Governance Series is designed to answer this year.

How does your organization stack up?
Take the Modern Governance Quiz

The 2020 Agenda

With our 2020 predictions locked in, it's time to set the agenda. As part of our Modern Governance Series, Diligent is tackling a slate of topics and partnering with other industry leaders in a big way.

JAN/FEB

2020 Governance Outlook

The State of Modern Boardrooms

Diligent and CGLytics assess the state of modern boardrooms and outline governance predictions for 2020. What's on the road ahead for US companies and boards?

MAR/APR

Leadership in the Digital Age

Future-proofing the C-Suite

Diligent partners with Merryck & Co. and Meridian Compensation Partners to explore how leadership roles are evolving in the face of digital transformation.

- 7 characteristics of highly transformative CEOs
- How the GC role is evolving to meet new demands
- The compensation committee's role in incentivizing innovation

MAY/JUN

Data & IT Transformation

Technology as a Competitive Advantage

Today's business challenges demand both agility and security, and legacy IT systems can pose great risk. How can boards and management teams ensure their organizations are making the right choices? Diligent partners with Unqork to pinpoint best practices.

- How organizations can avoid costly mistakes
- Questions boards should be asking management
- Entity management: a roadmap for global expansion

JUL/AUG

Demystifying Digital

Navigating the Talent Landscape

Diligent partners with Spencer Stuart and the Next Gen Board Leaders to take a closer look at today's digital landscape. Discussions will focus on talent at all levels—from the boardroom to the frontlines.

- Trends impacting the talent landscape
- The board's role in driving digital strategy
- Understanding digital challenges and skill sets

More topics to come this year!

Subscribe to updates and learn more at diligent.com/modern-governance-series