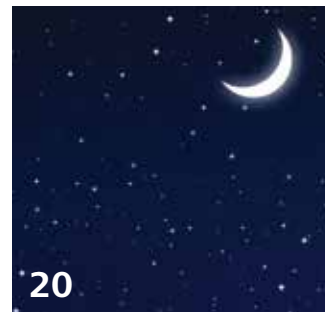


Directors' Alert 2013

Lead or be led: Time to take advantage of the new business reality





Boards of directors have an important role to play in helping their organizations determine how to respond to the new operating environment.

Table of contents

2	Introduction
4	Capital management
6	Regulation, governance, compliance
8	Risk management
10	Crisis management
12	Strategy
14	Sustainability
16	Performance
18	Management succession
20	Talent management
22	Technology
24	A closed door or an open one?
25	Contacts



Lead or be led: Time to take advantage of the new business reality

More than four years have passed since the 2008 financial crisis and its reverberations still continue to shake the global economy.

In November 2012, the Organization for Economic Cooperation and Development (OECD) reduced substantially its economic global growth forecast for 2013. The OECD considers the greatest threat to the world economy to be the recession in the Euro-zone and in the United States.

The risks created by continuing difficult and, if the predictions are correct, worsening economic conditions are, by now, familiar ones for boards of directors. Yet, perhaps because many organizations have, in recent years, implemented robust, integrated enterprise risk management systems and are also developing more risk-aligned strategies and initiatives, many boards expect they will need to spend less time on risk management on its own in 2013.

If this expectation proves true, these boards will have more time to focus on other top priorities facing them and their organizations. The boards that lead rather than being led, will be the ones that have successfully adapted strategies to turn challenges into opportunities and leverage compliance requirements to make innovative developments.

One of those priorities is talent. In countries with aging populations, organizations need to replace retiring top talent, many of whom are in top decision-making positions, including in the C-suite. Some organizations may also face a tough battle for the skilled workers they need to enable them to meet the global demand for their products and services. Organizations of all types in several jurisdictions need to develop and implement strategies that enable them to attract the talent they need, and to motivate, develop, and retain highly talented people.

New regulations continue to be introduced around the globe. These rules often arrive in piecemeal fashion, leaving organizations to sort out their response to them, often in a disconnected fashion. However, the experience organizations have had addressing the many regulatory changes over the past decade might enable them to realize opportunities that may be gained

by looking at regulatory requirements holistically, looking beyond compliance and figuring out how to use the rule changes to their advantage.

Social media and new mobile technologies are transforming the way organizations interact with their stakeholders, enabling them to open new communication channels to attract customers, employees, and investors. Rather than follow the pack by following the latest tweets and trends, the boards and management of leading organizations are developing well thought out strategies for these technologies and are putting the appropriate resources and processes in place to realize their objectives.

Stakeholders' expectations continue to grow regarding the performance of organizations and the quality, transparency, and timing of the information they disclose about their activities. Today, people look to organizations to provide them with a broader range of information – from traditional financial topics to non-financial subjects including the environmental behavior, workplace practices, community social responsibility, and more. Organizations that meet these expectations not only build greater trust with their stakeholders, but, as studies in the area of sustainability demonstrate, they may also be better performing organizations as well.

This publication examines these and other top challenges likely to face organizations and their boards of directors in 2013.

The purpose of this publication is not to provide solutions to the issues discussed. The best approach for any organization will depend on its own particular circumstances. Our objective is to assist directors in identifying the issues of importance to their organizations, and to help promote boardroom discussions around the strategies and options management has put forward to address current and future challenges, mitigate the risks, and seize the opportunities that lie ahead.

This publication offers insights from governance specialists from Deloitte member firms ("Deloitte") around the globe – Asia, the Middle East, Europe, and the Americas; these specialists have applied local and international perspectives on these and other top boardroom priorities within the context of today's business environment. Each article includes questions that directors may ask to further explore the issues with their own boards and of management. In addition, articles are supported with tools and resources so directors can "dig deeper" to broaden their understanding of the issues and improve their board's effectiveness in dealing with them. These additional resources can be obtained by contacting your Deloitte partner.



Capital management

Find the best value for cash

Questions for directors to ask:

1. Do we have a good understanding of how our organization's capital investments affect its competitive ability? How do these investments compare to those of other organizations in our industry?
2. What are the expectations of our shareholders and other stakeholders on how we utilize our available capital? What has their reaction been to our past uses of capital and how has that affected their investments and/or lending decisions?
3. What framework and metrics does our organization use to measure the strategic linkages of a proposed capital project? Does this framework allow us to compare the value that would be created by other projects or uses of capital? Does it assess how well a potential investment would fit into our organization's risk profile and appetite?
4. Has management prepared a capital deployment strategic plan that looks at different project funding scenarios (including maintaining the status quo) over a three to five year period?
5. Do we adequately stress test the projected returns on our capital expenditure activities against various economic scenarios?
6. Have we been criticized about the cash being held on our balance sheet? What is our response to those who claim that our idle cash is a drag on economic growth?

Resources:

- El Gobierno Corporativo y el papel del Consejo en las Inversiones (Mexico, in Spanish)
- Are CFOs And Board Members Expected To Perform Miracles? (South Africa)
- Economic Woes Demand Optimum Use of Capital: Extracting Full Value (South Africa)
- The Board of Directors And Capital Allocation (United States)



Faced with continuing global economic uncertainty, some companies have fortified their balance sheets with large amounts of cash, often called “rainy day” funds. U.S. companies alone are estimated to be holding as much as \$2 trillion in cash reserves¹. With interest rates at multi-decade lows in most countries, however, these idle funds carry an opportunity cost.

Companies that want to put available funds to work to build their organizations need to determine a plan to achieve the greatest value from their investment. Potential opportunities may include mergers or acquisitions, or acquiring new technologies and capabilities to improve efficiency and facilitate organic growth. Other options may include returning cash to shareholders, via share buybacks or dividends.

Not-for-profit organizations and government agencies may not have the same cash reserves as some large publicly-listed companies, but they, too, need to decide which uses of their funds will create the best value for their organizations.

Comparing funding choices is often difficult in any organization given differences in strategic benefits, stakeholder interests, risk levels, interdependencies, urgency, timing of returns, investment type, and other factors. What’s more, an organization may use different metrics to measure different types of projects and their return on investment, which further complicates the cross comparison of different uses for the same funds.

Such comparisons can be made easier when boards proactively set out the parameters they want to see in funding proposals. These requirements may include creating a framework and process for quality capital decision making identifying, for example:

- How the investment fits into the organization’s overall strategy.
- How the investment fits within the desired capital structure.
- How the investment fits the organization’s risk profile, risk appetite and risk tolerance.
- The impact of financing the investment, when the organization’s own cash reserves are not sufficient to cover all costs of a project.

When uses for capital are proposed to the board, directors should consider having the sponsor explain what the project might look like if they received only 70 percent, 80 percent, or 90 percent of the requested funding. Such an exercise distinguishes parts of the project that could be completed from those non-essential components. It may also uncover missed or hidden benefits that may not be otherwise fully accounted for or addressed.

With the continuing uncertainty in the global economy, many companies have moved beyond a static approach to capital deployment to a dynamic one that gives them the strategic flexibility to anticipate changes in the business environment and quickly adapt their strategies ahead of their competitors as that outlook is clarified. For example, if a wireless telecom provider sees a dramatic uptick in data usage from customers and waits until the annual budget process before doubling down on investments to grow capacity, it may be too late to seize that opportunity.

¹ 10 Companies with the Biggest Cash Stockpiles in America, Chiefexecutive.net, October 4, 2012.



Regulation, governance, compliance

Get ahead of the next regulatory wave

Questions for directors to ask:

1. Do we have a clear picture of regulatory activities and proposals and their potential impact on our organization at both the global and local levels?
2. Do we have a regulatory “Achilles heel” – an area of our operations or reporting that would be severely affected if regulations pertaining to it were to change? Are we monitoring global regulatory activities to determine whether regulators or legislators are proposing ideas in these areas?
3. While new regulations may be made in piecemeal fashion, do we also adapt to them in a piecemeal way? Do we avoid duplications of effort, or gaps between processes and systems, that may arise by simply layering on new regulatory requirements?
4. What relationships do we have with regulators and legislators and how do these relationships affect our ability to provide input into regulatory decision making? Have we identified someone in our organization to be accountable for those relationships and to manage the regulatory issues facing us?

Resources:

- Evolving In Response to Global Re-Regulation (Canada)
- Competition Law Compliance Program (Romania)
- Securities Law Compliance Issues (Romania)
- The Board's Role in Ethics and Compliance (United States)
- The Risk Intelligent Chief Compliance Officer: Champion of Risk Intelligent Compliance (United States)



As night follows day, it seems every new set of problems is quickly followed by new regulations introduced to try to fix what the consensus opinion believes went wrong. This pattern could be seen as a piecemeal approach that has saddled markets and organizations with a kaleidoscope of regulations to try to rationalize and incorporate. Not surprisingly, then, regulatory compliance is becoming more expensive in terms of both time and money. Reported increased costs would not include those incurred in management and board time to focus on ensuring compliance at the expense of other priorities, such as setting and overseeing the execution of strategy.

What's more, the compliance burden is not likely to get any lighter in the future. Although they do not face the same requirements as publicly-listed companies, private entities and not-for-profit organizations also face an array of changing regulations pertaining to the environment, antifraud, anti-money laundering, privacy, workplace conditions, and more.

In a global business environment, organizations need to keep abreast of actual and potential regulatory changes in more than just their home markets. The UK Bribery Act 2010, for example, applies not just to companies listed on UK exchanges, but to all companies that do business in the UK, which could be liable for offences committed outside the UK by an employee, agent, subsidiary or third-party. Regulatory changes occur in all jurisdictions, especially in emerging markets where they have the potential to change the risk/reward balance and alter the competitive abilities of players operating in those markets.

Today, organizations and their boards need to balance short and long-term issues. Boards again face the risk of devoting too little time to longer-term strategic objectives in order to oversee the organization's response to more near-term regulatory matters. Publicly-listed companies, for example, must satisfy the capital market's demand for profits today while also planning and investing for the future. Of course, the shorter-term focus of both regulators and shareholders makes it more difficult to keep this balance.

Taking the necessary steps to remain compliant with multiple regulatory changes can be a major challenge, but organizations cannot afford to do so solely in a reactive way. Instead, they must get ahead of the regulatory wave. To do so, some organizations have become proactive, either directly or through industry associations, commenting on regulatory proposals and recommending that problems be solved by fixing the current regulatory requirements rather than patching them with new layers of rules.

Some boards maintain a list of the top issues that could potentially impact their company, suppliers, customers, business partners, and other associated entities. They monitor global legislative and regulatory agendas around those issues, and develop different scenarios to assess, in advance, the impact these changes may have on their operations, including looking at how regulatory changes may create opportunities and not just compliance needs.



Risk management

Avoid risk analysis paralysis

Questions for directors to ask:

1. Do we recheck and reassess the risks associated with our strategic initiatives on a regular and ongoing basis as our strategic and other key initiatives proceed? Do we get the right kind of information about risks so we can assess those risks effectively?
2. Do we periodically reassess our organization's risk profile, risk appetite, and risk tolerance? Have we reconsidered these issues in light of recent changes in economic or market conditions?
3. Are we identifying portfolio risks, especially with initiatives that are undertaken either in partnership with other organizations or are outsourced and, therefore, are processes that our organization no longer controls directly? Do we monitor the risks faced by our strategic partners in order to be able to identify early on those that may significantly impact us?
4. When projects arise outside our normal profile either because of their size, geography, or other factors, are we confident that we have the experience and expertise – at both the management and board level – to fully understand and monitor the risks associated with that project? Does the board need to consider recruiting directors with more recent or more relevant risk management experience?

Resources:

- Corporate Governance Forum: Information for Supervisory Board and Audit Committee Members (Germany)
- Mitigation, Not Regulation, the Key To Risk Control (Singapore)
- Risk Committee Resource Guide for Boards (United States)
- Risk Intelligence White Papers (United States)



In today's challenging global economy, the identification, monitoring, and mitigation of the significant risks facing the organization has been a top priority. Since 2008, companies have invested significantly to build enterprise risk management programs where the initial primary goal was often managing downside risks – avoiding losses – rather than pursuing the upside opportunities associated with growing the organization.

Today, boards' involvement with risk oversight has broadened beyond just day-to-day financial and operational risks to also include strategic and environmental risks, such as the state of the global economy and competitive landscape, commodity prices, sustainability, regulatory and reputational risks, and even the possibility of sovereign default.

Some boards are shifting away from their recent emphasis on risk avoidance to instead adopt a better balance among the oversight of risk, growth, performance, and strategy. Getting this balance right is critical for every board and management team. Those that focus too heavily on downside risk and attempt to manage everything that may possibly go wrong run the risk of becoming stalled – falling into risk analysis paralysis. If so, they may be missing out on opportunities.

One way to pursue opportunities without losing sight of risk is through risk-aligned project design, in which risk is incorporated into the design of projects and strategic initiatives. Incorporating risk into the design of initiatives, and integrating the risk appetites of the organization and/or risk tolerances within its business units, helps ensure that the associated risks are visible, thereby providing greater assurance that they will be fully identified and properly managed.

Boards can improve their ability to bring to light risks related to an initiative simply by asking the right questions. In today's volatile market, boards that ask, "What economic or environmental events could affect this initiative?" may uncover a variety of potential market and environmental risks. However, broadening the question to instead ask, "What could possibly go wrong with this initiative?" may identify a wider range of potential value-destroying risks beyond just those created by the market and environment.



Crisis management

Expect the unexpected

Questions for directors to ask:

1. When was the last time we reviewed our organization's crisis management strategy? Is it up-to-date with our current organization, its markets, and objectives? Does it leverage the latest technological developments, such as social media and cloud computing?
2. Are we confident that the people identified to be our corporate spokespeople have the necessary public speaking skills and abilities to interact effectively, particularly with the news media? Do any of them need public speaking or media training sessions?
3. Do people in the organization understand who is authorized to speak on its behalf during a crisis and how inquiries from the media and others are to be handled?
4. What would happen if a crisis occurred outside our organization's home jurisdiction? Are there additional issues – or ones with different nuances – that we would need to manage if a crisis occurred in different parts of the world?
5. Do we regularly explore what may be the emerging/unknown risks faced by our organization, in addition to planning for "black swan" risks?

Resources:



- Surviving and thriving in uncertainty: Creating the Risk Intelligent Enterprise (Unites States)

What could suddenly derail your organization or its key strategies? Is it the political turmoil occurring in many parts of the world? Extreme weather conditions, such as tornados and hurricanes, extreme rainfall or droughts, unusual hot or cold weather? Social media that magnifies uncertainty and shortens the reaction time to bad news? A product design or supply chain failure?

While most organizations and their boards devote considerable attention to staying on top of significant potential risks, that does not necessarily mean they are prepared to deal with a crisis when it occurs. When it does, the media can usually be counted on to quickly hone in on the problem and the company and, under such scrutiny, many organizations publicly flounder, blindsided by a disaster they should have identified and been monitoring as a key potential risk.

Boards should ensure that management develops a crisis management plan that addresses scenarios that might affect the organization based on its industry, size, operating locations, and other key characteristics. A consumer products company with a visible brand name, for example, may receive more media attention when it faces problems than a capital goods manufacturer. The nature of these crises may also differ. Some may be problems that simply make the company look bad, while others may be more serious events with significant human, environmental, and

other impacts that threaten the continued viability of the organization. Financial position is also important; companies with greater liquidity and access to funding may be able to “ride out” a crisis better than others.

Every crisis, however, can cause harm to the organization and they all need to be managed if and when they occur.

While the often fluid nature of a crisis requires adept responses by management and the board, organizations cannot afford to wait until a crisis occurs before developing the strategy to deal with it. Crisis management plans need to be developed in advance and updated periodically, and should identify the person who will be the primary spokesperson for the organization (often the CEO or board chair, depending on the situation) as well as specific individuals who will be responsible for communicating with each of the organization’s key stakeholder groups. Each party needs to understand the key messages they are to deliver, which may differ from one stakeholder group to another.

While the organization’s senior leadership needs to work in tandem during a crisis, the roles of the board and management are different. The CEO and the management team will have the primary responsibility for managing the operational issues required to resolve the crisis. The board’s role is to protect shareholder value and maintain the public confidence in the organization.



Strategy

Maintain long-term consistency and short-term flexibility

Questions for directors to ask:

1. Is our board's role in setting and overseeing strategy and its execution appropriate? Should we establish a strategy committee to take lead responsibility for this activity? How frequently should our organization's strategy be an item of the board's agenda? Do we schedule offsite retreats for the board to focus on strategy?
2. Do we engage our people in strategy discussions, and encourage them to help us identify opportunities and put forward ideas?
3. Have we built strong linkages to indicate the role that business units and individual projects play in helping achieve our strategic objectives?
4. Do we require our people to consider and build in our organization's strategic objectives and value drivers into their projects and proposals?

Resources:

- The Board's Role in Aligning Strategy with Risk (Global)
- Brasil 2015 – As descobertas do crescimento (Brazil, in Portuguese)
- The Directors' Series (April 12, 2012) the Board's Role In Growth And Strategy (Canada)
- Corporate Governance Forum: Information for Supervisory Board and Audit Committee Members (Germany)
- Improving Board Effectiveness: Oversight of Strategy (United States)
- Shaping A Risk Intelligent Strategy: Confronting Assumptions To Find Risk And Opportunity (United States)



It can be difficult to set and maintain a consistent longer-term direction in an uncertain economic environment where sudden, unexpected changes may arise that require fast, flexible responses.

The ongoing volatility of global capital markets continues to disrupt many organizations' ability to achieve their strategic objectives. Since 2008, the financial markets and its players have all undergone some major changes, which may make it more difficult for many organizations to finance growth and expansion strategies through the issuance of equity or debt. And while some companies have large capital reserves, many organizations are not able to self-finance strategies necessary to maintain their position and increase their revenues.

On the other hand, the rapid and widespread adoption of new technologies – from social media and mobile apps to cloud computing – are radically transforming many industries by changing consumer, stakeholder, and other behaviors with the result that traditional business channels may be shrinking while new ones are opening up. Crowdfunding, for example, enables organizations and people to pool their resources through social media and the internet to collectively support key initiatives.

Given the volatility of today's markets, boards need to determine whether their organization's ability to connect its strategic plans with its financial and other reporting systems would enhance its ability to make better real-time strategy adjustments. Most importantly, however, boards should ensure that their organizations formulate and pursue strategies that focus on the organization's essential core competencies – those that are the most difficult ones for competitors to imitate or match. It is these competencies that should provide the foundation for developing strategies that achieve and sustain a competitive advantage.

How well an organization develops and executes its strategies depends on more than just the role and abilities of the board and management; all levels of the organization should be challenged to identify strategic opportunities and ways to achieve them. Boards should ensure that the organization's strategic goals and key risk considerations are clearly communicated throughout the organization, together with information about what drives value for the organization (e.g., market share, supplier relationships, retention rates, brand strengths, technology optimizations, etc.). The better people within the organization understand these objectives and value drivers, the better they will be able to identify and pursue initiatives to help achieve them.



Sustainability

Create an environment for superior performance

Questions for directors to ask:

1. What is our definition of sustainability? Do we have a sustainability policy, and is it accessible to the board, management, and employees? Do we have a clear understanding of our stakeholders' expectations around sustainability? How well does our definition of sustainability match that of our stakeholders?
2. Do we consider sustainability to be philanthropy? Are our sustainability activities something we do in addition to and around our core business activities, or are they something that we've fully integrated into all of our strategies and ideas?
3. How do we report our sustainability activities? Do we measure our progress using recognizable, comparable metrics? Are we confident that our sustainability reputation will meet the expectations of stakeholders who take time to scrutinize our practices?

Resources:

- The Leadership Premium: How Companies Win the Confidence of Investors (Global)
- The Directors' Series (April 13, 2011) Social and Environmental Issues in the Boardroom (Canada)
- Sustainability and The CFO In Association With Business In The Community Ireland (Ireland)
- El Consejo de Administración sustentable (Mexico, in Spanish)



There are many ways an organization can gain a competitive advantage, such as being an employer of choice for the most talented individuals, being able to access the best financing, having the highest quality supply chain partners, and, of course, being a supplier of choice for customers. Sustainability is an important factor in helping companies achieve, and maintain, these key competitive drivers.

Sustainability is not just environmental responsibility. Investors and others increasingly refer to “ESG,” (environmental, social, governance) or “CSR” (corporate social responsibility). Both of these terms suggest that sustainability includes ethical, social, and governance factors, including workplace and community relations, compliance, and reporting in addition to the organization’s impact on the environment. Organizations’ corporate social behavior is closely scrutinized from all corners of the marketplace, including investors, employees, regulators, competitors, customers, and communities, and is factored into their investment, business, purchasing, and employment decisions.

Studies undertaken by organizations such as Deutsche Bank² and the Harvard University Business School³ have found that organizations with good sustainability practices tend to be better corporate performers and are able to access better financing rates. Strong sustainability performance alone is not enough to achieve these benefits, however; organizations need to communicate such information so stakeholders can include these sustainability commitments, activities, and achievements in their decision-making.

Top performing ESG and CSR organizations do not view sustainability as something that can be layered on to the organization. Instead, it is an integral part of it; they build sustainability into their business strategies, integrate it into their brand, and tie it to their core business. It is also a key element in their decision-making, for example by ensuring that their supply chain and other partners also have strong sustainability practices. When they measure and report their sustainability activities, they do so using recognized and measurable sustainability metrics, such as those developed by the Global Reporting Initiative, which helps ensure their practices are transparent and easily compared to those of other entities⁴.

² *Sustainable Investing: Establishing long-term financial performance*, DB Climate Change Advisors, Deutsche Bank Group, June 2012.

³ Beiting Cheng, Ioannis Ioannou, and George Serafeim, *Corporate Social Responsibility and Access to Finance*, Harvard Business School, Working Paper 11-130, May 2012.

⁴ The GRI G3.1 reporting guidelines are available at www.globalreporting.org.



Performance

Cut through the “white noise” in performance reporting

Questions for directors to ask:

1. How well do we understand our stakeholders’ information needs? Do we have the systems in place to capture that information? Should we develop system capabilities to do so even if they go beyond what is needed for compliance reporting?
2. Has our transition to different types of reporting (e.g., IFRS, XBRL, etc.) been approached solely from a compliance perspective? Should we do more to identify opportunities to improve the quality and usefulness of our disclosures?
3. How integrated is our reporting? Do we try to provide users with a comprehensive, connected picture of our financial and non-financial activities? Do we take advantage of technology to enable readers to drill down to learn more?
4. What insights can our investor relations group provide regarding our corporate reporting and how well it meets the needs of investors?
5. Should we invite stakeholders to provide their input regarding our reporting? If so, what channels exist to enter into such a dialog?

Resources:

- The Future of Productivity: Clear Choices For A Competitive Canada (Canada)
- European Pulse Survey: Aligning Your Remuneration Policy with Your Strategy (France)
- Disclosure of Long Time Business Value (United States)



In corporate reporting and disclosure, “more” doesn’t necessarily mean “better”. The volume of corporate reporting continues to expand as a result of a variety of factors. Globalization, for example, has led to the need for some companies to report in more jurisdictions, with more varied reporting requirements. New regulations give rise to more disclosures and stakeholders demand more information on a wider range of matters of importance to them, such as corporate social responsibility or environmental social governance impacts.

Keeping up with the corporate reporting burden is a significant compliance challenge. But has the value and usefulness of corporate reporting kept pace with the growth in volume? Even before the financial crisis and the new disclosures required since then, a 2008 survey of investors conducted by the SEC’s Office of Investor Education and Advocacy found that “many investors do not actually read disclosure documents” and that investors complained that “too much legal or technical jargon gets in the way of clarity, the documents can be too long and wordy, and information is sometimes hard to find in the reports”.⁵

Recently, the UK Kay Review recommended that publicly-listed companies no longer be required to provide quarterly reports. Its report noted, “...the opportunities created by modern information technology have led many people to overestimate the value of this flow of data. Much of the data which flashes across screens is simply noise, although commentators constantly endeavour to attach significance to it. Much of the content of reports and filings is boiler plate – verbiage which is reproduced in almost identical form from year to year and by company after

company. Some of the material in these reports is fluff – self congratulation with little substantive content”.⁶

If stakeholders can’t find information that is relevant, understandable, and timely it may be because the information they want has not been provided – for example, many stakeholders feel the non-financial information they receive is inadequate for decision-making. It may also be because the information that is provided is not connected; organizations report financial, non-financial, governance, operational, and strategic matters, but these reports are often stand-alone documents that are not well integrated or linked.

Boards have an important responsibility for ensuring that the organization provides useful information to its stakeholders. If the objective is to maximize value for all of its stakeholders, then the organization must first understand what each of its stakeholder groups value, and the value that the organization either gains or loses from the way it is perceived. With this knowledge, boards can then help management to begin cutting through the “white noise” of their corporate reporting – an important objective in organizations where a primary purpose of corporate disclosures is to attract investors. Transparent, useful disclosures may also help the organization win support among other stakeholders, including employees, customers, and others, by demonstrating the company’s commitment to and performance in areas of importance to them. A good test for those preparing information disclosures is to ask whether members of their own family would understand the discussion; if not, the average stakeholder would not likely understand it either.

⁵ *Toward Greater Transparency: Modernizing the Securities and Exchange Commission’s Disclosure System*, 21st Century Disclosure Initiative: Staff Report, January 2009.

⁶ *The Kay Review of UK Equity Markets and Long-Term Decision Making*, July 2012.



Management succession

A board priority

Questions for directors to ask:

1. Does our organization control the management succession process, or does it just react when the need for succession occurs? If we suddenly needed a new CEO today, how quickly could we develop a short list of potential candidates?
2. How well does our organization manage CEO succession? How successfully have we transitioned CEOs in the past? Based on that experience, are we confident that we will manage the next transition successfully?
3. Does the board have a robust CEO succession strategy with the necessary support processes? Are we confident that our management development program is helping us build new leaders from within our organization, or will we likely have to look outside it to find our next leaders?



Resources:

- Planning for Family Business Succession (Ireland)
- CEO Succession Planning and Talent Considerations (United States)



Governance leaders believe that CEO succession is an important board priority, along with risk management, disclosures and oversight of corporate strategy. With average CEO tenures continuing to shrink, not only is succession a priority, but it is also a recurring one.

CEO succession might best be viewed as a subset of a broader leadership development process in which succession plans are developed and reviewed regularly for all key leadership positions. However, nurturing talent takes time, which is one reason why, when changes in marketplace or other conditions occur that suddenly result in the need to replace C-suite members, many entities can only do so by looking outside their organizations. While that has the advantage of bringing fresh insights to the business, it can be costly – both in terms of money and transition time – and carries the risk that incoming executives may not be a good cultural fit or will need time to get up to speed, thereby delaying or disrupting important decision-making.

Given these challenges, organizations need to put in place a CEO succession strategy that gives them the necessary time to plan and carry out its implementation. Boards are increasingly making CEO succession a quarterly agenda item and growing numbers include it as a discussion topic at every board meeting, during executive sessions when directors meet separately from management. Some boards devote an annual off-site meeting to it, in much the same way as they do strategy discussions, in order to dive more deeply into the issues.

Indeed, the issues surrounding CEO succession are significant, may be as volatile as overall business conditions, and need to be managed carefully. CEO succession strategies should be linked to organizational strategies, since an incoming CEO needs to have the appropriate knowledge

and skills to implement them. As circumstances create the need to adjust corporate direction, CEO succession activities should be adjusted to reflect those changes.

CEO succession processes should be tailored to the organization. A key component of these succession processes should be a transition strategy that guides how the organization will bridge from an outgoing CEO to a new one without losing focus and momentum.

Also important is the need for an emergency succession strategy to cover situations where the incumbent CEO suddenly becomes unable to act. Emergency succession plans differ from longer-term succession plans. While longer-term plans should be geared towards ensuring the company has the best CEO in place, the best current person to execute corporate strategy, and the best one in-line to take over, the focus of emergency plans is to ensure a seamless transition during a crisis situation. Often an interim CEO is put in place – usually a C-suite executive with appropriate operational expertise – to give the organization time to identify the best new CEO candidate for the organization.

An important consideration related to CEO succession is compensation. While executive remuneration has come under critical scrutiny in recent years, the appropriate incentives are necessary to attract quality CEO candidates. Balanced scorecards with well thought out target objectives can help ensure that the CEO's personal performance objectives are aligned with those of the organization. Care must be taken, however, to ensure that inappropriate penalties are not built into the incentive program, for example if a CEO needs to make decisions with negative short-term impacts (e.g., on quarterly earnings) in order to achieve a much greater longer-term benefit.



Talent management

Understand talent-related risks that underlie strategy

Questions for directors to ask:

1. How well do we understand the talent risks associated with our organization's business strategies? Does management need to more closely align the organization's talent strategies with its business strategies?
2. How well does our board provide oversight of talent-related risks and activities? Do we review it on an ad hoc basis, or have we formally assigned oversight responsibility to a director or committee? How often do we review talent issues and in what depth?
3. Do we probe the talent requirements related to key business initiatives, such as the development of new products or the entry into new markets? Does management undertake sufficient talent-related due diligence when dealing with joint ventures or mergers & acquisitions situations?



Resources:

- Talent-Intelligent Board (Global)
- Talent 2020: Surveying the Talent Paradox from the Employee Perspective (Global)
- Aligning talent and risk management (United States)
- Gen Y – or Gen Whine? Deloitte Debates (United States)



While boards pay close attention to the risks facing their organization, their focus is often on controls, processes, technology, and other risks. Less emphasis is typically placed on risks related to the organization's people, apart from the board's responsibility for CEO succession planning. Similarly, boards have a recognized role in the areas of risk governance, ethics, and corporate responsibility, but fewer may recognize their role related to the oversight of talent throughout the organization. Yet the organization's people have a direct link to its risk culture and tone at the top.

If not managed properly, talent-related risks could severely affect an organization's performance. These risks may include a lack of sufficient talent to support investments and execute business strategies, senior executives with weak leadership skills, reputational damage due to ethical breaches or poor performance of executives, and broader human resource risks, such as failure to comply with labor regulations.

Boards need to provide proper oversight of the organization's talent risks, including ensuring that management understands and manages those risks.

Some boards undertake semi-annual talent reviews in which the organization's chief human resources officer (CHRO) summarizes the organization's human resource programs, external trends, workforce and talent strategy, and talent risks. These reviews may focus on:

- Career development opportunities provided by the organization, activities to strengthen the employer brand as a "best employer," and work/life balance and other employee assistance programs
- Key human resource data, including job satisfaction, attrition, and other factors related to talent retention for all critical positions, including comparisons to data related to other organizations in the same industry and/or the organization's own historical performance, and
- The CHRO's perspective on global talent trends that may impact the organization in the future.

Boards should ensure that they review talent supply and demand data as part of their review of capital investments and business strategy, and a best practice is to do so at least annually if not more frequently. The need to develop new products, enter new markets, or face new competitors will dictate the demand for people with specific experience and skills. Boards should ascertain that management puts plans in place to meet these demands, and that the board and management understand industry hiring trends, the talent the organization has, and the talent it will need to achieve its business objectives.

Boards should also ensure that they appropriately address talent issues related to initiatives that come to them for their review or approval. In mergers or acquisitions, for example, talent due diligence may often be neglected or not performed in sufficient depth and, as a result, the company may not gain the talent it expected to acquire through the merger.



Technology

Will technology enable your organization to innovate its way to growth?

Questions for directors to ask:

1. How well are we incorporating social media into our customer relations activities? For example, are we using social media to shape the conversation and ensure that customers understand that their interests are shared by our organization?
2. Are we proactively using social media to identify new ideas and innovations put forward by our employees, suppliers, and customers?
3. Do we understand the risks related to our use of social media? For example, are our practices compliant with privacy regulations and commercial practices? Is the data sufficiently protected?
4. How well do we understand how mobile apps may be changing our industry? Are we ahead, keeping pace, or falling behind our competitors?



Resources:

- Cloud Computing: Forecasting Change (Global)
- Deloitte's TMT Predictions 2012: Simply connected (Global)
- The Tech-Intelligent Board: Priorities for Tech-Savvy Directors as they oversee IT Risks and Strategy (Global)
- The Innovator's Solution: Creating and Sustaining Successful Growth (Canada, United States)



Growth is undoubtedly easier in a buoyant economy where a rising tide lifts all boats. With global economic waters again growing stormy, growth in 2013 – especially when attempting to follow traditional strategies – may be challenging for many organizations.

Despite weaknesses in the overall global marketplace, there will be organizations that maintain their growth rates, and a few will grow dramatically. These growth leaders are often innovators, organizations whose above average growth rates are propelled by a unique breakthrough, such as the launch of a much in-demand product, or the implementation of a ground-breaking business model. Every organization would like to be an innovator, and most will find the best opportunities come by finding ways to improve existing products, services, and processes – often through the implementation of new technologies – to make them more distinctive and unique.

Over the past few decades, technology has transformed organizations and industries to a greater degree than almost any other phenomenon. Boards may wish to ask management about its strategies for recent technological breakthroughs that are continuing that transforming trend such as social media, mobile devices, and cloud computing to name a few.

Today, many organizations are active social media players, utilizing applications such as Facebook, Twitter, and blogs, to attract customers, solicit feedback, generate ideas, promote their brand, recruit talent, and more. To be successful, however, organizations need to set out clear business objectives for their use of social media, supported by formal programs and policies to achieve those goals. Similarly, mobile devices – smart phones and computer tablets – are increasingly the technology of choice for conducting transactions. Boards should ensure that their organizations develop and apply a mobile strategy that

is appropriately supported with business objectives, models, applications, and infrastructures geared toward mobile devices (rather than merely scaling down websites, for example) if they are to create a sustainable business advantage.

New and existing technologies have resulted in an explosion of data that organizations can use to gain competitive advantage and better serve their stakeholders. To do that, however, they must first turn reams of raw data into nuggets of valuable insights through business analytics so they can drive their decision-making through statistical and qualitative analyses, explanatory and predictive modeling, and fact-based management.

The growing popularity of cloud computing – where the organization's computing hardware and software resources are provided by a third party and delivered via the internet – has been spurred by a confluence of changes in the business and information technology landscape. While this presents an attractive opportunity for organizations to streamline their technology costs and resources, boards should also ensure they understand the risks associated with outsourcing critical business services, including those pertaining to data security, confidentiality, and privacy issues.

While innovations can occur almost spontaneously – e.g., if someone addresses a routine task a different way – a more formal focus on innovation may yield more consistent results. Boards should inquire about the way innovative activities – through technology or other means – are incorporated and supported in strategic plans since planning how to improve existing offerings for the future, and identifying complementary new ones, normally takes both time and money. Innovation strategies also need to account for risk, since not every idea will succeed, and those that do will likely have their own risks to mitigate.

A closed door or an open one?

As the articles in this publication have highlighted, the global business environment continues to be reshaped by many factors – globalization, economic conditions, regulatory changes, technological advances, demographic shifts, changing stakeholder expectations, and more. As a result, some opportunities that once existed have disappeared, while new ones are being created. Boards have an important role to play in helping their organizations determine how to respond to the new operating environment. Will they wait in the hope that more familiar business conditions and opportunities will return at some point in the future, or will they be leaders in finding ways to turn the changed business environment to their advantage?

This publication discusses some important issues for boards in 2013, but there are many others including those that are unique to an industry, operating jurisdiction, or individual organization.

Since many of these issues will evolve rapidly, and because new ones are continually emerging, perhaps boards should create a list of New Year's resolutions for 2013 in which they resolve to:

1. Educate themselves so they keep pace with the challenges facing their organizations and commit to helping their companies address those challenges. Many business schools offer education programs for boards that often use real-life case studies to help boards build their knowledge of emerging trends and issues, and build and enhance the skills they require to lead their companies in addressing these challenges.
2. Make time to carry out their responsibilities. Boards need to ensure they give themselves sufficient time to fully review materials and documents in advance of meetings, participate actively on board committees, and maintain their knowledge of the issues.
3. Find time to network with directors of other organizations. Several social media websites are available to bring together board members and to provide them with a forum for sharing ideas and experiences.
4. Ask better questions. The discussion of issues presented in this publication includes suggested questions for boards to ask to help focus on the needs of their own boards and organizations. It also offers additional resources for directors to use to further their knowledge of specific topics.

It is our sincere hope that this publication serves as a catalyst for discussion on your board. We encourage you to contact your Deloitte partner to continue the conversation.

“When one door closes, another opens; but we often look so long and so regretfully upon the closed door that we do not see the one which has opened for us.”

– Alexander Graham Bell

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