

Rotman

DISRUPTIVE TECHNOLOGIES AND CORPORATE GOVERNANCE

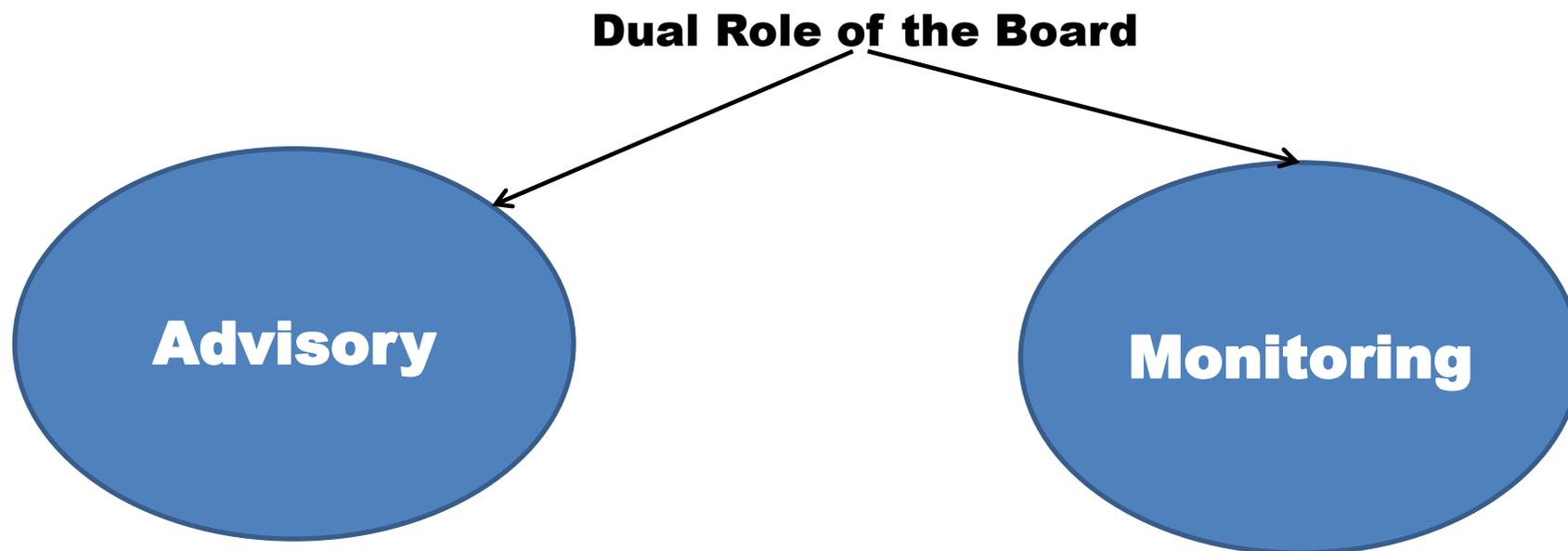
The impact of technological disruption on the role of board of directors

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DUAL ROLE OF THE BOARD



Disruptive technologies changing the nature of both of these roles

What is the strategy?

Disruptive technologies changing firms' strategies:

- Are you “digital” yet?
- Cuts across industries – every company is a tech company (67% of CEOs think so)¹
- Firms' sustainability has significantly decreased over time (lifespan 15 years)²



Board implications:

- Existential threat → more time needs to spend on strategy planning and recruiting talent



Where is the risk?

Disruptive technologies as a source of new risk:

- Cybersecurity and IT related risks are pervasive risks → IT/data risk
- New technologies are subject to new, world-wide regulations → regulatory risk



Board implications:

- Expanded risk oversight to prevent corporate crises.



Where is the risk?

Technology as an accelerator of existing risks:

- Due to social media and non-stop access to news, information (favorable and unfavorable) spreads very fast
- Reputation risk at all time high
- Legal and financial implications of increased reputation risk

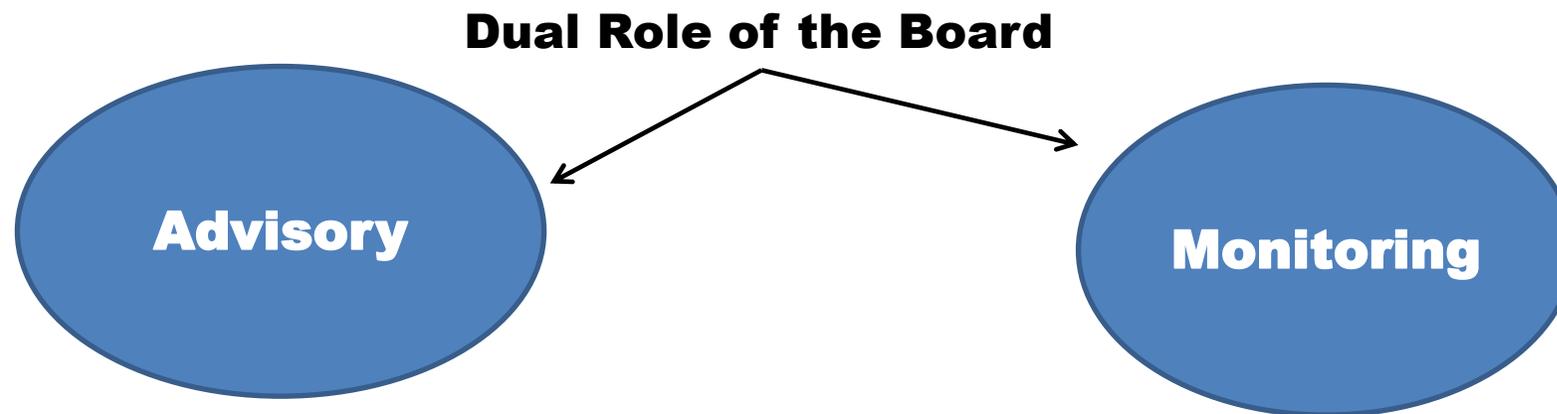


Board implications:

- Expanded board role to react to corporate crises – i.e. to have a crisis response plan



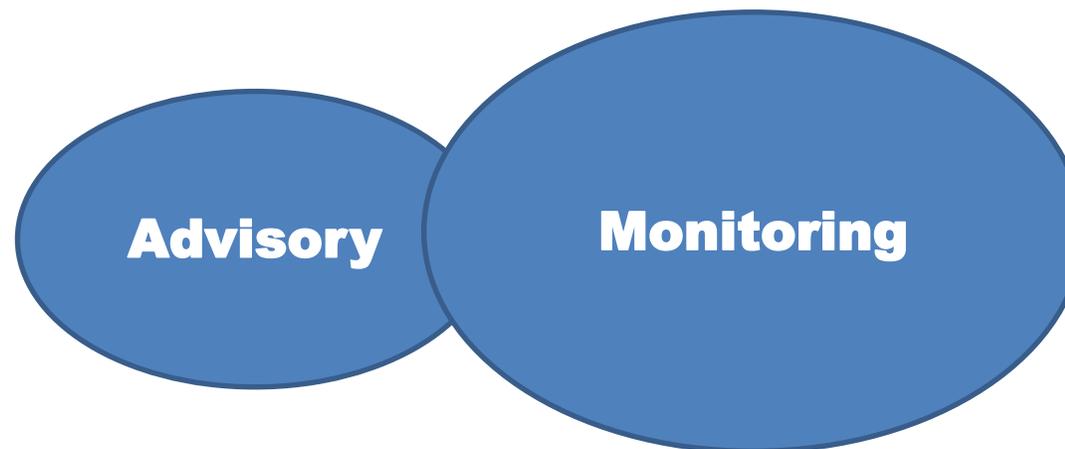
DUAL ROLE OF THE BOARD: Which takes precedence?



The demand on directors' time increases significantly

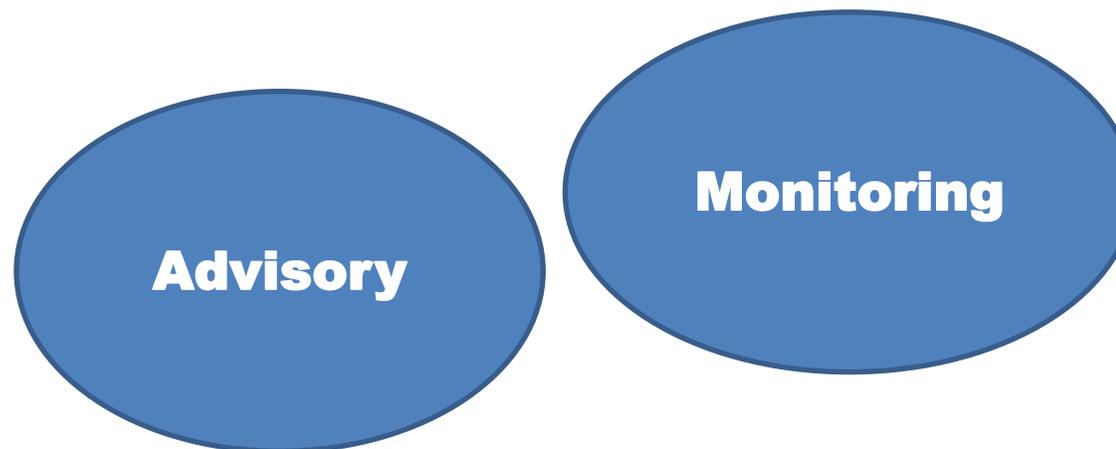
- How should the time be allocated between value-enhancing advisory role and compliance role?
 - i.e. What increases shareholder value?
 - Will/should advisory role of the board expand?

DUAL ROLE OF THE BOARD: Are the two types of tasks compatible?



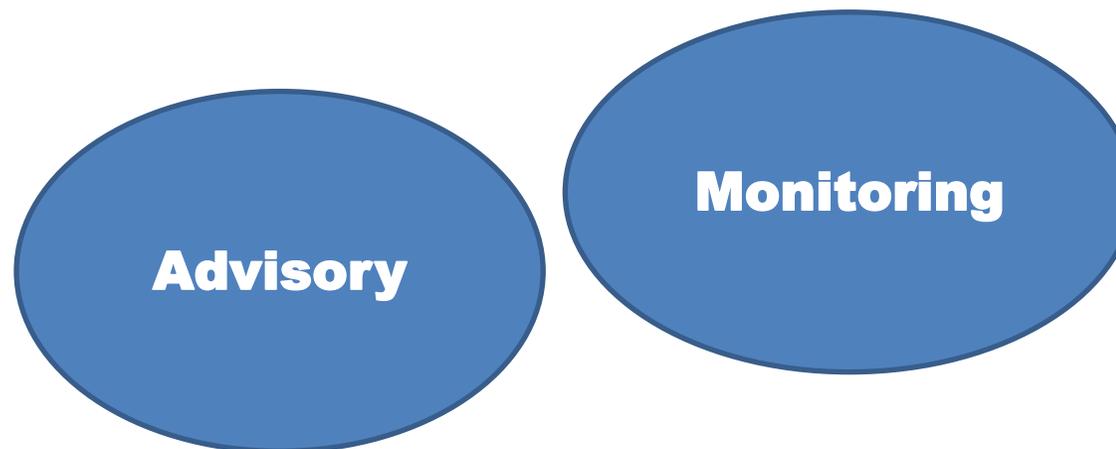
Are the two roles more incompatible now than ever?

- Monitoring role requires focus on risk mitigation and elimination of uncertainty
- Directors tend to be risk-averse – little upside, only downside risk
- Disruptive technologies require flexibility and embracing of uncertainty – strategy needs to be adaptable and fluid

SKILLSET: Does the board have right skills?**Is there a right skill-set on the board?**

- Are there directors who understand emerging technologies and its impact on the firm's strategy?
 - Age gap between workforce and a typical board – is there a technological gap too?
- Are there directors who are willing to stand by and approve risky propositions?
- Are there directors who have crisis response experience?

BOARD DYNAMICS: Is board functioning quickly and decisively?



Does the right board dynamic exist?

- Highly responsive and courageous³ boards needed
 - Skill matrix not enough to ensure this
 - Are there demographic or individual characteristics that can capture this?

COMPENSATION AND RISK TAKING: When should risk taking be rewarded?



Does the incentive structure need to change?

- What is the risk-reward trade off for the CEO?
 - Do we need to rethink “risk” – is it bad?
- What are the right benchmarks when the competitive landscape changes daily?
 - Who are the competitors when industry lines are becoming more and more blurred?

Operational Changes

- Directors need to monitor much broader set of developments
 - Self-education or director training?
 - Closer relationships with CTOs/CIOs to understand corporate issues better
 - Closer relationships with HR to understand talent pool and recruitment strategies
 - Technology strategy subcommittee
- Delegation of work to committees
 - Prioritize board agenda to focus on key issues

Operational Changes

- Strategy evolvment on regular agenda
 - Cannot afford annual review/approval process
 - Outward looking focus (at least for a subcommittee)
- Cultural shift to embrace strategic risk and be OK with risk taking
 - Revisit the definition of risk-taking in the context of executive compensation – how to reward the right effort even when results are not immediate?

Board Composition Changes

- Directors who understand emerging technologies
 - More than half of firms surveyed in the US have no technology expertise on their boards⁴
 - 79% of directors said their boards did not understand technology sufficiently⁵
 - Younger board – representative of workforce and consumer base?
 - Digital thinker, disruptor, leader or transformer⁶

Board Composition Changes

- **Directors with experience in different areas of technology**
 - E.g. Cybersecurity, social media, big data, ecommerce
- **Directors who are multidimensional**
 - Cannot afford directors who are not at least digital thinkers while experts in another area
- **Directors with demonstrated ability to be courageous, responsive, adaptable, agile**
 - Easier said than done, but recruiting process can incorporate skill search along these dimensions.

In summary, disruptive technologies:

- Increase the demands on directors' time – to monitor and to advise
- Require that directors focus more on strategic risks – strategy on top of the agenda
- Require that directors become outward focused too – stay on top of developments
- Force directors to rethink their relationship with “risk”
- Implore boards to recruit multidimensional directors with expertise in emerging technologies

Failure to adapt may lead to an existential threat



References:

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4. Mui, Redshaw, Pripp (2016). Your Next Board Member Should Be a Geek, *Strategy+Business*, Summer 2016, Issue 83.
5. PwC 18th Annual Global CEO Survey. *A Marketplace Without Boundaries: Responding to Disruption*, January 2015.
6. Rickards and Grossman (2017). The Board Directors You Need for Digital Transformation, *Harvard Business Review*, July 13, 2017.