

Board Perspectives: Risk Oversight

The digital revolution currently taking place is transforming our world. Over the next few years, many organizations will need to undertake radical change programs and, in some cases, completely reinvent themselves to remain relevant and competitive. Is disruptive innovation sufficiently emphasized on the board agenda?

Ask executives and directors about their biggest concerns, and chances are their answer will include being on the wrong side of disruptive change. As the results of our latest top risks survey indicate, the rapid speed of disruptive innovation and new technologies, as well as resistance to adapting operations in the face of indisputable change, are at the top of our list of the most significant risks.¹

Digital technology is not only about embracing the latest software tools and apps; it also raises the bar in the war for talent. Organizations that want to thrive in the digital age need to think and act digitally — and that requires a different set of capabilities and strengths.

Think about it. Talented people aspire to be contributors in a contemporary, dynamic and digitally focused business with its best days ahead, rather than bound to a slow-moving dinosaur of a company that is not structured to be innovative and dynamic, even though

it may have a strategy that asserts it will be. Innovative, market-changing organizations are built differently, not because they have a “digital strategy” but because they “think and behave digitally” in setting and executing strategy.

From the perspective of the board, management had better get it right. As many organizations have discovered in recent years, strategic error in the digital economy can be lethal. Hyperscalability of digital business models and lack of entry barriers enable new competitors to emerge and scale very quickly in redefining the customer experience, making it difficult for incumbents to see it coming at all, much less react in a timely manner to preserve customer loyalty. The stark reality is that a digital focus doesn’t always translate into a coherent strategy, as many organizations do not fully understand the potential opportunities and risks and are not demonstrating the necessary sense of urgency.

¹ *Executive Perspectives on Top Risks for 2018*, Protiviti and North Carolina State University’s ERM Initiative, December 2017, available at www.protiviti.com/toprisks.

Key Considerations

The good news is that board engagement with technology matters is on the rise.² However, our experience indicates that most boards do not fully grasp the opportunities and risks associated with digital transformation. As we see it, there are four important activities for organizations to consider as they contemplate what digital means to their business and strategy.

1. **Assess digital readiness.** Protiviti's original research has identified more than 30 competencies at which digital leaders excel. These competencies, some of which are illustrated below, consist of empirically supported capabilities and structural characteristics that can be used to benchmark the organization to identify its strengths and weaknesses.

The competencies are arrayed across six core disciplines that many traditional businesses struggle with:

- Vision, mission and strategy
- Management and employee culture
- Organization, structure and processes
- Communication, marketing and sales
- Technology innovation and development
- Big data, analytics and automation

Using the vision, mission and strategy as a context, management should identify and analyze gaps across the business.

To illustrate a few of the competencies, we'll comment briefly on the first two disciplines, beginning with "vision, mission and strategy." Executive management must have a clear understanding of the potential impact of digital disruption in the industry segment(s) in which the organization operates and be able to articulate a clear strategic vision fit for the digital age. The entity must have proven capability in disrupting traditional business models and the capacity to adopt hyperscalable models that reduce dependence on human resources. Digital strategy-setting and review should be a continuous business and in-boardroom activity. The team responsible for the organization's digital strategy should be fed continuously with analyses of the

markets and competitor landscape in which the business operates and then formulate and assess alternative scenarios.

Simply stated, the organization must be capable of challenging conventional thinking and disrupting previously established value chains and ways of working (e.g., management dissects the traditional analog value chain and rethinks the role of all key players rather than just focusing on the current role of the business within the value chain).

Regarding "management and employee culture," the executive team must understand the impact that the digital revolution could have on the business, and be able and willing to take the necessary steps to ensure that the digital transformation program and its various projects are positioned to succeed. To that end, the organization must:

- Have a clear road map to gain and maintain competitive advantage and achieve digital leadership in the market
- Make use of the company's digital assets — whether brand, human resources or technology — and deploy digital solutions
- Cultivate a strong corporate culture from the top down that promotes an open and participative management environment — characterized by trust, mutual appreciation and respect — and motivates and rewards staff to be creative and highly innovative
- Understand and attract the type of employees needed to be competitive in the digital era
- Have a workforce composed of highly talented people who come from diverse backgrounds and have a good understanding of technology and digital business models

The board and the executive team must also exhibit the above qualities and undertake an active digital leadership role.

In summary, leaders must think about how they can embrace the opportunities emerging technologies present. The digital age is forcing organizations to radically rethink how to engage with customers

² *Managing the Crown Jewels and Other Critical Data*, Protiviti, March 2017, available at www.protiviti.com/itsecuritysurvey.

and pursue design breakthroughs for improving processes and functions continuously to deliver enhanced value. That means they must balance outside-the-box thinking with the practical considerations of repositioning the business.

The above and other competencies can be useful when benchmarking the organization against the industry and relevant case studies and plotting the path toward digital maturity. The point is that the strategy should reflect the competencies that currently define the organization and address the absence of those that present barriers to success.

Many strategies ignore these fundamental issues, resulting in a business that is digital on the edges but not at the core. Our view is that a truly digital business has a digital core. To that end, digital readiness is the focus of a current-state assessment.

2. **Define and refine continuously the digital vision and strategy.** Once the organization's digital readiness and capabilities have been assessed, management is positioned to think strategically. A leader of the organization must own responsibility for understanding the competitive landscape, the opportunities emerging technologies present and the threats to existing revenue streams.

Organizations need to make a conscious decision about whether they are going to lead as the disrupter or transformer of the industry or, alternatively, play a waiting game, monitor the competitive landscape and react only when necessary to defend market share. For many companies, the answer may be somewhere between the two. For those organizations choosing not to actively disrupt the status quo, their challenge is to be agile enough to react quickly as an early mover. Few are ready for that challenge, however.

A relevant analogy is that no one should attempt to climb a challenging mountain too quickly. Fitness, preparedness, teamwork and knowledge of expected weather conditions are critical to success. It is a fool's errand to attempt a climb before one is ready. In the same way, management must frame the digital vision, and the strategic initiatives supporting it, around what the enterprise is good at: its differentiating core competencies that deliver unique customer experiences. To that end, the vision must reflect the direction in which relevant digital technology is trending and how it can elevate what the organization does best.

This is a never-ending discipline of continuously redefining vision, strategy and capabilities. It is about much more than developing a plan; with technology and regulations changing and innovation happening so rapidly, the business needs to review and refine its digital priorities constantly.

To illustrate, Agile is not just another software development approach, but rather a way of thinking about applying adaptive planning, evolutionary development, early delivery, continuous improvement, and rapid and flexible response to change that can and should be applied to all business processes, including strategy-setting. Similarly, a digital business needs a responsible executive and team who are focused on disruption of the business model (what we call "disruption focus").

In the digital age, an organization is more likely to be successful if it challenges conventional thinking, places "driving value for the customer" at the heart of its decision-making, has a deep understanding of maturing technologies, and can apply that knowledge to drive innovation that creates new types of value for existing customers and opens up new markets. As they say, it's disrupt or be disrupted.

3. **Define the target operating model.** With the current-state assessment against projected needs as a baseline, and a compelling vision and strategy articulated, management should define the processes, organization, methodologies and systems comprising the future state operating model — including the talent needed to make the model happen — that remains true to the company's identity and brand promise.

In the rush to become digital, the importance of policies shouldn't be forgotten. Areas such as robotics, machine learning and artificial intelligence (AI) present all sorts of opportunities, but bring with them significant risks, as well as ethical questions for leaders to consider.

Too often, policies, processes and organizational structures get in the way of a business becoming and remaining digital. The key is to empower, trust and monitor people, not control them. That's a different way of thinking for many organizations rooted in "command and control" structures. Once the business is clear about where it's going through its vision and strategy, management must recruit the right people and train them in the right

way while ensuring that the enterprise's policies, processes and systems are suitable to compete in a digital world.

With the current and future states defined, improvement plans should be developed to close the gaps based on industry best practices and reviewed with executive management and the board. The risks associated with the target state should be identified and assessed against the entity's risk appetite. In this respect, management should be careful to avoid understating the hyperscalable business model component of digital transformation. Digital thinking requires organizations to solve the problem of rapid growth and scalability, without dependence on people. Thus, high levels of automation are critical in digital business models. Not only do these capabilities drive efficiencies, they also enable the business to scale rapidly to meet demand. With a digital business model, management no longer needs to scale ahead of demand.

4. **Align the organization with the needed change.** Using digital technologies to improve products, services and processes requires focus and discipline. To enable continuous or breakthrough change with confidence, buy-in must be obtained from executive management (and from the board of directors for significant changes in strategy, processes and systems). In addition, support is needed from other key stakeholders such as business-line leaders, operating personnel and process owners most affected by the change. The communication of organizational change and its implications must address why a digitally focused culture is necessary for the entity to survive and thrive. In doing this, it must make a compelling case that the collective interests of employees and the enterprise are inextricably linked to effecting change.

Depending on a director's perspective, the exciting or worrisome truth is that the digital revolution is only just getting started. For most large, established companies today, it's not a question of *if* digital will upend their business but *when*. Even when executives are aware of emerging technologies that obviously have disruptive potential, it is often difficult to have the vision or foresight to anticipate the nature and extent of change.

That is why every organization must chart its own digital journey. To that end, the board should be engaged in all the above activities, from readiness assessment to organizational alignment. When addressing digital, directors should recognize the signs of myopic short-termism and executive management's emotional investment in traditional business models. This dysfunction can frustrate the needed commitment and tone at the top in driving disruptive change. Ultimately, the board must ask the necessary questions to encourage management to advance the enterprise's digital journey at a pace that will sustain the company's sources of competitive advantage and market position.

Questions for Boards

Following are some suggested questions that boards of directors may consider, based on the risks inherent in the entity's operations:

- Does the board have access to the expertise and experience needed to understand how digital disruption can affect the organization and provide oversight over how management is incorporating digital thinking into the strategy-setting process?
- Has management assessed the organization's digital readiness and identified the strengths and weaknesses across the business in the context of its digital vision, mission and strategy?
- Does the company have a digital transformation program in place that is well-defined and positioned to succeed? Are adequate resources allocated to support the program's execution? Is there a compelling customer-centric vision and an accompanying strategy driving it?
- Is there sufficient support for decision-making within the organization on whether or how to embrace new or emerging technologies? For example, are digital concepts (e.g., speech recognition, natural language processing, AI, robotics, machine learning, visualization techniques) being used to reimagine key operating processes and such functions as finance, information technology, procurement, risk management and internal audit?
- Are there barriers to innovation and digital transformation that exist within the organization that require the board's and executive management's attention from a change management standpoint? Are steps being taken to eliminate these barriers?

How Protiviti Can Help

Protiviti is working with 60 percent of the *Fortune* 1000® and 35 percent of the *Fortune* Global 500®, as well as smaller companies, including fast-growing technology organizations, both pre- and post-IPO. We have a proven track record of bringing innovative solutions to help companies solve some of their most difficult business problems. Our digitalization offerings focus on:

- **Customer engagement** — Exploring new ways to build strong relationships with customers.
- **Digitization of products and services** — Launching new, enhanced products, and exploring new business models.
- **Better informed decisions** — Enhancing information available to enable timely and effective, data-driven decision-making.
- **Operational performance** — Creatively using technology to improve performance.

Is It Time for Your Board to Evaluate Its Risk Oversight Process?

The TBI Protiviti Board Risk Oversight Meter™ provides boards with an opportunity to refresh their risk oversight process to ensure it's focused sharply on the opportunities and risks that truly matter. Protiviti's commitment to facilitating continuous process improvement to enable companies to confidently face the future is why we collaborated with The Board Institute, Inc. (TBI) to offer the director community a flexible, cost-effective tool that assists boards in their periodic self-evaluation of the board's risk oversight and mirrors the way many directors prefer to conduct self-evaluations. Boards interested in using this evaluation tool should visit the TBI website at <http://theboardinstitute.com/board-risk-meter/>.

Learn more at
www.protiviti.com/boardriskoversightmeter

Protiviti is a global consulting firm that delivers deep expertise, objective insights, a tailored approach and unparalleled collaboration to help leaders confidently face the future. Protiviti and our independently owned Member Firms provide consulting solutions in finance, technology, operations, data, analytics, governance, risk and internal audit to our clients through our network of more than 70 offices in over 20 countries.

We have served more than 60 percent of *Fortune* 1000® and 35 percent of *Fortune* Global 500® companies. We also work with smaller, growing companies, including those looking to go public, as well as with government agencies. Protiviti is a wholly owned subsidiary of Robert Half (NYSE: RHI). Founded in 1948, Robert Half is a member of the S&P 500 index.

Protiviti partners with the National Association of Corporate Directors (NACD) to publish articles of interest to boardroom executives related to effective or emerging practices on the many aspects of risk oversight. As of January 2013, NACD has been publishing online contributed articles from Protiviti, with the content featured on <https://blog.nacdonline.org/author/jdeloach/>. Twice per year, the six most recent issues of *Board Perspectives: Risk Oversight* are consolidated into a printed booklet that is co-branded with NACD. Protiviti also posts these articles at protiviti.com.