FUTURE OF FUNCTION SERIES

BUILDING DIGITAL BOARDS

From where should a progressive board get its digital direction?

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INTRODUCTION

2020 will be remembered as the year the world was forced to make a radical and life-altering pivot. Change has been forced upon organisations and they've had to be quick to adapt. One of the major themes that has been accelerated is the adoption and use of digital technology. Whether it's how we work, where we work, how we shop or how we spend our leisure time, digital technology is embedded in every area of our lives. The barriers to change have been taken down and acceptance of change has never been greater. Despite this, boards of UK companies have seemed slow to adapt and digital and technology leaders are as a result, woefully underrepresented on them. This must change if UK businesses are to survive and thrive in a post-COVID, post-Brexit world.

In 2019 Savannah Group **published a report** which looked to find a correlation between good corporate governance and shareholder return within the FTSE 100 in the last decade. The report concluded that there was no correlation between a businsess shareholder return and the perceived quality of its governance. In fact, several of the businesses that had extremely low governance scores ranked the highest for shareholder return. The report cited a number of factors affecting the success or failure of boards including "board composition and governance and, in particular, non-expert board leadership".

Later that year, MIT Sloan Business School **published a report** that concluded organisations with three or more digitally savvy execs/NEDs had, on average, 17% higher profit margins, 38% higher revenues with 34% higher return on assets, and 34% higher market cap growth.

A report by Ondra, the financial advisory firm, demonstrated that for total shareholder return, the FTSE 100 has underperformed versus its peer group. It currently has 719 NEDs of which only 14 (1.94%) identify as coming through the digital or technology route. Of 1325 NEDs in the FTSE 250, only 31 organisations (2%) have NEDs with a background in digital and technology.

Could it be that there is a correlation between the lack of digital and technology savvy leadership on boards and the under-performance of the FTSE 100? That an index full of "traditional" boards trying to operate in a digital world will find they rapidly become extinct?

Over the past few months, we have interviewed numerous Chairs, NEDs and CEOs about what they believe to be the benefits of having technology and digital capability on their boards. What became clear is that a "technologist", whose only focus is on modernising and who has not moved beyond the confines of the technology estate, certainly has no place on a board. There is, however, a place for digitally savvy board members who have a breadth of knowledge and commercial understanding and who can also work well in a team. From the conversations we had, the very survival of these organisations might depend on it.

PART ONE

THE TRADITIONAL STRUCTURE OF BOARDS

It is clear that pre-COVID, many boards were not moving fast enough to react and adjust to the technological changes that were impacting their industries and organisations. Nor were they aware of just how much they are increasingly reliant on technology for their continued existence. They remained stuck in the past.

The traditional role of boards has been to validate the annual business strategy and to oversee the successful delivery of that strategy through the support and hiring of a team fit to execute it. At a typical (bi) monthly or quarterly board meeting, a board will ordinarily discuss an update on the business, and governance and compliance issues, then focus time on the financial review and forecasts for the next period. At points throughout the year, controls and risks in the past and current period will be reviewed along with bonus criteria, realisations and operational programmes. Beyond the initial annual strategy session there is little time available to be spent on reviewing the strategy throughout the year, even less time to spend on technology and no time at all on innovation. In John Tusa's new book, he argues that "boards overly fixated on finance. Governance is more than that."

> "Technology is so pervasive and so important for any business model that it has to be a board discussion."
>
> – FTSE 100 NED

Why, when technology commands the most significant spend in almost every business, are there so few people on boards who understand it? How can organisations deliberate on technology-driven disruption and determine whether the company is going to be adversely affected, or can harness what is coming, if the right questions are not being asked? Ready or not, there is no hiding from the tsunami of digital disruption that has been trigged by COVID.

Fifteen years ago, a **Harvard Business Review report** stated that boards had a fundamental lack of understanding of which questions needed to be asked about IT risk, and more importantly, competitive risk. It highlighted a significant lack of board oversight for technology which, with its substantial investments, was hugely dangerous.

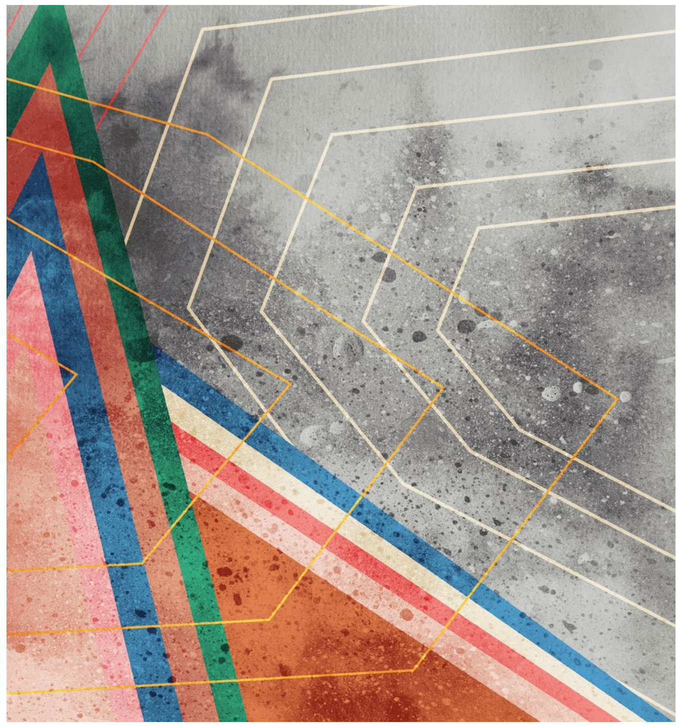
Fast forward fifteen years and it could be argued little has changed. One NED of a global bank stated: "Even now there are many boards which are wholly uncomfortable with the jargon and language that is used when discussing technology." The outcome of this is that it is not discussed at all and thinking is not challenged.

Many board members still struggle to find the right language and understand the context of some of the digital challenges that are facing their businesses. This can lead some to avoid the discussion and avoid tackling the issues. Many do not see it as the purview of the board to identify digital risks and opportunities so their interaction with CIOs/CTOs is ineffective. They don't know what questions to ask or how the answers they hear should challenge them further. Technology is no longer a niche topic which can be limited to its own agenda item and driven by specialists. Instead, leading boards understand that digital and technology is as fundamental a discussion as finance and operations. A voice that can help to demystify and highlight areas of risk and opportunity should enable organisations to perform better.

Outside of the FTSE we do see this playing out differently. The CEO of a privately owned company shared her views of the role her board plays beyond governance. The Chairman and one NED are digital leaders; they alert her to what is coming over the horizon, both threats and opportunities. By asking the tough questions, they challenge her thinking and make her lean into the areas in which she is less comfortable.

"There are plenty of sectors where technology has come in from the side. Look at banking and payments. New entrants have rattled the incumbents, and no one was looking."

– CEO Financial Services Business



PART TWO

DIVERSITY OF THOUGHT

The world has already woken up to the need for gender and **ethnic diversity on boards**, and numerous studies have shown that diversity positively impacts business performance. Part of what makes a board successful is the diversity of thought that comes from bringing people in who are genuinely different. Colleagues who bring a different view of the world enable the board to consider a wider range of perspectives, and therefore more accurately reflect the customer base.

NEDs who come from a technology or digital path think differently. As leaders, they are adept at dealing with ambiguity, can assimilate data quickly to make bold decisions and propose a decisive course of action. This is the world in which they live. They are not afraid to ask questions, are willing to challenge preconceived norms and accept that they don't know everything.

A consistent theme in our interviews was that a different way of thinking creates positive tension in board discussions. Questions being asked in a different way, and from a different perspective, enable boards to get a more holistic understanding of what can and cannot be achieved. The world view of a technology leader and a commercial business leader will naturally be very different, but the dialogue that can result from these discussions will get organisations to the very best outcomes for the business as a whole.

> "Organisations are missing out on huge opportunities by not bringing people onto their boards from "non-traditional" backgrounds such as technologists or former apprentices. Having people who think differently and see the world differently only adds value in the longer term and challenges how the board can think about current and future opportunities and threats."
>
> – Michael Tobin OBE
> former CEO Telecity & NED

PART THREE

TECHNOLOGY DOESN'T HAVE TO BE TECHNICAL

One of the clear benefits of having diverse thinking on boards is the natural tension that can be generated. Achieving the right level of tension requires learning on all sides. Technology is no longer the domain of just the technologist. Just as the business is no more the domain of distribution and investment. Everyone has to know more about everyone else's world.

Consumers are becoming increasingly tech-savvy, they have higher expectations of how they engage with companies and brands, and this is ever-evolving.

We hear of many instances where technology teams work on something with the best of intentions and what comes back is not what the business was expecting. The result is a post-mortem on how they missed the mark. Often this is due to a lack of understanding at a senior level of what the technology team was actually aiming to achieve, rather than it being a lack of intent. It's a perfect storm where the business doesn't understand technology and the technology teams don't fully understand the business strategy. The result is distrust from both sides and a hesitance to commit to projects in the future.

A point that seems to be frequently overlooked is that bar the CFO, the CIO is the only other CXO that has intimate knowledge of the workings of all areas of the business, yet the CIO rarely features on the supervisory board.

PART FOUR

INNOVATION

A **recent Accenture study** found that 56% of executives believe that rapid advancements in technology and scientific innovations are set to disrupt their industries. Yet there are few digitally savvy people on boards to help navigate this minefield. If the innovation agenda is not being pushed from the board down, then where will it come from?

A theme that emerged from our interviews is that when it comes to innovation, the most successful organisations ensure that they have central ownership and accountability for driving innovation. As businesses look to navigate rapid advancements, often additional support in terms of consultants or programme based subject matter experts are employed. These partnerships can be beneficial in helping to guide and accelerate innovation and change programmes, but to extend these changes for continued success, organisations need to embed an innovation culture and knowledge into the framework of the organisation and make those in the business responsible for leading the change.

At a time when disruption is happening in all sectors, not just driven by the digital giants but by innovative, agile startups disrupting around the edge, organisations need to be continually innovating. The organisations that are innovating own the core of their technology, outsource the utility, and innovate at pace.

> “Spending money on digital does not make for a digital business.”
>
> – FTSE 100 CIO and NED

COVID has created an environment where people are starting to ask the right questions. Where digital has been at the core, businesses have become much more adaptable. Organisations that have been in control of all the areas of their business, enabling them to control and deliver a continuity of customer experience, are the ones that are forging new and financially successful paths.

Building innovative digital and technology capability is not linear. The days of being able to calculate ROI from technology spend over the next three to five years, and developing long term strategies, are long past. In the digital age, enterprises need iterative and evolutionary strategies that are flexible, dynamic and can respond to the markets as they change. Focusing on building out capability that will enable the organisation to predict, or at least react swiftly to, changing market dynamics and conditions will ensure survival. Where once digital was an advantage, it is now a requirement.

PART FIVE

THE SHORT TERM FOCUS OF INCENTIVES & REMUNERATION

Digital is not just about physical technology. Digital also encompasses new ways of working and new ways of assessing success which empower people in organisations to be innovative.

Although not immediately obvious, the chair of the RemCo is vital to the success or failure of innovation and the ability of organisations to thrive in the new digital world. With newer business models being adopted, such as DevOps, Agile, and OKR, organisations are focussing on outputs and the delivery of key objectives that may not generate in-year revenue or cost savings.

In many of the organisations we spoke to, an individual's incentives and bonuses are predominantly determined by in-year financial targets. These targets are counterproductive if teams are focusing on iterations to deliver a strategy over two to three years. This disconnect between how bonuses have historically been awarded, versus how teams now need to operate for agility, can in fact stunt and in some cases halt the delivery of overarching strategic goals.

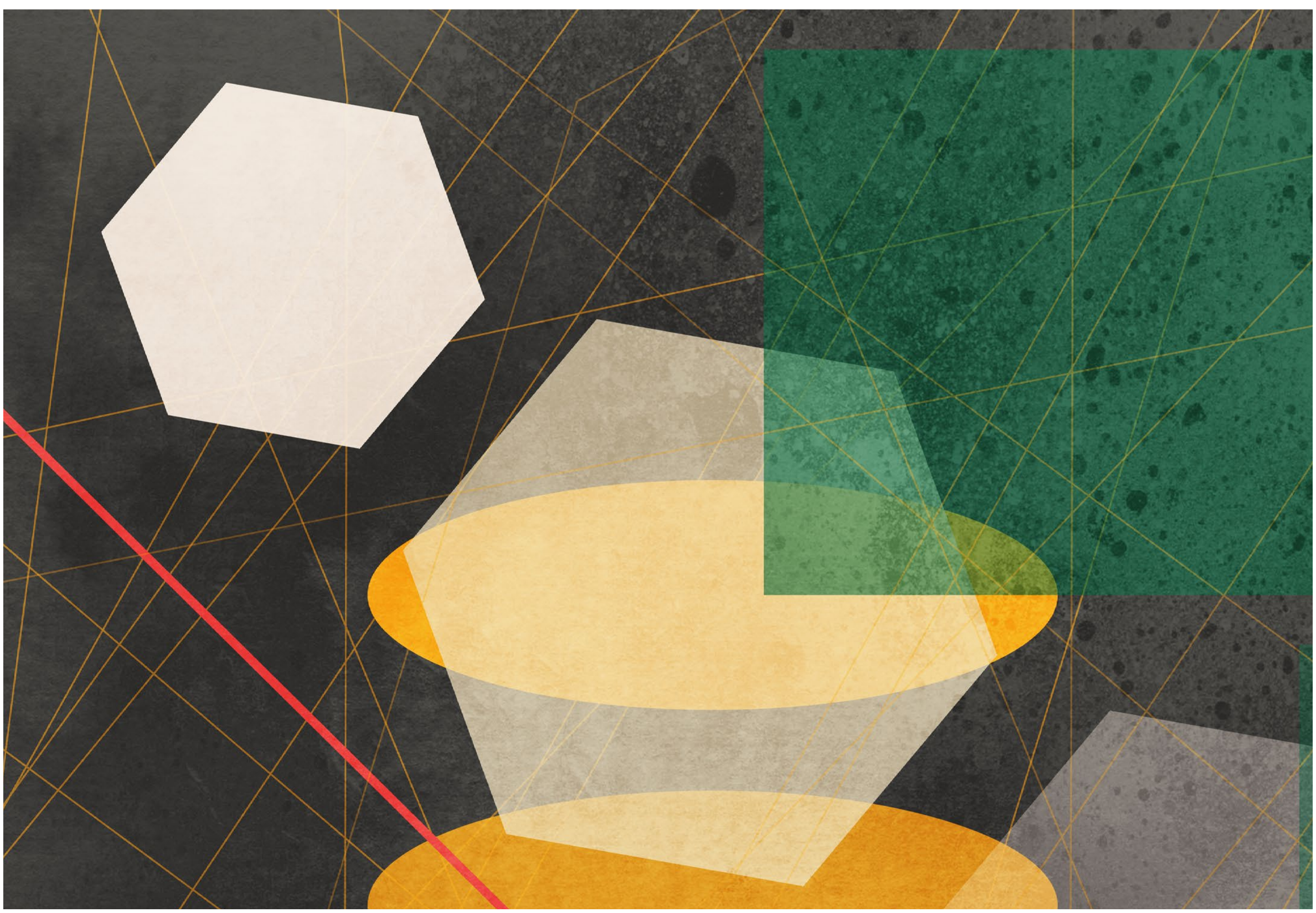
For example, in one FTSE 250 organisation we spoke to, the Managing Director of the largest business unit was bonussed solely on financial targets. He had several product delivery teams who were targeted against delivering outcomes. Halfway through the year, the director was slowing work and preventing the development of the product teams. It transpired that the product teams weren't going to be able to deliver benefit in that year and he didn't want to carry the cost of projects that were not going to deliver ROI that year.

It can be hugely difficult for boards to look for longer-term strategies if this is at odds with the demands of shareholders. Boards that try to build longer-term objectives into the management's compensation will sanction direct investments into R&D, test new business models or acquire innovative and potentially disruptive companies. Yet these decisions are often criticised by shareholders who complain about wasted financial resources and insufficient board oversight.

In many organisations, the remuneration structure for executives and their teams is focused on STIPs or annual incentives unless they are also tasked with setting the strategy of the business. Even for those strategy-setting executives, the effectiveness of their LTIP schemes is questionable. When considering **how progressive the business will need to be** to innovate at a rate which disrupts their existing business model in order to out-innovate newer entrants, or how long that change might take to be realised in increased shareholder value, market cap or profitability, the validity of LTIPs is called into question. LTIP incentives tend to focus on marginal improvements to the top line and bottom line over three to five years. A strategy which differs from the exponential growth models has been successfully developed and deployed by businesses in other indices, most notably in the USA. Unless remuneration structure is adjusted to focus on a much longer term strategy (perhaps even 10-years plus) for a much wider number of employees, it's hard to see how FTSE 100 businesses are going to unlock and commit to innovation opportunities. But then why would the executives leading the business want to put themselves under increased scrutiny to achieve such ambitious goals when it is so at odds with the norm in the market? It's a structure that encourages steady returns rather than pioneering change and it's the long term shareholders who stand to lose the most.

In our 2019 report on FTSE governance vs shareholder return, we concluded that the "pressure to conform with what is measurable is a distraction from board effectiveness in carrying out their fundamental obligation to promote the long term success of the companies." With many technology strategies not paying dividends until year two or three, and in some cases far beyond that, it can be a difficult proposition to sell to shareholders who are accustomed to frequent and steady annual dividends.

The understanding of new, digital ways of working at board level will enable these discussions around remuneration. Board members cannot all be expected to know of the new ways that businesses deliver their products and services, and how the teams are structured, but there must be a voice around the table who can help to articulate and challenge.



PART SIX

WHERE DO WE GO FROM HERE?

Until recently, organisations were working towards digital transitions that were five to ten years in the future. Now those transitions have seemingly happened overnight and with relative ease. Our research has shown that over the past few months, many sectors that were shying away from digital have now been forced to make changes.

Boards need to be brave, question what they know and be open to challenges. It is okay for board members not to be technology experts as the pace of change is unprecedented. They must however surround themselves with people who know the things they don't. Technology is no longer a niche skill. It is as fundamental to an organisation as Finance or Operations.

Chairs have to be brave and look for people outside of their own networks, world and sphere who will challenge them to think differently and present a different viewpoint. In doing so, these people create natural tensions that will enable the business to be more successful. For technology leaders to be seriously considered for board roles they will also need to up their game to ensure they understand the wider business strategy and their obligations to shareholders. Boards should look to support that development by providing the necessary exposure to their CIOs and CTOs.

Commercially astute business leaders who have come up through technology will bring a wealth of skills and experience to any board. And having a clear path to the top for Technology leaders is also critical from a diversity perspective.

This year, the final Hampton Alexander report announced that women now make up around 40% of all NEDs on the FTSE 350. A seismic shift compared to ten years ago. The report highlighted that the next key area of focus is on the executive level which is a conduit for entry to the board in the future.

The report also points to the number of young women who are taking on undergraduate studies in STEM (science, technology engineering and maths) subjects. A number that has increased by over 50% in the last ten years. In the past year however the number of female CIOs in the FTSE 350 has dropped to 16%.

It is essential that if we are encouraging more women into technology we then provide a route through to executive and non-executive leadership. It is a huge waste of talent if they hit a glass ceiling once they become a CIO or CTO. Having diverse voices around the table to reflect diverse backgrounds, diverse workforces and diverse customers is critical.

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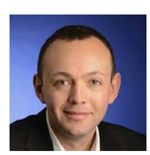

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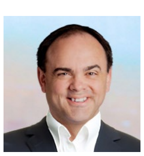

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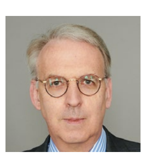

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ABOUT SAVANNAH'S TECHNOLOGY AND DIGITAL PRACTICE

The digital agenda is a strategic imperative for all businesses. We are helping our clients answer the key question: what problems are you trying to solve and for whom? Whether developing innovative new services and products, reinventing business models for a digital world, managing cybersecurity threats, or leading technology migrations, our cross sector knowledge of what great digital and technology leaders look like helps secure individuals who work strategically and collaboratively across your organisation.

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Kersty is the lead partner in our interim Technology and Digital practice. She works closely with technology leaders, and non-technical executives to help deliver varied people centered talent solutions for the evolving business landscape. She works across FTSE, PE, Fortune 500, AIM, TSX and SMEs globally. She is a passionate advocate for Diversity and Inclusion within technology and in helping organisations bring digitally savvy NEDs and advisors into their business.

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