McKinsey & Company

The Board Perspective

A collection of McKinsey insights focusing on boards of directors

Number 3, Spring 2022

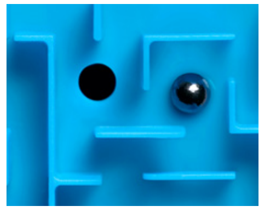
Cover image:
© SIphotography/Getty Images

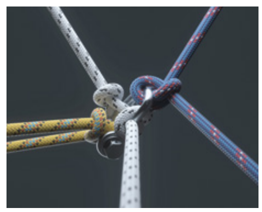
Chapter images:
© akinbostanci/Getty Images,
© t_kimura/Getty Images,
© Jekaterina Nikitina/Getty Images

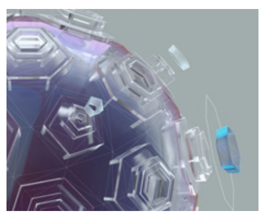
McKinsey Board Services supports CEOs and boards of directors to improve board effectiveness and unleash the value creation potential from good corporate governance. Our solutions are tailored, integrated, and supported by deep industry, functional, and board expertise.

Contents

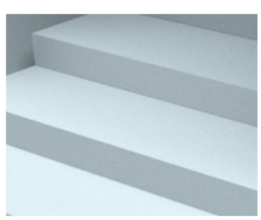
The role of the board







Board structure and foundations



Board effectiveness

Introduction

Welcome to the third edition of *The Board Perspective: A collection of McKinsey insights* focusing on boards of directors.

While demands and expectations placed on boards have been rising for several years, the reality is that many have continued business as usual, making limited improvements. That's changing.

The past two years have been a catalyst for strengthening board effectiveness. By putting extraordinary pressure on organizations across the globe, the pandemic triggered significant changes, with many boards seizing the opportunity to step up their game and provide much-needed guidance to their organizations.

Over the past few years, we have focused our research on some key new responsibilities directors have taken on, including defining purpose, overseeing the digitization of their organizations, and ensuring more effective guidance on talent and culture topics. We also closely studied how major crises can affect the board's role.

This year's compendium presents a selection of recent insights from McKinsey experts and board practitioners. The research draws on interviews with successful chairs, global surveys of board directors, our work with boards around the globe, and the deep experience of our subject matter experts.

We have organized the content into three sections:

- **The role of the board:** Which activities should the board engage in, and how?
- **Board structure and foundations:** What mix of capabilities and experiences do you need to deliver on the increasing expectations from stakeholders?
- **Board effectiveness:** How can you increase the overall impact of your board?

This compendium is a selection of perspectives, not a comprehensive analysis of what it takes to develop an effective board of directors. We would, however, welcome your input on what this would require.

We hope you enjoy this compendium, that you find the insights useful, and that they trigger interesting discussions on how to further enhance the value of your board.

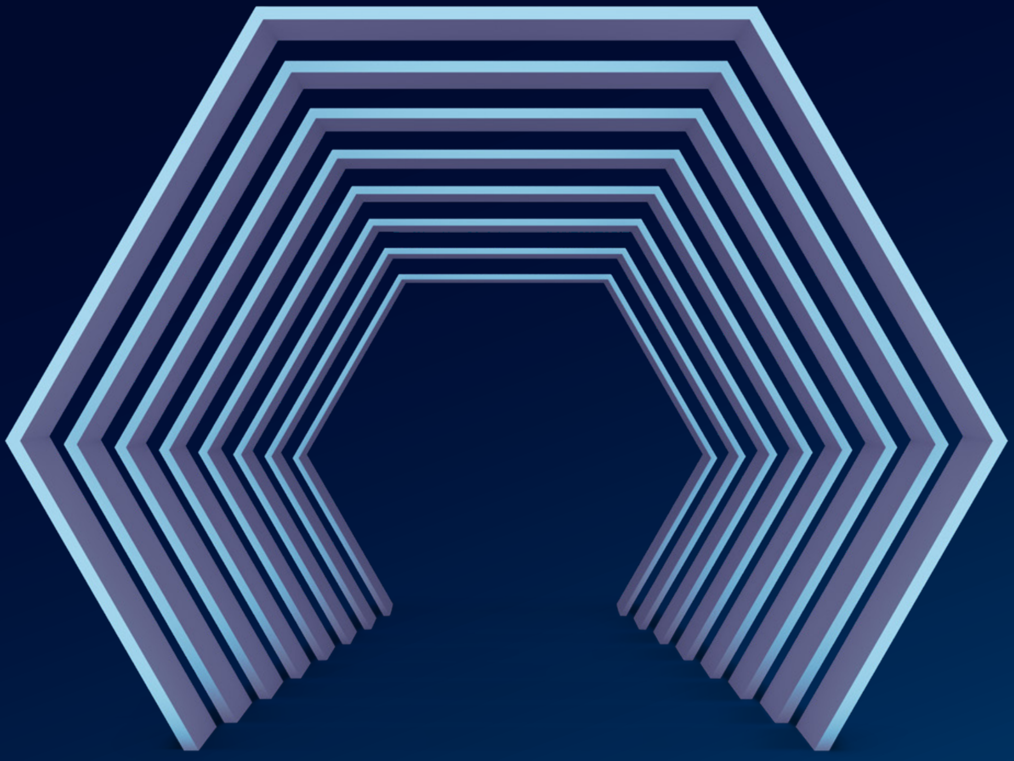
Please direct comments or questions to us or any of the authors at McKinsey_Board_Services@McKinsey.com.

Frithjof Norman Lund
Senior partner, global leader of McKinsey Board Services, Oslo
Frithjof_Lund@McKinsey.com

Celia Huber
Senior partner, NA leader of McKinsey Board Services, Silicon Valley
Celia_Huber@McKinsey.com

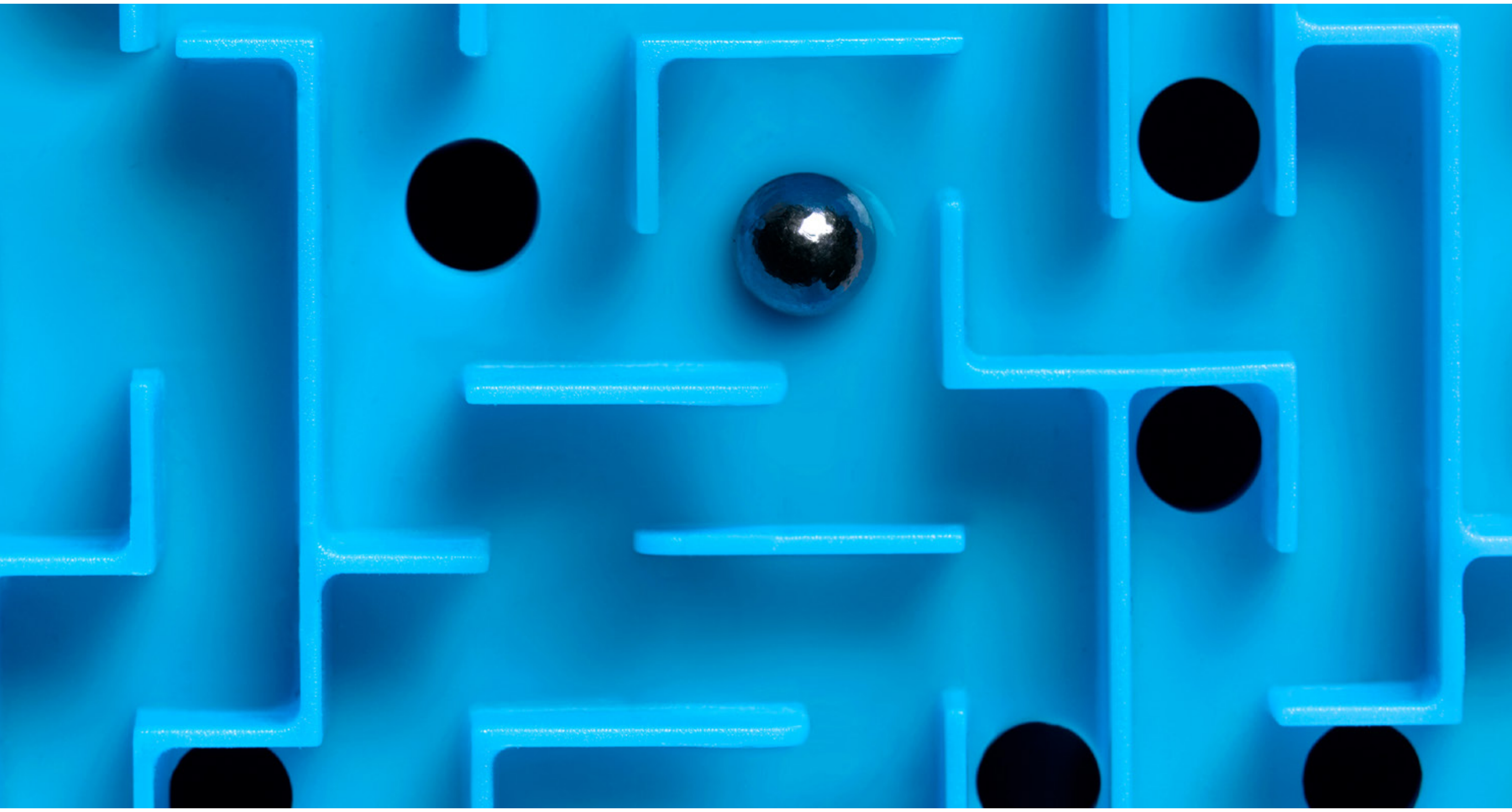
Nina Spielmann
Senior expert, global director of practice management, McKinsey Board Services, Zurich
Nina_Spielmann@McKinsey.com

The role of the board



Boards, talent, and culture

Boards need to ensure that management walks the talk on culture and values.



© Peter Dazeley/Getty Images

Board members are increasingly challenging management to ensure the organization's talent pipeline can meet the needs of the strategy. In this episode of the *Inside the Strategy Room* podcast, we continue our series on board perspectives by looking at the board's role in helping organizations develop the right talent and culture. To explore this topic, Frithjof Lund, the global leader of McKinsey's board services work, speaks with two experts on governance and organization. Hugo Bague, a former group executive at Rio Tinto, is a nonexecutive director on the board of Jones Lang LaSalle (JLL), a global real estate services firm, where he chairs the compensation committee. Mary Meaney is a globally recognized leader on change management and organizational transformations who until recently co-led McKinsey's Global Organization Practice and served on the global governance board. This is an edited transcript of the discussion. For more conversations on the strategy issues that matter, subscribe to the series on Apple Podcasts or Google Play.

Frithjof Lund: The importance of maintaining a strong culture and talent pipeline has arguably grown during the pandemic. Hugo, how do you see that play out in boardroom discussions?

Hugo Bague: All the technological changes, market changes, and changes in the employment market have led to discussions at the board table because, of course, they link with strategy. Do we have the right talent to fulfill that strategy? While years ago, financial capital was the dominant aspect of board discussions, that is now balanced with these other topics.

Frithjof Lund: One of the board's key roles is overseeing CEO succession. Are boards now extending that lens to other talent?

Hugo Bague: Yes. When I was at Rio Tinto, and now on the board at JLL, I have seen a huge shift. Traditionally, the role of the board was indeed looking at succession planning, but now it has expanded to questions such as, if we make these strategic shifts, do we have access to the critical skills needed for those shifts? What is the health of the leadership pipeline, and not only in terms of robust succession plans for the top team but for other critical roles?

It links with capital investment as well. At one time at Rio Tinto, we discussed investing in a particular industry and let go of one of those potential investments because we were not sure if we could get the right talent in place. That was an example where talent was on the front line of a strategic decision.

Mary Meaney: I agree that we are seeing a shift. Historically, boards did not spend much time on talent and culture, and when they did, it was very narrowly focused on CEO compensation and succession. Even with that narrow focus, many board members were unhappy with the quality of the debate and outcomes. Now, many companies realize that human capital is incredibly strategic, and that attracting, developing, retaining, and deploying that talent is a real source of competitive advantage. For the board, that involves a delicate balancing act because executing this is the role of management but it is the board's role to ensure governance.

Hugo Bague: The board can be enormously powerful in the questions they ask or fail to ask and what they put or don't put on the agenda. All that sends a big signal about what matters. I do see a trend toward more companies and boards putting talent on the agenda, and even at the top of the agenda. Sometimes they rename committees—for example, from a Remuneration Committee to a Talent and Rewards Committee. Anecdotally, I would observe that the time the board spends on talent is proportional to the time that operational business leaders spend on talent. Twenty years ago, CEOs and other members of the senior team delegated talent to the chief HR officer [CHRO]. Today, that is changing, too.

> **‘In today’s world, strategy is relatively easy to replicate and capital is relatively easy to access. What gives you a real source of competitive advantage is your talent and culture.’**

—Mary Meaney

Frithjof Lund: You mentioned, Mary, the sensitivity around the delineation of roles between the board and the management team. I am currently working with a new chair who has a strong mandate from the owner to become involved in talent beyond succession, while the management and the CEO are skeptical about opening that up to the board. How do you manage that sensitivity?

Mary Meaney: A lot depends on the ownership structure, whether the company is family-owned or publicly listed or private equity–led. It also depends on the relationship between the chair and the CEO. Historically, the board put their noses in but kept their fingers out. It respected the management’s responsibility to develop the strategy and execute it but asked questions and played that governance role. But the COVID-19 crisis was an unprecedented time. One of the CEOs I work with put it well: “I have to make 100 percent of the decisions with only 10 percent of the information I need.” The way he thought about it was, “I want to get the board’s perspectives because it is part of my sensing mechanism and a way to process this crisis.” When you create a constructive relationship between the CEO and the board, extraordinary things happen.

Hugo Bague: I would add two things that I, as a board member, try to do. One is probing. When you see that your CEO can talk in detail about the talent that sits two levels below him or her and has met those people personally, that gives you assurance that there is robustness in the talent system. We also ask management to give those lower-level people exposure to the board.

Frithjof Lund: What are the best moments for the board to ask those probing questions?

Hugo Bague: In my experience, and that goes back to my time at Rio Tinto, it is around key investments a company wants to make. Where do we have the talent to fulfill the promise on that investment, whether that is a greenfield investment or an acquisition?

Mary Meaney: I would agree. The board needs to ensure that enough thought has been put into understanding the strengths of the target company’s talent and whether it is a good match in terms of values and culture. Are we going to be able to retain that talent? Otherwise, you lose a lot of the acquisition’s value. The second area is around big moves. There are numerous risk assessments in making a major strategic thrust but, in my experience, companies do not always look at the talent risk. Do we have the talent that will enable us to deliver this? What evidence gives us confidence that we do?

Frithjof Lund: Many board remuneration committees have been reconfigured to take on a broader talent view. How much of the talent discussion do you find happens in the committee versus in the broader board?

Hugo Bague: At JLL, those questions are discussed with the full board. JLL made a large acquisition two years ago and more than once we had a full discussion about culture and talent and mitigation strategies around the risk of losing critical talent.

Frithjof Lund: What happens if the board is not satisfied with the answers to its questions about talent? Have you seen boards make active interventions?

Hugo Bague: I would say boards *ask* for more active interventions, not *make* active interventions themselves. You can give advice and suggestions.

Mary Meaney: What I see is more about challenging and questioning the CEO and the CHRO, and also CHROs being present more often at the board meetings and fully participating in the discussion. The board has to hold the senior executive team to account to make sure that they are fully addressing talent, culture, and purpose, because in today's world, strategy is relatively easy to replicate and capital is relatively easy to access. What gives you a real source of competitive advantage is your talent and culture.

Frithjof Lund: That's an interesting point. Some of my private-equity clients whose portfolio companies have boards link directors who have experience in people and organization issues with the company CHRO. They create these dynamic duos that can work across the board and the management team on these topics.

Let's pivot toward culture, which is closely linked to talent. In the UK, the oversight of corporate culture is now also part of the Corporate Governance Code. Why is that, Mary?

Mary Meaney: The reason culture is increasingly on the agenda is because there is a huge downside when you get it wrong. We have seen many great organizations stumble and sometimes even collapse because they had deep cultural issues. There is also a massive upside when you get it right. We have data showing that companies with strong cultures outperform by a factor of three their peer sets.

Frithjof Lund: How do you define culture?

Mary Meaney: It is a bit of an amorphous topic. The way I think about culture is as a set of mindsets and behaviors that shape how work gets done and decisions are made. It is very much about what people do on a day-to-day basis and the mindsets and beliefs that drive those behaviors. That makes it hard to measure, but it is critical to understand what the culture is. In large organizations, there is often not just one culture but a number of very different subcultures. Are some of those subcultures unhealthy and represent a risk because people are cutting corners or doing things they should not be doing?

Boards are getting increasingly involved in a governance capacity for those reasons—to make sure that senior leadership understands the culture and the risks. Culture is not an end in itself; it is a way of enabling the organization to deliver on its strategy. The board can ask: Based on our strategy, what cultural elements and themes are most important?

Hugo Bague: Cultures can also change more rapidly than boards think. Board directors sometimes underestimate the influence the CEO has on the culture. The CEO's behaviors are quickly copied throughout the organization.

Mary Meaney: I completely agree, Hugo. The culture needs to be owned by the senior leadership. People

‘When the CEO can talk in detail about the talent that sits two levels below him or her and has met those people personally, that gives you assurance that there is robustness in the talent system.’

—Hugo Bague

will watch their feet, not their lips. They will watch who gets promoted and who gets sidelined, which shows what is real and what is just rhetoric.

One other area of culture where the board can be really powerful is around lifelong learning. From the boardroom down to the engine room, everybody’s skills are growing obsolete faster and faster, so one of the critical success factors, both for individuals and institutions, is having a thirst for learning and an external orientation.

Frithjof Lund: You point to something important, Mary, which is the board as a role model on the cultural dimension. I saw that exemplified when a large retailer made a big acquisition and the board flew coach to visit the target’s headquarters. They rented a van and drove to the different outlets and then the board had a meeting in the head office canteen. The reason was that continuous improvement and cost consciousness were big cultural and business drivers for that business niche, so the board wanted to send a strong signal: we are living this.

How do you learn the culture? Is it about surveys and data or more about talking to people one on one?

Hugo Bague: You need to do all those things to get a rounded picture. One of the things we were privileged to do at JLL is, after board meetings abroad, we would have dinner with local talent. We learned an enormous amount in those exchanges about how people interact with one another. Do they challenge one another? Do they support each other? You see the culture at work.

Mary Meaney: What is a waste of time are carefully orchestrated road shows where you get slick presentations but don’t get under the surface. You need different data points. I remember at one organization, when I talked to people in the factory they would look over their shoulders before they answered any question. That happened repeatedly, and I realized there was a culture of fear.

It is important to get that 360-degree perspective. I often find that broad-based culture surveys highlight disconnects between what senior leaders say and what people at other levels in the organization report. It is interesting to look at how big the disconnect is and where it happens. Typically, leaders are more positive about the quality of the leadership. At one large company, the senior team all rated themselves top quartile on leadership, direction, culture, work environment, you name it, but what was fascinating is that their direct reports rated them at the bottom of the lowest quartile. It was right there for everybody to see.

It is particularly important for the board to delve into cultural elements that give you cause for concern. When people don't have a strong sense of personal ownership or accountability, that makes me nervous because it suggests that the risk culture may not be there. If people do not have strong professional standards and values, or they feel disempowered, those are things to probe.

Frithjof Lund: What would you advise to board directors who want to become more engaged on issues around talent and culture?

Hugo Bague: Don't only count on your own experience as an executive but be constantly on the lookout for what other companies are doing. Have exchanges with board members of other companies in other industries and see what you can apply to your own company.

Mary Meaney: This goes back to that mindset of lifelong learning, whether that is through external experts or the latest research or spending time with the organization. There is a huge amount at stake in getting this right.

Hugo Bague is a McKinsey senior adviser and a nonexecutive director on the board of Jones Lang LaSalle; **Mary Meaney** is an alumna of McKinsey's Paris office; and **Frithjof Lund** is a senior partner in the Oslo office.

Comments and opinions expressed by interviewees are their own and do not represent or reflect the opinions, policies, or positions of McKinsey & Company or have its endorsement.

This edited transcript of *Inside the Strategy Room* appeared on McKinsey.com in August 2021.

How boards can help digital transformations

Boards can add value to their business's digital transformation in five specific areas.

by Celia Huber, Alex Sukharevsky, and Rodney Zemmel

© Getty Images

Few board directors would dispute the importance of digital and how it's fundamentally reshaping the competitive landscape in almost every sector. But many of those we speak to are uncertain about what their role should be in helping senior management drive the digital transformations that businesses need to execute in order to survive.

In-depth discussions with dozens of board directors have helped shed some light on where boards can add value. What is emerging is a model where the core mandate of the board is unchanged but its scope for intervention on issues such as risk and competition is expanding. We see five things boards members can do to have the greatest impact.

Be clear about the implications of technology

The complexity and speed of change in digital and technology can make it difficult for board directors to focus on technology as a crucial strategic priority that can unlock new revenue and competitive advantage. The goal for the board isn't to understand the technology but, rather, to understand its *implications*. Artificial intelligence (AI) is a good example. Because AI can provide a huge leap over standard approaches in terms of delivery speeds, costs, and quality—often by a factor of ten—companies can more quickly and cheaply test new markets, products, and business models. Emirates Team New Zealand's America's Cup sailing team, for example, used AI bots to test and refine designs through a process of reinforcement learning, speeding the team's design process by a factor of ten.[1]

One way to address this issue is to bring on new board members whose experience aligns with the business's strategic priorities. If e-commerce is crucial, find a board member with that experience and expertise. If it's supply-chain digitization, then a different profile with that background is needed. Intensive training with the goal of demystifying technology, and demonstrating what technology makes possible, can be formative. Of 75 board members who completed this kind of immersive training, more than 50 percent of them went on to make digital transformation the top agenda item for the business.

Ensure that the digital transformation is fundamentally changing how the business creates value

Digital transformations aren't about being digital; they're about creating value. That aligns with the board's most important mandate, and the board can be particularly helpful in assessing value across three vectors:

— *Scale*. The typical aspirations of digital transformations often lead to changes at the margins (5–10 percent increases over the previous year). This is fueled by an insufficient understanding of what digital can do. As a rule of thumb, digital initiatives should have the potential to change at least 20 percent of operating profits. Boards can push their CEOs to shoot higher.

— *Source*. Technology is often an efficiency conversation about cost savings. But the greater value of tech is in its ability to build value. Recent McKinsey research into cloud economics, for example, has shown that as much as 75 percent of the $1 trillion at stake in cloud will come from business innovation.[2] Directors can make sure that management is exploring ways to tap tech to create new sources of value.

— *Scope*. Short-term pressures can overtake any business, especially when the market is volatile. Digital transformations, however, require long-term commitments to reap the full rewards they can deliver. Boards can press their CEOs to make sufficient expenditures for long-term initiatives.

Track whether the digital transformation is working

Almost every business has embarked on some kind of digital transformation, but for all the activity, it can be hard to know if it's working (or, more often, why it isn't working). That's because, while board

[1] "Flying across the sea, propelled by AI," March 2021, McKinsey.com.
[2] Will Forrest, Mark Gu, James Kaplan, Michael Liebow, Raghav Sharma, Kate Smaje, and Steve Van Kuiken, "Cloud's trillion-dollar prize is up for grabs," February 2021, McKinsey.com.

members generally have some kind of dashboard to review, the metrics don't help show whether "digital" is happening.

On one level, it's simply a matter of tracking the return on investment (ROI) of digital and technical investments, but this is a surprisingly infrequent occurrence. On another level, however, boards need metrics that truly reflect digital progress often in the "guts" of the business. For example, one key metric is the speed with which new ideas are translated into frontline tools. Another is the percentage of talent that's actually working in agile teams where true change occurs. One consumer-goods company tracks how many prices put into the system were AI-driven.

Get expansive about talent

Boards are often intimately involved in hiring C-suite leaders, but executive hires aren't always the most important ones. We find that roles deeper in the business are the backbone of the digital business and can make or break a digital transformation. McKinsey analysis shows, for example, that top engineers can be ten times more productive than their more junior peers.[3] Boards don't need to be involved in hiring data engineers, product managers, and scrum coaches—among many others—but they need to engage with senior leadership on progress made in developing this digital talent bench.

Because few companies will be able to "hire their way to victory," upgrading existing talent must be a core pillar of the business's program. Boards can help companies move past outdated training approaches and push senior management to develop targeted learning journeys that map to the capability needs of the business for the next six to 12 months.

Understand where nontraditional emerging threats are

Boards have traditionally provided guidance on how to navigate emerging threats to the business landscape, but digital has radically shifted where threats come from and how quickly they emerge. While cybersecurity is now a top board agenda item, local compliance or national security laws, for example, have created risks when businesses have their servers located in these corresponding locations.

Similarly, boards will need to expand their view of where threats exist as digital businesses migrate into new sectors. Think about e-commerce businesses getting into data management, tech companies moving into banking, or retailers into logistics. Boards can help press executive teams to look for "analog threats" rather than direct competitors and to inject more creativity into scenario-planning exercises. For example, some hedge funds are developing AI- and machine learning–driven analyses to better understand trends and to provide more sophisticated scenario planning.

Even before COVID-19 hit, 92 percent of executives believed their business models would need to adapt to respond to digital.[4] Boards have a broader role to play in helping their businesses respond and accelerate their digital transformation programs.

For a deeper look at how boards can support digital transformations, read "Five questions boards should be asking about digital transformation" on hbr.org.

Celia Huber is a senior partner in McKinsey's Silicon Valley office, **Alex Sukharevsky** is a senior partner in the Moscow office, and **Rodney Zemmel** is a senior partner in the New York office.

The authors wish to thank Alexander Gromov for his contributions to this article.

This executive briefing appeared on McKinsey.com in June 2021.

[3] Peter Jacobs et al.,"It's time to reset the IT talent model," *MIT Sloan Management Review*, March 5, 2020, sloanreview.mit.edu.
[4] Jacques Bughin, Tanguy Catlin, Martin Hirt, and Paul Willmott, "Why digital strategies fail," January 2018, McKinsey.com.

The role of boards in fostering resilience

The lessons learned from the current crisis can help corporate boards make the organizations they serve stronger.

© Andriy Onufriyenko/Getty Images

Boards of directors play a critical role in ensuring that management is well prepared for a wide range of potential shocks. In the fourth episode of our series on board perspectives around the most important issues facing organizations, the *Inside the Strategy Room* podcast looks at the role that boards play in building resilient companies. Frithjof Lund, who heads our board services work, leads a discussion with Gordon Orr, a nonexecutive member of several companies' boards and a McKinsey senior partner emeritus, and Martin Hirt, the global co-leader of McKinsey's Strategy & Corporate Finance Practice. This is an edited transcript of the discussion. For more conversations on the strategy issues that matter, you can listen to the episode and subscribe to the series on Apple Podcasts, Spotify, or Google Podcasts.

Frithjof Lund: If there has ever been a year when corporate resilience was tested, it was 2020. Martin, you have led a lot of our research on resilient companies. What does resilience mean in this context?

Martin Hirt: Broadly speaking, resilience refers to a company's ability to weather a crisis well. That means being prepared to deal with an unforeseen event such as an accident or, more commonly now, a major global health or economic crisis.

Gordon Orr: I don't think resilience is only about unforeseen events. As boards, we would not criticize ourselves for failing to anticipate a pandemic in 2020, but for not having included in our portfolio of potential risks something that would have the kind of business impact that COVID-19 has had and developed the key actions to take.

Martin Hirt: I would concur: resilience is about preparing for both unforeseen and predictable crises. Companies aware of how various types of events would affect their economics are generally better prepared. That is what drove our research. We looked at how organizations fared during previous economic crises and defined resilient companies as those in the top 10 percent of shareholder return outperformance through and after the crisis. We tried to understand at a very granular level what these companies did that differed from others and how those actions played out over time.

Gordon Orr: The share price metric is clearly critical, but assessing how well a board or management performs during a crisis has to encompass externalities, not only preparedness and actions taken midcrisis. During this crisis, share price changes of the companies on whose boards I sit have ranged from a 50 percent decline to an increase of 200 percent, and the biggest difference has been the nature of demand. An airline flying out of Hong Kong is now more than a year into demand at 1 percent of historic levels, whereas a manufacturer of PCs has seen the highest demand for its products in years. The resilience challenge at the computer manufacturer has been about ensuring the supply chain works, whereas for the airline it was more about balance-sheet resilience.

Martin Hirt: So it makes sense to differentiate between the actions companies take before a crisis strikes to prepare themselves where the timing is uncertain, and the actions they take once these externalities hit.

Gordon Orr: I agree. Shareholders tend to see the board's annual enterprise risk assessments as tick-the-box exercises to meet stock exchange requirements. But if they are done well, they are foundational elements of being prepared, because you discuss the range of risks the organization faces and how those risks play into the financials. The overarching takeaway from that process is often, "Do we have enough capacity in the balance sheet to deal with the shock?" At crisis time, it is too late to start paying attention to the balance sheet. You have to have been thinking about that in advance.

Martin Hirt: There is an additional layer of how the board engages with management so the needed actions are taken. In about 2006, we worked with a large Australian real-estate company whose board had asked us to help them think through how their economics, balance sheet, P&L, and cash flow could be affected by certain events. After the financial crisis, in about 2010, they told us they only implemented half of the recommendations. They said, "In hindsight, we wish we had done everything because what we did do saved us."

Gordon Orr: Well, the development of the risk map and plan is not done in isolation of management. In fact, management and the risk team do the heavy lifting and we, as the board, stress-test. A particular challenge we had this year is that it wasn't just the COVID-19 crisis—we also had a geopolitical and social stability crisis. Over the past four or five years, companies have been facing increasing levels of geopolitical risk, particularly in the technology space, and some of those issues have intersected with COVID-19 around market access and security of supply. Multiple dimensions are amplifying the effects of the pandemic and each other, and increasing the chance of something that might have been incremental turning into a major discontinuity.

Frithjof Lund: At what point and how should a board intervene to ensure the company is developing resilience?

Gordon Orr: That generally is first debated in depth in the audit and risk committee, working with the finance team and the strategy team. That is then synthesized and elevated to the full board for discussion to stress-test and challenge. In crises, the dynamic between the chair and the CEO becomes incredibly important because they talk several times a week and then inform the board and the shareholders, and potentially get the board together to make decisions. Do we reach out to the governments for support? Do we need to communicate with investors? Do we need to resize a business significantly? As a board member, this is

'Shareholders tend to see the board's annual enterprise risk assessments as tick-the-box exercises to meet stock exchange requirements. But if they are done well, they are foundational elements of being prepared.'

—Gordon Orr

the moment when you show up. This is what a high-quality board member prepares for because these are difficult decisions you have to make quickly.

Martin Hirt: One important resilience factor we have seen, especially in this pandemic, is how quickly companies shifted their operating model at the top—how they collaborate, how they make decisions and at what pace, and how they support those processes with war rooms or teams providing a synthesized version of external information, structured into scenarios so decisions can be taken confidently. In your experience, what role does the board play in triggering those operating-model changes, Gordon?

Gordon Orr: The judgment between acting too fast or hanging on in the hope that things turn around is tough. The board's role, at a first level, is to be a counterweight to what management proposes: Why are you saying "A" when the opposite of "A" is equally valid? Secondly, the board has to stand back and take a strategic perspective because management is likely doing firefighting at this point. The board should ask, "Will things ever get back to the way they were before? What does the post-COVID world look like? Will the business model we used ever come back?"

Martin Hirt: One of the big insights we had from working with hundreds of corporations during this crisis is that, especially when uncertainty is extremely high, not just focusing on firefighting—although firefighting is important—and not just focusing on the long term but focusing on key decisions along the entire timeline is crucial. I found, for example, that many teams struggled to decide whether to accept stimulus, because many companies that had been quick to accept government support during the financial crisis started regretting it within months because it came with big strings attached and getting out of it was not easy. That is one example of a decision that has to be taken in two or four weeks' time but has potentially multiyear implications.

Other critical decisions, of course, are related to employee health and safety. Then come the decisions about resource reallocation. One interesting insight from our research was that before and at the start of the last crisis, resilient companies divested 50 percent faster than their peers. They were willing to accept lower asset prices in order to create liquidity or make new acquisitions that repositioned them ahead of trends in order to come out of the crisis in a better position.

Frithjof Lund: You have talked about what boards should do, but what are the big pitfalls boards should avoid? Some boards, for example, made fairly high demands for information updates in the early stages of this crisis.

Gordon Orr: It has been very helpful for boards to get more information. The board and management need to have a common understanding of the most important information and at the right level of detail. For me, that means a dozen key performance metrics that tell you the input volumes and demand and how the company is addressing externalities, and getting that information weekly. It is already going to management, so just add a few more people to the distribution list. And yes, recognize that when we get back to normal, returning to the monthly rhythm of information sharing will be fine.

Martin Hirt: The information sharing is an interesting one. It builds on the points we discussed earlier about the way boards and management teams look at key decisions during a crisis and the timeframes they consider. One of the differentiators we see is how well management teams use scenarios. It starts with the number of scenarios. If you have three or five, I would say you are operating in one scenario. You need to have an even number [so you do not naturally gravitate to the middle scenario], and structure the information in such a way that management and board directors don't have to start every conversation with a lot of context setting but are operating in the same frame. Updating those scenarios with the latest information, on the basis of a set of assumptions understood by everybody, is foundational. Once boards and management teams are on the same page, decisions can be taken very swiftly.

‘The question is, will the insights that the board and management gained about the operating model during a crisis be institutionally preserved, or will they have to be relearned?’

—Martin Hirt

If there is information asymmetry—which scenario are we operating in, and what does it mean?—it causes misunderstandings. In a crisis, there is a huge premium on decision speed and accuracy. In the military, the team that prepares the information and feeds it in a consistent way is called a plan-ahead team. It is different from the crisis management team, which is taking actions, executing decisions, reacting tactically in the field. The plan-ahead team sits next to the decision maker, and its only function is to take information from all sources of intelligence and work it into these scenarios.

We have learned a lot about how these teams work best. For example, you should structure them around issues so when a decision comes at you—Do we take government stimulus? Do we ramp down our process-intensive operations that will require a long ramp-up time later?—it flows to that team and around these decisions the scenarios are applied. You have a structure that feeds decision-ready information to the board and the management team.

Gordon Orr: On the teams point, effective boards now are working as teams, and it helps if the large majority of board members have been together for a while, with an understanding of the business, the industry, and management, and with a level of trust in each other such that the synthesis coming up to the full board is of high quality. The orchestration by the chairman as the team leader becomes very important, particularly as you shift to virtual meetings. Members who joined the board recently and lack the experience of going through multiple balance-sheet cycles with management become a challenge for that team dynamic.

Martin Hirt: In order to be an effective team, people have to be trained. How does the board’s operating model change during a crisis, Gordon? What type of capability building and preparation have you seen be effective?

Gordon Orr: Skill building and training is another one of those things investors think boards do to tick the box. But boards do it because they want to get better. When you look at digital, for example, the board needs to be smart enough to challenge management. There are various ways of addressing that, such as an expert talking to the board. It could shape the decision on where we hold board meetings. If we want to understand the Indian market better, the board can spend time there as a group. It would be a red flag to investors if boards were not conducting a regular program of skill development.

Frithjof Lund: In terms of the chair’s role and the new dynamic between management and the board, how much of that do you think will persist beyond the crisis?

Gordon Orr: The role of the chairman has become much more time consuming, and that may stay in the form of outreach to investors, governments, and other stakeholder groups. Many countries are piling more and more responsibilities on the board, which is becoming a challenge. Environmental, social, and corporate governance [ESG] is an enormous new topic in terms of board time. Cybersecurity is another. Being a board member is not a full-time job but it is getting closer to that, particularly in Europe. You are asking people to show up for 12 board meetings a year, plus committees, and to do this for a fraction of the compensation they received before.

Martin Hirt: I would add an individual component. Now that boards and management teams have worked together through the crisis, there is a level of bonding and understanding each other. But management teams and boards change. The question is, will the insights that the board and management gained about the operating model during a crisis and how to shift to it quickly be institutionally preserved or will they have to be relearned?

Frithjof Lund: If we look ahead, what are the top things boards should ensure are in place to handle future crises?

Gordon Orr: If there is one thing to remember from our conversation, it is the importance of preparation across a broad set of potential risks. Second is to lean in to decision making. Taking them sooner is generally better. And because of geopolitical risk, avoid the small and risky investments: initiatives that could create value but are potentially highly risky, where you could get a disproportionate negative impact on the business in return for relatively small gains.

Martin Hirt: As we think about future crises, we should not forget that we are still in this one. There is still a lot of uncertainty. We have seen in China that when the virus is domestically under control, economic activity jumps back, uncertainty drops, and economic growth returns to previous levels, if not higher. It is also relatively clear that the recovery will happen sometime in late 2021 or first quarter of 2022 for most countries that have been ahead of the game in ordering vaccines. Where the uncertainty remains high is how long the stimulus will continue. After the financial crisis, some governments cut off the stimulus too quickly, which stifled their economies. If that happens now, we could see a wave of bankruptcies and financial difficulties coming toward us.

But what I would stress from a board perspective is that the trends that have been accelerated through this crisis are almost certain to stay. The question is, are you acting on the writing on the wall? Traditionally, one of the most difficult things for corporations is reallocating capital and resources toward new initiatives. Helping the management team accelerate that process is absolutely critical right now.

Frithjof Lund: Aside from the stimulus ending too quickly, what sources of potential future crises should boards have on their radar?

Gordon Orr: Geopolitics is not going away. ESG and the potential inability of businesses to keep up with the expectations of society and investors could cause major discontinuities. And third are the massively greater levels of government intervention in business and potentially the return of active industrial policies by governments in many sectors.

Martin Hirt: There is a longer-term issue we all have to reckon with, which is that stimulus has been given out at astonishing rates. Some may say, “When it comes to central bank accounting, you can just cancel the whole thing out.” That may not be realistic for some governments. So how we deal with the bill from this crisis is a potential future crisis.

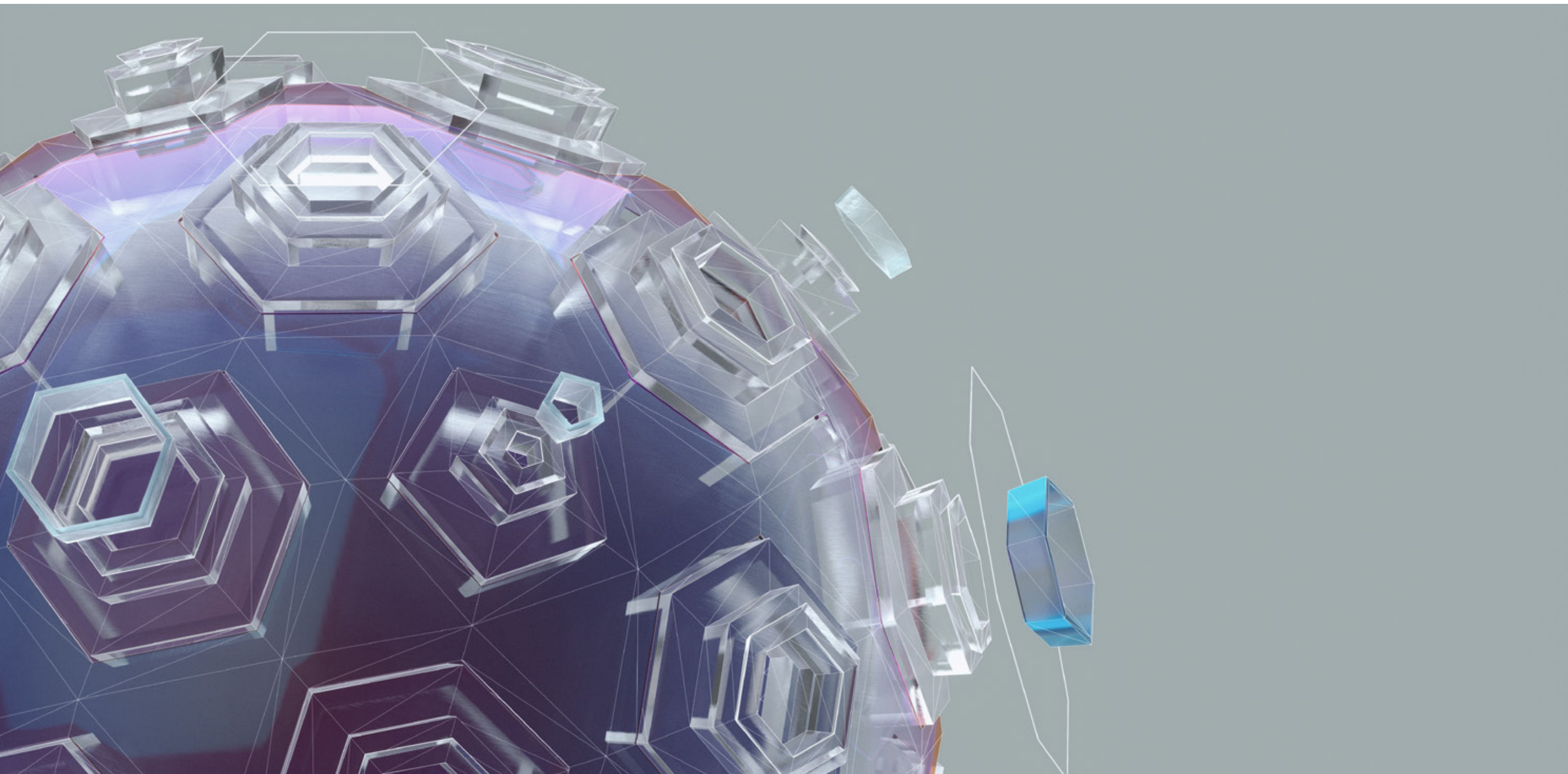
Martin Hirt is a senior partner in McKinsey’s Greater China office. **Gordon Orr** is a nonexecutive member of several boards and a McKinsey senior partner emeritus based in Hong Kong. **Frithjof Lund** is a senior partner in the Oslo office.

Comments and opinions expressed by interviewees are their own and do not represent or reflect the opinions, policies, or positions of McKinsey & Company or have its endorsement.

This edited transcript of *Inside the Strategy Room* appeared on McKinsey.com in June 2021.

Boards and cybersecurity

How boards should prepare for the rising cybersecurity threat.



The board agenda has been crowded since the start of the pandemic, and many issues have acquired new urgency. In this episode of the *Inside the Strategy Room* podcast, Frithjof Lund, the leader of our board services work, speaks with two cybersecurity experts about how boards of directors should help their organizations ensure they are prepared for potential cyberattacks. John Noble is the former director of the United Kingdom's National Cyber Security Centre and a board member of NHS Digital, the national information and technology partner to the country's National Health Service. Wolf Richter is a McKinsey partner who helps chief information officers (CIOs) capture the benefits and mitigate the risks of tech-enabled transformations.

Frithjof Lund: Cybersecurity has been on the board agenda for some time. In our latest global board survey, participants rated it among their top four priorities. However, when we ask board members about their key challenges today, only one in five mentions cybersecurity. Have you seen a shift in how companies are approaching this issue?

Wolf Richter: It used to be mainly the regulated industries—particularly banks and insurance companies, as well as utilities and public-sector entities on critical national infrastructure—that prioritized cybersecurity. After the WannaCry ransomware attack a couple of years ago, however, many others realized that even without being on the high-target list, they could fall victim to a cyberattack. Retailers and manufacturing companies in particular have become a lot more aware of the vulnerabilities that digitization brings to their operations. Now that working from home has become the norm, and given the massive increase in ransomware attacks that we are seeing, most companies realize how vulnerable they are in an environment where most of their business and employee interactions are conducted through online channels.

Frithjof Lund: You mentioned an increase in cyberattacks. What is driving it?

John Noble: There are two things. One is the change in the business model among the people carrying out these attacks. Cybercrime is becoming industrialized. Vulnerabilities are identified by one set of groups that then share the information with criminal groups. Those criminal groups can, in effect, lease the ransomware in exchange for a percentage of the profits and employ it against victims. That has enabled a massive increase in both the volume of attacks and their sophistication. Ransomware can not only affect the availability of your systems but also result in the release of sensitive data.

Frithjof Lund: Are companies sufficiently prepared to handle this rising threat?

Wolf Richter: It's a mixed bag. It is becoming apparent who has been thinking about cybersecurity systematically and who has just recently woken up and is starting to improvise. On the one hand, we have seen a massive acceleration in digitization as companies have moved their operations to the cloud and granted remote access to employees. Needless to say, very few had the time to think through the cybersecurity implications. On the other hand, those who have spent the past couple of years preparing—identifying their critical assets and processes, testing the procedures with employees, putting in place emergency plans and fallback scenarios—are seeing those investments pay off.

Frithjof Lund: What approach should boards take to this topic, especially those whose companies are less prepared?

Wolf Richter: The board of directors and the executive leadership need to engage in a critical conversation. The board's responsibility is to make sure that the executive team has a plan, is prepared, and is preparing the whole organization

‘Cybercrime is becoming industrialized. Vulnerabilities are identified by one set of groups that then share the information with criminal groups.’

—John Noble

for the eventuality of an attack. The question is not whether the attack is going to happen and how to prevent it. The real questions are, when will it come? Is the organization prepared to detect it? Is it prepared to stop it? Can it mitigate the effects and get back to normal operations as quickly as possible?

John Noble: Cybersecurity is an issue for the whole organization. Whether it is in advance of or during an incident, you should not just leave it to the chief information officer and the technical team. Leaders need to decide how to manage the tensions between usability, security, and cost, and that is very much where we need the board challenging and testing processes.

Frithjof Lund: What should a board do when an incident happens? John, you have seen that up close in many situations.

John Noble: Going back to preparedness, there is a big difference between how an organization reacts if it has exercised its processes around dealing with an attack in advance and one that has not. Communication is essential. There needs to be a single version of the truth, so everybody both within and beyond the organization understands how the incident is being handled. The board has a crucial role there in supporting the executive team. As I saw during the 800-odd incidents while I was at National Cyber Security Centre, the executive teams are under tremendous pressure and they need the board’s support and guidance.

The WannaCry incident in May 2017 had a very big impact on the UK National Health Service, where I am now a nonexecutive director on the NHS Digital board. The important thing at the board level was communicating with the vast number of stakeholders across the healthcare system. I can’t say that the NHS got everything right, but it certainly learned a tremendous number of lessons. This meant that going into the pandemic, the board was much more prepared, understanding the vulnerabilities we are carrying and asking the right questions around how those are being mitigated.

Frithjof Lund: Any caveats you would highlight for boards or management teams?

John Noble: Generally, the incident response will go badly if it is just left to the CIO and the technical team. They have a critical role in resolving the incident, but the consequences go beyond the immediate damage. There will be reputational, legal, and operational issues. You need the whole senior-management team to come together.

Wolf Richter: A cyberattack tends to elevate and exacerbate tensions that already exist within an organization. I have seen things go particularly poorly in decentralized organizations with no central leadership team or where it was unclear who would lead during a crisis. When people are not used to working together, establishing trust during a crisis is extremely difficult. Finger-pointing starts, and people fight each other instead of the enemy attacking them from outside.

Frithjof Lund: How do you build cybersecurity capabilities within the organization? What are the key areas boards should focus on?

Wolf Richter: First and foremost is awareness among the whole leadership team. We often see a concerned board member and the CIO but a vast amount of ignorance in between. There should be a shared sense of urgency about this issue within the executive team and the level below. It's about the awareness that this is not something that affects others but is an existential threat to the organization in the digital world.

The second step is to develop the concepts and tools. This is the hard, unglamorous work that has nothing to do with the folks in black hoodies building some new cybersecurity incubator. It's about checking, which are the critical assets and processes? Are there procedures in place in case of an attack? It is important during this phase to balance the controls and red tape you put in place so they do not stifle internal innovation, which can give cybersecurity efforts a poor reputation. That's why these initiatives should be led by people with a business mindset, not just a control or technology mindset.

That leads to the third part, which is building capabilities. This affects the whole company—the process architects and marketing and salespeople when they negotiate with customers, who more and more are asking about security features, especially in engineering and high-tech industries. All these folks need to know whom to turn to for information. When cybersecurity becomes a joint capability, the whole organization becomes more cyberresilient.

John Noble: I would add that with ransomware, one of the big risks is around legacy equipment, which almost every organization has. It represents a vulnerability that attackers are exploiting. We have to treat legacy equipment as untrustworthy and put in place controls to manage it. But only some of those controls are technical, and the business and IT teams need to engage to see whether some of the risk can be managed in other ways. Is that equipment needed? Can it be segmented? Maybe the answer is to migrate to the cloud, which will have investment implications.

Frithjof Lund: If I am a board director concerned about cybersecurity, how do I best understand how well my organization is prepared?

Wolf Richter: There are a couple of ways to measure this. Ideally, an organization would measure the business value at risk from a given incident. However, most companies lack the transparency or a reliable model to translate and collate the business impact of an incident. Many companies turn to what is called a maturity-based approach, using outside benchmarks to assess their controls' relative level of maturity. While that is better than not managing cybersecurity at all, sometimes it leads to the wrong incentive to simply invest in more controls.

If I was a board member, I would ask which assets or parts of the organization the cybersecurity team and the leadership team focus their attention on. Have they identified employee groups that are particularly vulnerable, such as field service agents or customer service representatives? Do they know how many people have privileged user rights? We live in an environment of scarce resources, and the executive team needs to balance the investments in cybersecurity with investments in all other parts of the business. The more specific they are

‘You need to expect attackers to be equipped with almost military-grade weapons. It’s like placing machine guns in the hands of burglars.’

—Wolf Richter

in targeting initiatives toward specific systems, infrastructures, processes, and people, the better I would feel as a director.

John Noble: I think that’s so important. We cannot just rely on KPIs such as the percentage of service that has been updated. You need to have that engagement. Another way the board can get further assurance is through a third-party challenge, such as penetration testing of critical assets. When was the last penetration test carried out? What did it reveal? What recommendations have been taken forward? But before you do that, you have to identify what is critical and needs to be protected.

Frithjof Lund: Are there cybersecurity investments you see companies making that are poor uses of resources?

John Noble: The cybersecurity market is still immature, and many people are trying to sell boxes that promise to “fix” all your cybersecurity problems. There is no single solution for cybersecurity. It needs to encompass a range of measures, and the most effective measures tackle the basics that make companies vulnerable around security updates, authentication, and how you access and configure the systems.

Wolf Richter: I often see companies doing one-time capital investments but shying away from operating investments in the people. We evaluated one insurance carrier that had a beautiful security operating center, all the licenses and sensors in place, but they lacked the staff to make it run 24/7. You need to have somebody processing the information, but they had one guy who was tasked part-time with translating and sharing the data with the rest of the organization. Of course, it didn’t happen. Companies are overinvesting in some parts but not thinking about how to bring those investments into the day-to-day decision making.

John Noble: To build on that, I saw a case study presented recently by one of the leading companies in this area, around how their detection system that uses artificial intelligence had flagged a system compromise. It turned out that there was nobody to interpret this data, so despite all that investment in a very expensive and sophisticated detection system, nobody took action to prevent damage.

Frithjof Lund: What about the capabilities within the board itself? Where are the main gaps?

John Noble: I think it’s essential that somebody on the board has cybersecurity expertise to provide a challenge for the CIO and the chief security officer [CSO]. They can also help with building up the overall board's knowledge, because leaving cybersecurity to one person is absolutely not the answer. You need the whole of the board to engage, to bring their experience of other areas to provide the right challenge in this space.

Wolf Richter: We need to demystify cybersecurity. The typical reaction of a board that has low cybersecurity skills is, "Ooh, that is not a topic for us. Let's call the CSO or the CIO and they can explain what is happening." But cybersecurity is not rocket science. It is somebody tinkering with your processes, systems, assets, and data. This realization usually comes easier if a board member says, "It is our job to make sure the organization is prepared. We don't have one guru or wizard who will fix all our problems."

John Noble: I very much recognize that description. The organizations that are not cyberliterate want to leave it to the CIO and the CSO. But those executives want to share some of the risks and to expose the critical issues to the board, not least because these issues often require investment and difficult trade-offs between cost, usability, and security.

Frithjof Lund: John, you mentioned that even having one cyberliterate board director could help build the capabilities of the entire board. Can you elaborate?

John Noble: I have seen companies organize exercises that serve as both teaching opportunities and opportunities to highlight the risks the organization faces: giving the board a briefing on the threat and then looking at how best-in-class companies address it.

Wolf Richter: We insert cyberexercises into Silicon Valley trips we do with boards. The directors visit high-tech companies and then we show them the dark side of digitization, demonstrating what can happen if you don't pay attention to the risks that come with the opportunities that technology provides. Getting their attention when they are doing something special outside their normal duties has proven tremendously effective in making it memorable.

Frithjof Lund: Wolf, you mentioned at the start an acceleration of attacks. What will be the big cybersecurity threats in the coming years?

Wolf Richter: We see a massive professionalization as more organized crime discovers cyberattacks as a profitable activity. You need to expect attackers to be equipped with almost military-grade weapons. The large military organizations have invested heavily in building those cybertechnologies, and we have seen more than one event where one of these military-grade attacks had leaked out onto the dark net. It's like placing machine guns in the hands of burglars around the corner.

The big difference is that these digital machine guns are tremendously hard to control and extremely easy to replicate. This is simply code—coding tools that you can copy and share with others. On the other hand, the goal of many attacks we are seeing, particularly involving ransomware, is to make money, so at some stage there is a negotiation over the ransom. That combines cybercrime with good old-fashioned crime that police and private investigators have experience with.

Much is happening on the technology side as well. The shift to the cloud poses a whole new set of risks. While, by and large, the infrastructures of the large-scale cloud providers are much more secure than what most companies can implement in their own data centers, it is naive to believe that the cloud service provider will take care of all your security needs. On the contrary: we are seeing a massive increase in breaches of cloud-hosted applications for lack of proper configuration. Your IT department needs to acquire a new set of engineering skills to manage cloud environments.

John Noble: The cloud, as you say, Wolf, is a great opportunity, in particular to move off legacy infrastructure, but issues such as authentication remain your company's responsibility. It's very important that the board understands that however secure cloud service providers may be, the company still holds a great deal of the risk. And, sadly, we see some very large-scale breaches as a result of people simply not understanding how the cloud works.

Frithjof Lund: Do you have any advice for board directors on how they can stay on top of the battle against cyberattackers?

Wolf Richter: Any digitization program should have a cybersecurity budget. Companies need to drive digitization in a secure manner. Haphazard digitization just creates legacy infrastructure of the future, so you need to use best practices now in terms of secure coding, secure agile, secure DevOps. Companies need to make sure there is a security mindset across the whole life cycle.

John Noble: I don't think it is inevitable that companies will be compromised. There are opportunities to get this right and they are around recognizing the genuine threat. We are building national economies on something that is inherently unsafe—the internet—and we have to mitigate that by taking a series of measures. The board has to ensure that executive leaders are looking at both the worst-case and best-case scenarios and are prepared to make some compromises to ensure a secure infrastructure.

John Noble is a senior adviser to McKinsey and a nonexecutive director on the board of NHS Digital, the national information and technology partner to the United Kingdom's health and care system. **Wolf Richter** is a partner in McKinsey's Berlin office. **Frithjof Lund** is a senior partner in the Oslo office.

This edited transcript of *Inside the Strategy Room* appeared on McKinsey.com in February 2021.

The board's role in embedding corporate purpose: Five actions directors can take today

A large spotlight is shining on corporate actions these days, and all stakeholders have growing expectations. A board's involvement in defining purpose helps meet those expectations.

by Celia Huber, Sebastian Leape, Larissa Mark, and Bruce Simpson

© Marko Geber/Getty Images

Multiple forces have increased attention on stakeholder capitalism, and most boards have not sufficiently grappled with the significant implications for their organizations. Last year, Business Roundtable, an association of CEOs who run major US corporations, committed member companies to serving the interests of all stakeholders, but their signatories have found it challenging to deliver fully on their promise. While 181 chief executives signed the roundtable's statement, only one did so with board approval.[1] Could boards have used this moment to engage more deeply with management teams to embed corporate purpose within their organizations—a role that fits squarely within a board's obligation to enhance the company's long-term performance?

Democratization of information has increased scrutiny of corporate actions and raised the standards. As one board member told us, "Corporations exist with the permission of society, and any sector can be regulated out of business." Purpose serves as the foundation that guides those actions and behaviors. In a nutshell, it is a company's core reason for being. It answers the question, "What would the world lose if our company disappeared?" By articulating a clear purpose, anchored in measurable environmental, social, and governance (ESG) commitments and goals, companies can better deliver on societal expectations. Organizations that define their purpose and use it to guide their activities see a clear upside in improving company reputation, alerting management to risks early, establishing the organization as a leader in raising industry standards, and enhancing business performance.

But delivering authentically on corporate purpose is difficult. As such, boards must ensure that their companies' management teams understand the urgency of the issues that the purpose aims to address, and the potential value at stake.

The growing importance of purpose

Even before the pandemic, attention to corporate purpose and ESG was on the rise. Stakeholder groups, from investors and regulators to employees and customers, have increased pressure on businesses to address humanitarian, social, and environmental problems. A full third of global assets under management today are screened for ESG considerations,[2] and investors are taking increasingly activist stances for sustainable corporate practices. The Government Pension Fund of Norway, known as the Oil Fund, for example, has asked portfolio companies to share detailed plans to shift to a low-carbon economy,[3] and voted to exclude three companies from its portfolio due to perceived violations of human rights norms.

Employee and consumer pressure is also growing. The reputations of some tech firms have been undermined by allegations of inequitable working conditions inconsistent with external statements, brought to light by employee whistleblowers. Recently, 65 percent of consumers declared they will buy or boycott a brand depending on its actions during the COVID-19 crisis.[4]

Purpose and ESG commitments help companies address vulnerabilities and contribute to increasing shareholder returns. A compelling corporate purpose attracts talent and unleashes its potential, improving long-term employee well-being and quadrupling engagement.[5] In fact, we recently quantified five links between a strong ESG proposition and improved business performance and long-term value.

Yet despite the value associated with purpose and ESG, and the risks that inaction poses, many companies struggle to rise to stakeholders' expectations. Some take a check-the-box approach or bolt simplistic catchphrases onto existing corporate social responsibility reports. Superficial

---

1 *Global Sustainable Investment Review 2018*, Global Sustainable Investment Alliance, 2018, gsi-alliance.org.
2 Review of ESG considerations includes both positive and negative screening of assets.
3 Gwladys Fouche, "Norway wealth fund to test business model of biggest CO2 emitters," *Reuters*, September 3, 2020, reuters.com.
4 *Trust Barometer special report: Brand trust and the coronavirus pandemic*, Edelman, March 30, 2020, edelman.com.
5 *Transforming culture in financial services: Driving purposeful cultures*, Financial Conduct Authority, March 2020, fca.org.uk.

branding efforts around purpose that are not anchored in the organizational DNA only serve to undermine leadership credibility.

The board's purpose agenda

How boards approach purpose and ESG differs based on regional regulations and norms, but a growing group of business leaders recognize that attention to all stakeholders is essential to protecting their companies' interests. Companies oriented to the long term outperform short-term companies, given the material impact purpose and ESG can have on companies' long-term performance, ensuring these commitments are ingrained within the organization and fall within the board's mandate.

Board directors can serve as thought partners to the management team in developing a purpose narrative and embedding it in the organization. Purpose can become a guiding lens for board engagement on strategy, investments, risk and performance management, HR and culture, governance, and external reporting (see sidebar, "Applying a purpose lens to a board's engagement with management"). In essence, purpose provides the North Star against which the board can stress-test key management decisions.

Below, we outline five specific actions around building, owning, assessing, reinforcing, and driving purpose (exhibit). These can assist board directors in partnering with management to create a purpose narrative with clear commitments and targets, fully embedding the purpose in the organization, and monitoring progress.

1. *Build an authentic purpose narrative with management.* The creation of a purpose statement and a supporting narrative should not be a branding exercise but rather a deeply reflective process. Accordingly, boards should encourage top executives to take the time to understand all stakeholders' perspectives on the company's strengths, vulnerabilities, and relevant industry trends in developing the purpose.

   Board members themselves should engage with stakeholders to listen to concerns, as these can simmer under the radar until they boil over into a public backlash. One board was recently caught off guard when an employee used social media to raise concerns about the company's contract with a foreign government. Boards need to create confidential channels through which employees can raise issues for their consideration in a safe way. They should also proactively monitor internal and external sentiment

Exhibit

Five actions can help boards further a company's purpose and environmental, social, and governance journey.

B	O	A	R	D
Build an authentic purpose narrative with management, engaging stakeholders proactively on the company's strengths, vulnerabilities, and possibilities	Own purpose in board practices; board composition should demonstrate diversity and ESG[1] competence; include purpose and ESG issues regularly on the board agenda	Assess purpose commitments, ensuring management sets clear, measurable goals, actions, and accountability at all levels of the organization	Reinforce purpose lens in core board decisions; boards can use purpose to pressure test decisions and trade-offs in company strategy, investments, risk and performance management, HR and culture, governance, and external reporting	Drive organizational accountability for purpose through management evaluations and reporting; tie ESG metrics to executive compensation and celebrate purpose successes

[1]Environmental, social, and governance.

Applying a purpose lens to a board's engagement with management

Directors can help ensure that management decisions are guided by the company's purpose within six areas of board oversight.

Strategy: As part of its responsibility to challenge and approve the corporate strategy, the board should confirm that the long-term business vision aligns with the company's societal purpose.

Investments and M&A: In ensuring that major investments are consistent with multiyear value-creation commitments, the board should consider their impact from environmental, social, and governance (ESG) and stakeholder perspectives.

Risk: The board can broaden the definition of risk to include ESG considerations when defining a risk culture that embeds both compliance and the pursuit of profitable risk.

HR and culture: When approving executive succession plans and ensuring talent plans, organization, and culture are consistent with overall strategy, the board can monitor that management is also investing in employees as a stakeholder group (through compensation, training and diversity, equity, and inclusion initiatives).

Performance management: The board should tie executive compensation to ESG commitments as part of its monitoring of long-term KPIs, earnings, capital allocation performance, and nonfinancial measures linked to value creation.

Core governance and compliance: In overseeing external communications and reviewing and challenging reporting, compliance, and policies, the board should stress the importance of societal issues and reinforce the need for ESG accountability.

alongside management. For example, the board of a leading industrial company recently replaced a planned board meeting with a listening tour with employees on the shop floor. Such insights can help the board incorporate stakeholder concerns into the purpose orientation.

2. *Own purpose in board practices.* Boards should ensure that purpose and ESG considerations are regular parts of their discussions. Furthermore, one of the board committees should include purpose as part of its oversight. One UK financial services regulator pointed out that, given his agency's access to the minutes of board meetings, "I can measure whether or not purpose and ESG are taken seriously."

   Additionally, board composition criteria should include ESG expertise and diversity (in gender, ethnicity, age, and sexual identity). For example, only 10 percent of board members at companies on the Russell 3000 Index are considered ethnically diverse, and women hold only 19 percent of board seats,[6] suggesting significant room for improvement around diversity in governance.

3. *Assess purpose commitments, ensuring management sets clear and measurable goals, actions, and accountability.* Purpose is made real when it connects to clear commitments, targets, and action plans that cascade down through the organization. The purpose statement should be specific enough to guide decisions

[6] Subodh Mishra and Kosmas Papadopolous, "U.S. Board Diversity Trends in 2019," *Harvard Law School Forum on Corporate Governance*, June 18, 2019, corpgov.law.harvard.edu.

on investments in time, capital, and other resources. A powerful litmus test of a purpose statement is to ask what the company should *stop* doing because of it. Board members can guide the management along this process by posing questions, pressure testing answers, and suggesting ESG metrics.

The board should also encourage management to report externally on its progress in meeting the goals the company's purpose sets out. For example, the Brazilian cosmetics company Natura &Co's purpose is "to nurture beauty and relationships for a better way of living and doing business." To support it, the company set ambitious goals around climate change, human rights, and economic circularity. Each pillar of its purpose strategy features specific initiatives, such as engaging supply-chain partners in ensuring sustainable sourcing and bolstering female empowerment through microfinance loans. Natura tracks and reports progress to both the board and in its annual reports.[7] "They live and breathe this," says a board member about the company's management.

4. *Reinforce purpose lens in core board decisions.* Boards can use purpose to pressure test decisions and trade-offs in company strategy, investments, risk and performance management, HR and culture, governance, and external reporting. For example, in 2010, the board of directors of Danish power company Orsted approved a long-term vision shift to support a commitment to the environment. In subsequent years, the company moved its portfolio from primarily oil, natural gas, and coal generation to renewable energy. By 2017, wind power accounted for 91 percent of Orsted's earnings before interest, taxes, depreciation, and amortization, and its market cap has grown 64 percent since its 2016 IPO.[8] Boards should also be vigilant in monitoring management decisions that could undermine the

A growing group of business leaders recognize that attention to all stakeholders is essential to protecting their companies' interests.

[7] *Creating the best beauty group for the world: 2019 report*, Natura, 2019, naturaeco.com.
[8] Meredith Annex and Tom Harries, "Orsted's profitable transformation from oil, gas and coal to renewables," Powering Past Coal Alliance, December 12, 2018, ppca.org.

stated purpose. For example, during COVID-19 some companies were criticized for laying off workers while instituting share buybacks or increasing executive compensation. Dissonance can also arise when a company engages with industry groups or lobbyists whose goals are inconsistent with the company's purpose orientation.

5. *Drive organizational accountability for purpose through management evaluations and reporting.* As part of its oversight role, the board should establish organizational accountability around purpose. At the highest level, it can link ESG performance metrics to compensation for the management team to ensure these goals are treated as seriously as profit and revenue targets. For example, Danone is factoring the cost of estimated emissions into its "carbon-adjusted" earnings reports.[9] The board can also take the lead in celebrating purpose-linked achievements, and noble failures (such as products recalled for not meeting new ESG standards). Boards can encourage management to share inspiring stories with employees and the public, via annual reports, ESG reporting, and press releases.

Importantly, the board cannot allow purpose and ESG goals to drop off its agenda during crises. The COVID-19 pandemic and the subsequent economic downturn have imposed unprecedented difficulties on many companies, but purpose-related considerations should guide decisions even—or especially—when organizations must make hard choices. Purpose can help companies evaluate short-term costs, such as offering employee-retraining programs in place of layoffs and loans to suppliers, as important investments in a better future—for both their stakeholders and society as a whole. Fundamentally, purpose is about leadership, and companies need all their leaders to provide purpose-driven inspiration during difficult times.

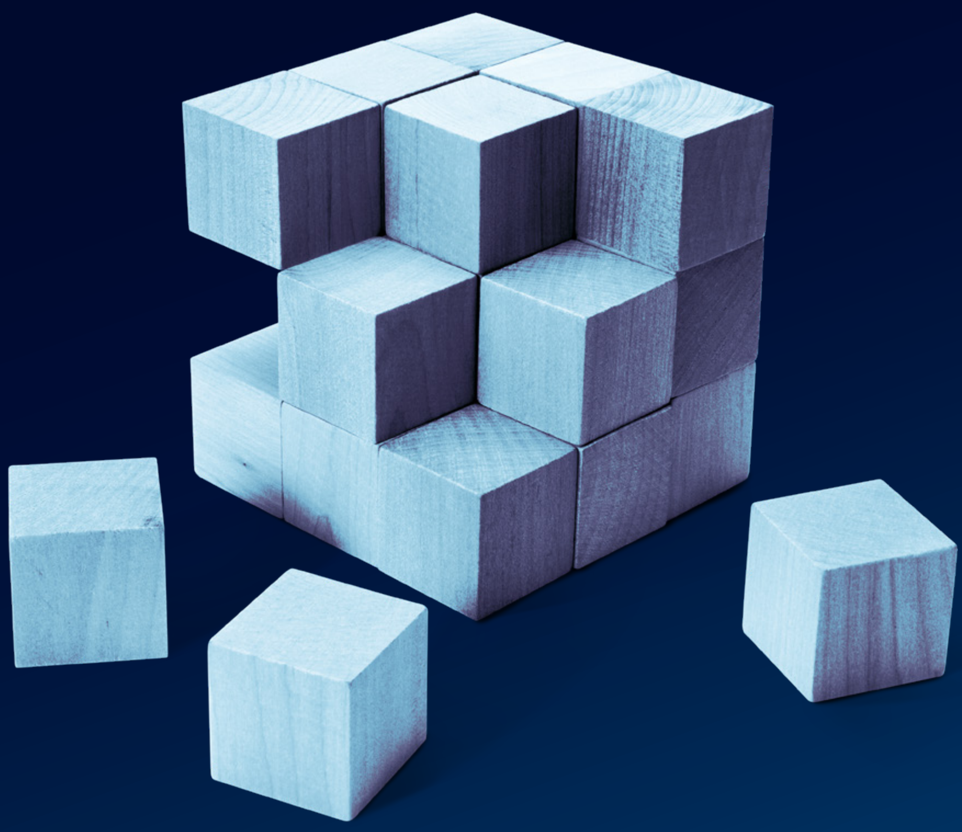
Celia Huber is a senior partner in McKinsey's Silicon Valley office; **Sebastian Leape** and **Larissa Mark** are consultants in the Washington, DC, office; and **Bruce Simpson** is a senior partner in the Toronto office.

The authors wish to thank the following board members and experts for their contributions to this article: Jonathan Davidson (UK Financial Conduct Authority), Sir Ian Davis (Rolls-Royce, BP, Johnson & Johnson, Majid Al Futtaim), Conor Kehoe (International Integrated Reporting Council), Nancy Killefer (Natura, Cardinal Health, Facebook), Frithjof Lund, Nina Spielmann, and Ron Williams (American Express, Boeing, Johnson & Johnson).

This article appeared on McKinsey.com in November 2020.

[9] *Shell sustainability report 2018*, Shell, 2018, reports.shell.com; Dieter Holger, "Danone pledges $2.2 billion climate plan," *MarketWatch*, February 26, 2020, marketwatch.com.

Board structure and foundations

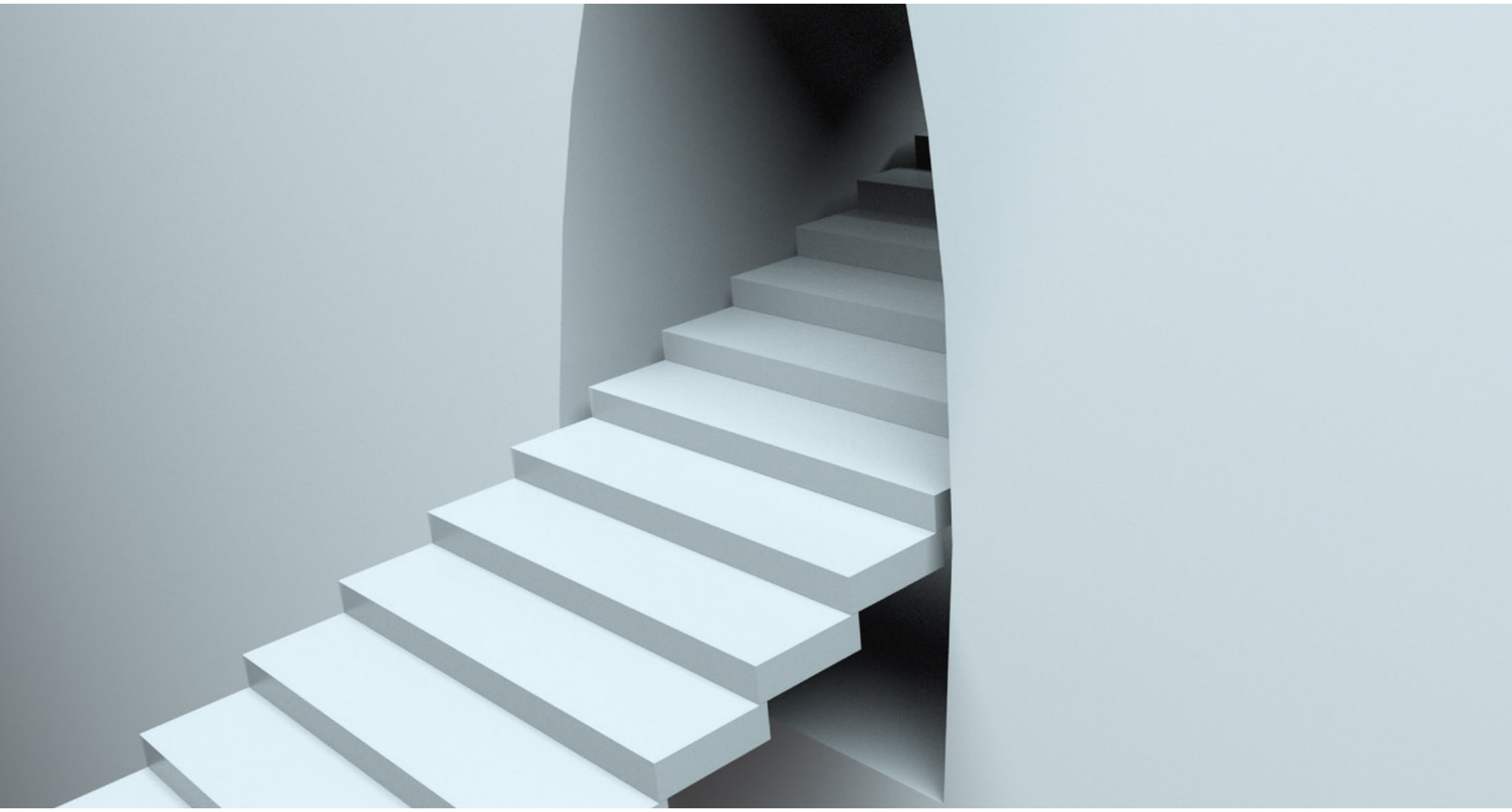


Climbing the private-equity learning curve

Commentary

CEOs who are used to engaging with public-company boards need a different playbook when it comes to private-equity boards. Here's what they can expect.

by Conor Kehoe and Tim Koller



Successful executives from public companies may be eager to take on the new challenges of leading a private-equity (PE) firm's portfolio company. However, they may not realize the differences in approach between the boards of public companies, which often view themselves as stewards, and the boards of PE portfolio companies, which frequently take a far more active role. As a result, C-suite leaders who are making the switch face a learning curve—which, based on more than 30 interviews conducted with CEOs of PE-owned companies over the past few years, typically spans three phases: the initiation, a realization of benefits, and full integration. It's an adjustment that may require the experience of several PE-ownership cycles, but here we describe the stages mapped onto one deal cycle.

The key differences

Our research has shown that public companies and PE portfolio companies alike can have engaged boards. However, boards of PE portfolio companies tend to systematically take a co-leader role with the CEO on important topics; engaged directors not only help set strategy and manage performance but also master the details needed to stress-test, push back on, reset, and dramatically improve the business.

Indeed, PE board members feel like owners themselves. Senior managers of the portfolio company typically own about 5 to 8 percent of the company stock, and the PE firm votes the rest of the shares, which are owned by the PE fund (in which the PE firm is a major investor). While there is no uniform board size or lineup, the boards of PE portfolio companies usually include the "deal partner," who is typically a midcareer financier, and one other member of the PE firm. There is typically a chair, who is frequently an ex-CEO, often from a much larger company than the portfolio company in question. Additionally, the boards will include one or two other nonexecutives—for example, experienced external nonexecutive directors with specific know-how in the company's core sector or in a functional topic, such as digitization or artificial intelligence, that is key to the company's future.

PE portfolio company boards are generally younger and smaller than public-company boards, thereby increasing each individual's engagement. This engagement and PE company board members' bias toward active ownership are what drive much of the "alpha"—outperformance relative to quoted peers—in any deal.

The learning curve

The active ownership of PE boards can take some getting used to. CEOs accustomed to working with boards of publicly traded companies typically go through three stages to climb the PE learning curve.

The first phase, *the initiation*, can last about six months. During this period, PE portfolio company executives come to realize that the PE board's approach is both hands-on and focused on the medium and long term. Short-term earnings targets, particularly in the first two years, matter far less than robust value creation by year four.

Right from the start, the board will be geared to engage. As part of their diligence in acquiring the portfolio company, the incoming nonexecutive board members often will have spent three or more months steeped in due-diligence reports, including reviews of management plans and projections. The board's commercial due-diligence team will have reported back on 50 to 100 interviews of suppliers, large customers, regulators, former employees of the company and of rival companies; other due-diligence teams will have delved deeply into financial accounts, legal commitments and liabilities, and environmental, social, and governance (ESG) risks. It adds up to the incoming board having a considered, research-based viewpoint on the company and its industry.

Almost certainly, the members will have developed their own multiyear value-creation strategy for the company as part of their investment plans.

Moreover, they know the plans can change: the new board members expect that the management team will have ideas they had not thought of and that new facts will come to light. The same will apply for CEOs when they present their plans to the PE board. They should be ready for detailed scrutiny and a robust back-and-forth.

PE boards have a determined focus on performance management and associated key performance indicators to meet longer-term strategic plans. This longer-term approach should, of course, apply for publicly listed companies as well—thoughtful public-company board members also recognize that a focus on short-term earnings-per-share targets is usually detrimental to long-term value creation. The reality is, however, that outside-driven, short-term targets can distract even the most conscientious public companies. These distractions are less of an issue in the PE context.

Indeed, new CEOs of PE-held companies may find that they need *less* time for formal board meetings overall because board members will already be highly engaged between meetings—visiting sites, customers, and suppliers and conducting ad hoc calls to advise management on opportunities or threats arising between board meetings.

The second phase of the learning curve is when PE portfolio company executives begin to *see the benefits* of working with PE boards. For example, should an executive need to fire a senior member of her team, it can be quite a lonely spot. With an active board, however, CEOs aren't alone; they have full thought partners on their board who know the company inside and out. An actively engaged board also helps inoculate CEOs against second-guessing; directors are right there, making the hard decisions, too.

The pace of decisions is quicker as well. Business isn't run at the artificial pace of board-meeting dates. Senior executives come to realize that the quality of their proposals to the board is higher; this, when combined with well-informed decision making, can be a double step-up.

With this realization, PE portfolio company executives are at phase three: *fully up the learning curve*. At this point, they find themselves enjoying the flow of ideas and encouragement from the chair and nonexecutives and from the deal partner. Based on anecdotes we've heard, at this stage, transitioning executives often feel like they are becoming better managers. In their public-company experience, they may have grown used to putting their ideas for enhancing the company through two filters: first, how hard it would be to explain this idea to their board, and, second—should they succeed with their board presentation—how hard it would be to convince a dispersed set of shareholders. In

With a deeply engaged private-equity board, members not only grasp the business circumstances immediately but also vote the stock and can convene an almost 'instant shareholder meeting,' if need be.

the process, they may weed out good ideas too early. That is not the case with a deeply engaged PE board. Its members not only grasp the business circumstances immediately but also vote the stock and can convene an almost “instant shareholder meeting,” if need be.

The lessons of longer-term orientation, open dialogue, and support for bold moves are ones that successful public companies can internalize, as well. In fact, companies of all types can learn from what makes good boards even better.

As senior executives confront the transition to PE ownership, experienced PE board members can let them know that they understand how discomfiting a manager’s experience can be, particularly at the start. For their part, CEOs who are transitioning to PE-held companies should understand what awaits them and how they can expect the experience to unfold. As in value creation itself, it’s a process for the longer term.

Conor Kehoe is a senior partner emeritus and senior adviser in McKinsey’s London office, and **Tim Koller** is a partner in the Denver office.

This commentary appeared in McKinsey on Finance in July 2021.

Investors remind business leaders: Governance matters

Activists continue to poke holes in corporate performance and returns, but they are having their greatest success with governance structures. Here's how to think about their moves.

by Michael Birshan, Madeleine Goerg, Anna Moore, and Ellora-Julie Parekh

Even before the spread of the novel coronavirus,[1] investors were calling on senior-management teams and corporate boards to focus on environmental, social, and governance (ESG) concerns. Investors were, for example, prompting companies to consider questions of purpose and to pay more attention to the impact of their actions on the environment. Now the pendulum is swinging toward social issues raised by the spread of COVID-19—for instance, worker safety and rising unemployment.

For many businesses, governance remains a less discussed area of vulnerability, in part because it involves internal systems, controls, and procedures, which in many cases are less visible to stakeholders and the broader public. For instance, stakeholders cannot always tell if boards and senior-management teams are preempting regulatory violations or communicating clearly with regulators, above and beyond standard reporting—until it is too late.[2]

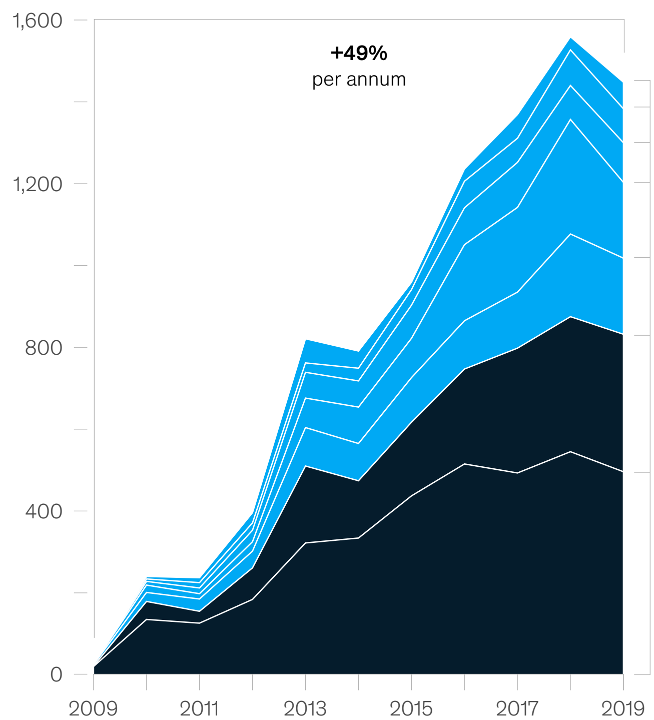
In the wake of the global pandemic, boards play a key role in guiding their organizations into the next normal. Indeed, this may well be the moment when boards and leadership teams prove their value—or show their flaws.

Companies that do not regularly review and address governance issues may be ignoring them at their own peril. Governance-related demands by activist investors around the world rose from just 27 in

Exhibit 1

Board- and governance-related campaigns by investors have increased significantly.

Demands by type, number



	CAGR,[1] %	
Structural demands	2009–19	2016–19
Voting rights	30[2]	29
Transparency and accountability	56	8
Remuneration	30[2]	3
Other bylaws	69	<1
Board composition	47	16
Personnel demands		
Leadership change	79	13
Gain board representation	38	–1

[1] Compound annual growth rate.
[2] 2010–19.

Source: Activist Insight

[1] "COVID-19: Implications for business," June 11, 2020, McKinsey.com.
[2] Witold Henisz, Tim Koller, and Robin Nuttall, "Five ways that ESG creates value," *McKinsey Quarterly*, November 2019, McKinsey.com.

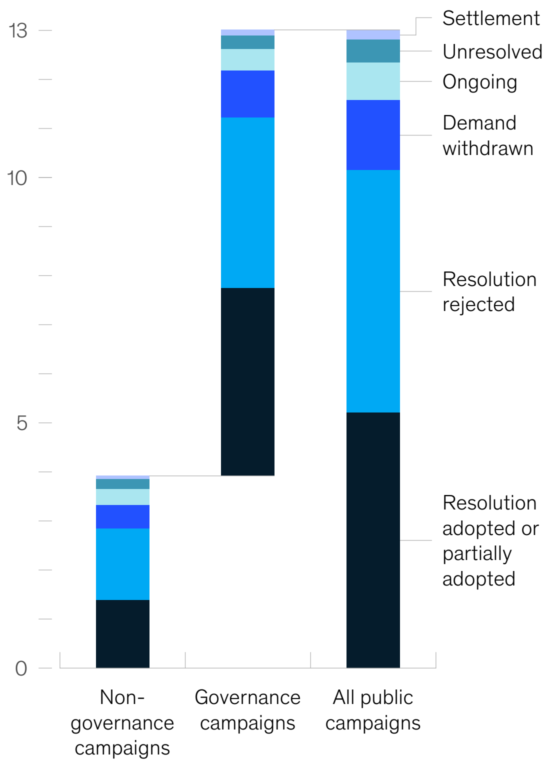
2009 to around 1,400 in 2019. These demands reflect activists' interest in a broad range of sectors, including the financial-services, basic-materials, energy, business-services, and technology sectors (Exhibit 1).[3]

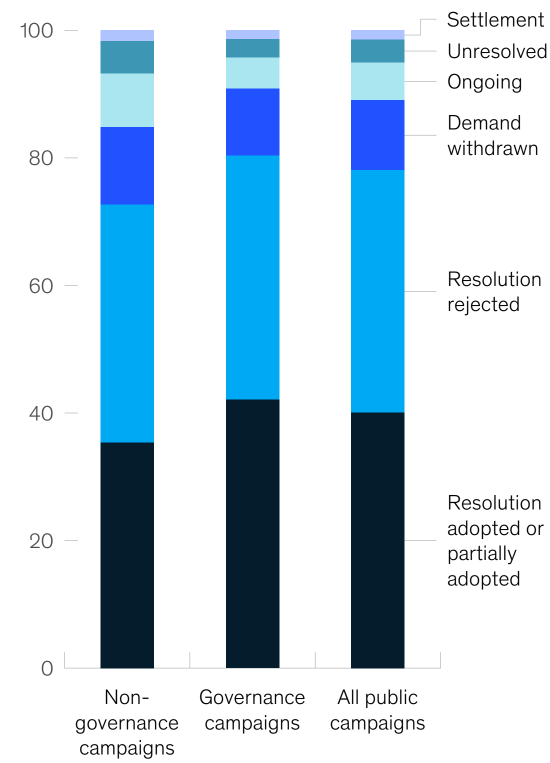
What's more, about 70 percent of *all* activist-investor demands over the past decade have focused on governance, and many have garnered support from proxy advisers.[4] Governance is also increasingly top of mind for institutional investors.

Activists' demands fall into two broad categories—structural and personnel-related—and cover a range of issues, including board composition, remuneration, accountability, voting rights, and leadership changes (see sidebar, "Two categories of concerns"). Governance-related demands have not only outnumbered others over the past decade but also more successfully achieved their targeted outcomes (Exhibit 2).[5] A typical example of such demands involves a manufacturer's delay in disclosing a transaction appropriately, as well as accusations that its

Exhibit 2

A significant number of governance-related campaigns have been successful over the past decade.





Source: Activist Insight; Proxy Insight

[3] Activist Insight Governance Module, 2009–19, activistinsight.com.
[4] Activist Insight Governance Module, 2009–19: 9,093 governance-related demands and 3,919 nongovernance-related demands. In the 2017–18 voting season, ISS and Glass Lewis supported most governance-related proposals from shareholders during shareholder meetings. In 2017–18, ISS and Glass Lewis supported 75 percent and 88.5 percent, respectively, of shareholder proposals for independent board chairs. Both supported 100 percent of proposals to adopt majority voting for director elections. Proxy Insight 2019, proxyinsight.com.
[5] In the past decade, more than 42 percent of governance-related resolutions from shareholder activists were adopted, compared with 35 percent of nongovernance-related resolutions. Activist Insight Governance Module, 2020.

Two categories of concerns

Our research shows that activist investors' corporate-governance concerns, while many and varied, tend to fall in two broad categories: structural or related to personnel.

Demands relating to structural concerns typically focus on the following five areas:

— *Board composition and independence*: the annual election of directors, the introduction of minimum requirements for the number of independent directors, changes to the number of board seats, and transparency about who is being appointed to top positions and about succession planning

— *Remuneration*: the proportion of long-term incentives in executive compensation; the introduction of incentives related to environmental, social, and governance issues; and benchmarks for executive compensation, options, bonuses, and expense accounts

— *Transparency and accountability*: changes in the auditing process or in the disclosure of financial statements, additional information on transactions, access to shareholder lists, and the results of internal investigations

— *Voting rights*: majority voting at shareholder meetings, the amendment or repeal of poison-pill or shareholder-rights plans, and the implementation of a universal proxy card so shareholders can vote for individual director nominees or oppose proxy contests for board seats

— *Other bylaws*: the threshold for calling special shareholder meetings, as well as proxy-access bylaws that require a company undergoing an election to include on the voting list the name of any person who meets agreed-upon ownership criteria and has been nominated by a shareholder

Proposals focusing on personnel-related concerns are typically related to the performance of individuals or teams. They challenge a company's stewardship by demanding such things as these:

— *Board representation*: improving oversight and diversity by challenging the expertise or independence of individual candidates put forward for election

— *Leadership change*: requesting the removal of senior executives or board members for failures of performance or campaigning to separate the roles of the chair and the CEO to increase checks and balances

executives had bought votes. These actions opened it up to a two-year shareholder-activist campaign culminating in the company's breakup.

As the manufacturer and many other companies have learned the hard way, it is always better to be your own activist rather than have demands thrust upon you. Executives and board members should respond to increased external pressures by continually reviewing their governance efforts and considering the best ways to shore up their governance credentials. These efforts have an added bonus: a strong governance program can promote success in many other parts of the business—including improved operations, motivated talent, and increased innovation—and can strengthen shareholder relations.

In this article, we'll examine the primary governance factors that activist shareholders have targeted and the ways in which some of their concerns were mitigated.

Quantifying the concerns

Not all governance proposals from shareholders are created equal. It is important for companies to quantify the number and type of possible activist overtures. Some of them focus on improving management fundamentals, others suggest board or leadership changes to give activists seats at the table, and still others propose what may be sensible measures for unlocking value.

Data from Activist Insight show that personnel-related demands—to gain board representation or changes in leadership, for instance—have accounted for more than 40 percent of all governance-related proposals since 2009. The other 60 percent or so have focused on structural concerns. An industrial, for example, faced an internal investigation after several quarters of operational issues. It then decided to delay the announcement of quarterly results. These problems and a related decrease in share price prompted activists to demand more frequent earnings disclosures and the election of independent external directors to the board. The manufacturer swiftly agreed, and the end result was greater transparency and, ultimately, increased corporate value.

Shoring up governance credentials

Frequent governance reviews are not only a good hedge against demands from activist investors and other shareholders but also simply good corporate hygiene. Companies often do not conduct such reviews because management teams are under less pressure to focus on these capabilities than on others. What's more, the acknowledgment of the direct links between good governance and value creation is a recent development in many companies. Our research and experience in the field suggest that businesses can take several steps to anticipate activists' concerns and shore up their governance credentials.

Change the board's composition

Activist shareholders are demanding more diverse, expert, committed, and independent boards. Rising shareholder expectations are prompting companies to bring in new profiles, adjust the sizes of boards, or review board-member terms and renewals. For similar reasons, a large company under pressure from activist shareholders cut its directors' terms to two years, from three, and reduced the size of its board to nine members, from 11. As a result of this board shake-up, four long-standing board members will step down by the end of 2020 or 2021 to allay concerns over a lack of sector-specific expertise and independence from the CEO.

Companies should not wait to be prompted by activist shareholders; rather, they should create a more inclusive and professional board by proactively adding to (and, if appropriate, shaking up) the current composition of the group, clarifying expectations for board members, and reviewing its level of engagement. Such reviews could include a detailed comparison between the current directors' skills and a "competency matrix" (the skills the company deems critical). They could also consider the directors' prior affiliations with the company, potential conflicts of interest, and the board's overall responsiveness.

Clarify your remuneration policy

Shareholders increasingly want to understand how senior management and boards have arrived at levels of leadership remuneration and whether it is fair. They are asking, for instance, if it is tied to performance or to specific ESG metrics or if it is in line with remuneration at peer companies. Aiming to align pay with performance, activist shareholders of one industrial conglomerate pushed to change the performance targets for all top executives. The activists sought to cut the bonuses for those executives whose businesses had recorded losses in 2017, including those of the CEO and CFO.

To anticipate activists' concerns about pay and performance, companies can, for instance, ensure that they have clear and communicable metrics that support their decisions on remuneration. Reacting to a public ESG campaign by a group of shareholders, a major oil and gas company decided to link the compensation of more than 1,000 top employees to its success in meeting reduced carbon-emissions targets.

Communicate clearly

When companies are involved in major transactions, investigations, or audits, shareholders look for full transparency. In one large company, shareholders stepped in to demand a governance overhaul given their concerns about an acquisition decision made by the board. As a result, the company ended up creating a board-level committee to consider the interests of noncontrolling shareholders in all major decisions.

To limit speculation and dispel concerns, it is critical for senior management and boards to give stakeholders a coherent narrative about major decisions and the potential effect on corporate performance. Establishing a rhythm of clear, frequent, and comprehensive updates on such decisions, as well as a mechanism for disseminating follow-up reports and metrics to key stakeholders, can help allay shareholder concerns.

Think about the rules of shareholder engagement
Given the pace of change in business and the world today, shareholders are demanding that companies adopt faster decision-making processes. Reviewing how shareholders participate (for example, by testing how voting rules affect shareholder engagement) can help keep up with changing shareholder expectations. A majority vote, for instance, is becoming the standard for board elections. According to Spencer Stuart's 2019 board index, 89 percent of boards in the United States require directors to resign if they fail to receive a majority of the shareholders' votes, compared with just 65 percent in 2009.[6] More and more companies must also submit proposals for poison pills, takeover defenses, and other matters for ratification by shareholders.

Circle back to purpose and societal impact
Shareholders and stakeholders in all sectors continue to make it clear that the impact of any business on the environment and society matters to them. The decision by a large commodity-mining and -trading company to cap its global coal output, for instance, was directly linked to shareholder pressure to align with the targets of the 2015 Paris Agreement. To head off the activists' concerns, senior-management teams and boards can regularly review their portfolios of business activities and map the impact on major global initiatives. A growing number of companies benchmark themselves against the UN's Sustainable Development Goals, for example, thus actively positioning themselves to attract top talent and socially conscious consumers and to meet critical regulatory requirements.

With activist investors and other shareholders increasingly focused on stewardship, now is the time to evaluate where you stand. A governance review should form a big part of any program to prepare for and engage with activist investors.

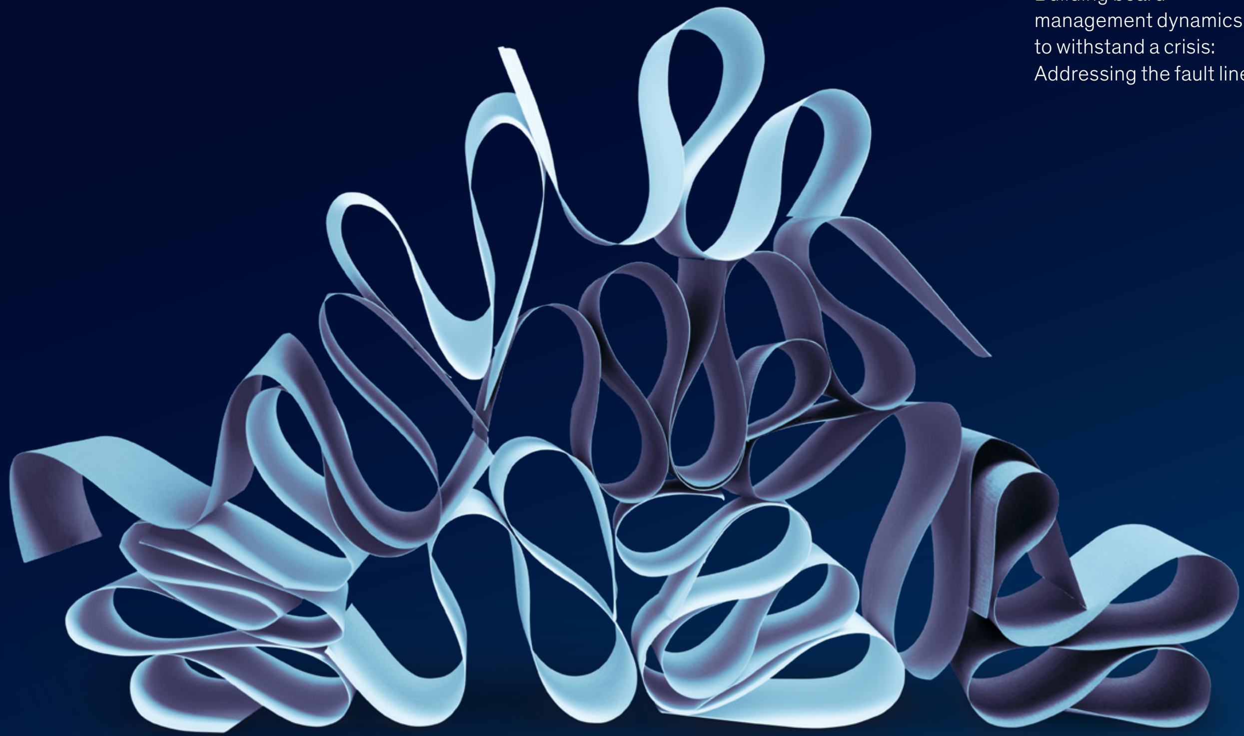
Michael Birshan is a senior partner in McKinsey's London office, where **Madeleine Goerg** is a consultant and **Anna Moore** is an associate partner; **Ellora-Julie Parekh** is a director of practice management in the Brussels office.

The authors wish to thank Joseph Cyriac, Tom Kolaja, Frithjof Lund, and Nina Spielmann for their contributions to this article.

This article appeared in *McKinsey on Finance* in February 2021.

[6] "2019 U.S. Spencer Stuart Board Index," Spencer Stuart, October 2019, spencerstuart.com.

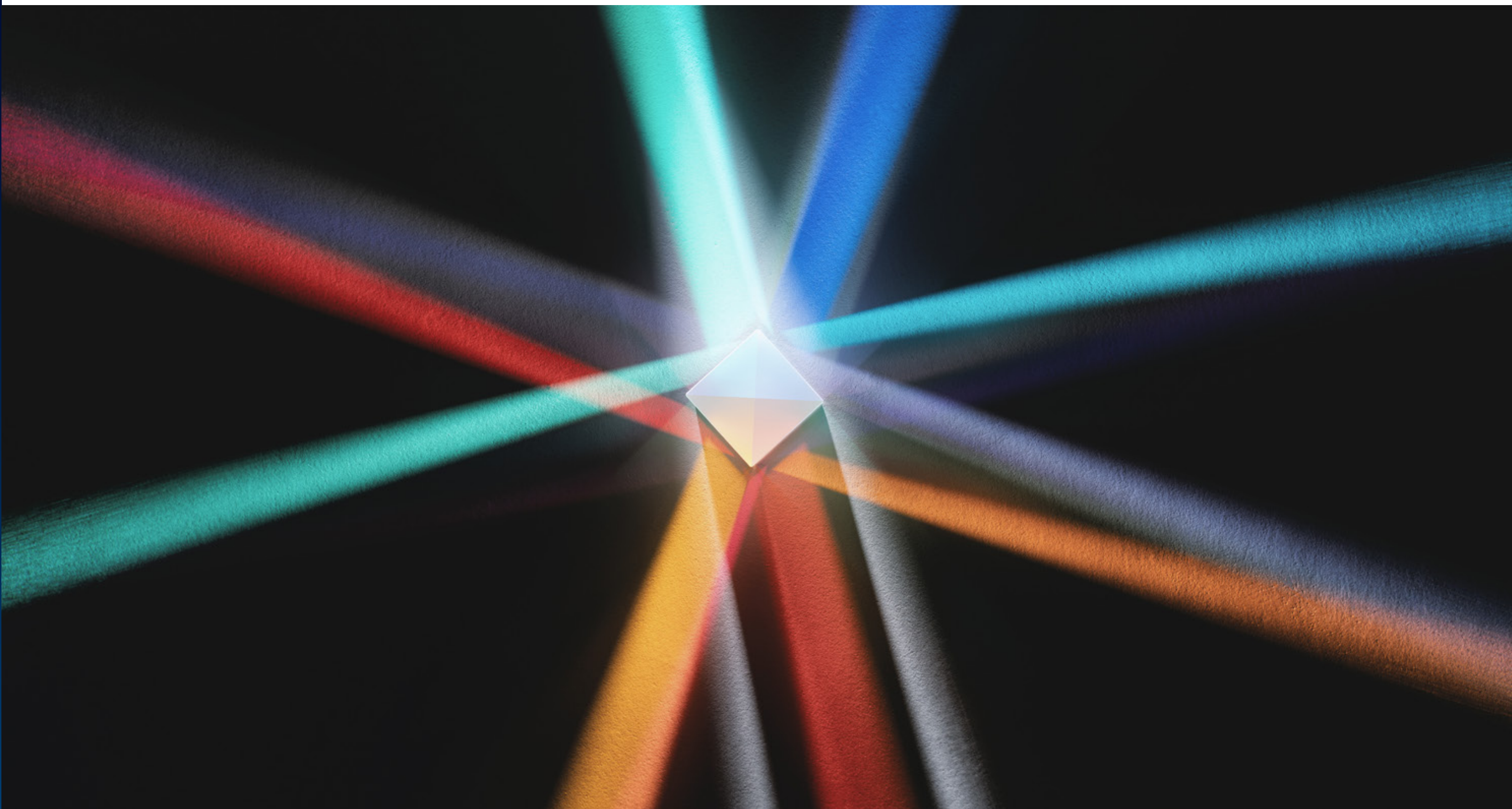
Board effectiveness



The postpandemic board agenda: Redefining corporate resilience

As boards move beyond crisis management, survey results suggest that specific risks and organizational issues are increasingly top of mind.

by Celia Huber, Frithjof Lund, and Nina Spielmann



Faced with a global crisis in 2020, board directors and executives reported a renewed focus on corporate resilience in our latest McKinsey Global Survey on the board.[1] Now, as boards (and the rest of us) look toward a COVID-19 recovery, the survey responses suggest that in the pandemic's wake, boards—especially those that were quickest to adapt to the crisis—are shifting their attention toward more specific risks and organizational and cultural issues.

When respondents were asked about the topics on their 2020 agendas, corporate resilience made the biggest jump since 2019—perhaps unsurprisingly, in the midst of a global pandemic. In our research, we identified boards that made changes to their structures, processes, and interpersonal dynamics during the pandemic *and* were effective in their overall response to the crisis. These "most adaptable" boards,[2] according to their directors, were more likely than their peers to have resilience on their agendas. But when asked about this year's agenda, directors at the most adaptable boards suggest that they are moving away from overall resilience as a topic: the share citing it has dropped 20 percentage points.

Instead, survey results indicate that the most adaptable boards will spend more time looking at the types of risks that, experience suggests, can test a company's overall resilience. These respondents not only expect to maintain many of the operational changes they made last year but also expect to focus more than they did in 2020 on three specific issues (Exhibit 1): political risks (up 15 percentage points since 2020), geopolitical and macroeconomic risks (up 19 percentage points), and climate-related risks (up ten percentage points). To tackle this growing set of responsibilities, respondents on the most adaptable boards also plan to spend much more time than peers on their board work this year.

Directors on the most adaptable boards also cite these issues as agenda items more often than their

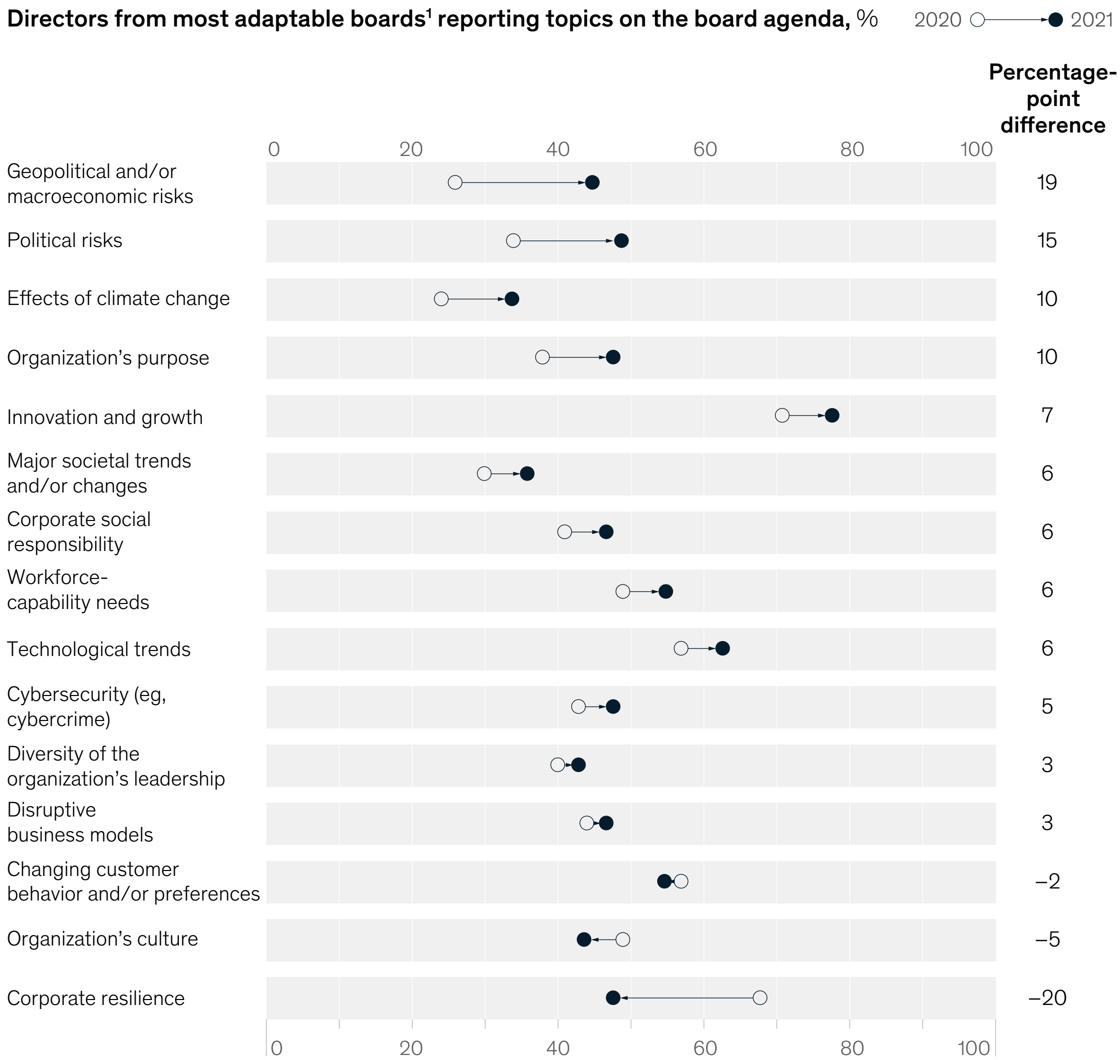
Boards that were quickest to adapt to the COVID-19 crisis are now focusing more on specific external risks than on corporate resilience overall.

[1] "How boards have risen to the COVID-19 challenge, and what's next," April 29, 2021, McKinsey.com.
[2] We define "adaptable boards" as those where respondents report at least one structural change, one process change, and one change to collaboration on their boards since the COVID-19 crisis began *and* that their boards have been effective at helping the organization respond to COVID-19; n = 143. This analysis included only board directors and not those respondents who identified as C-level executives and answered on behalf of their own company's board.

Exhibit 1

Since 2020, the boards that adapted most to the pandemic are increasing their focus on external risks (including climate change) and corporate purpose.

Directors from most adaptable boards[1] reporting topics on the board agenda, %



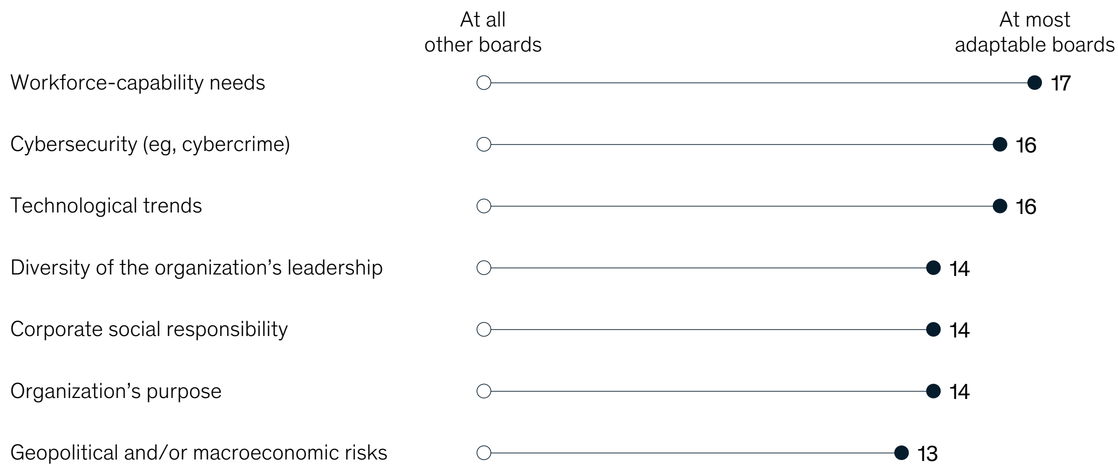
[1]Respondents who reported at least one structural change, one process change, and one change to collaboration on their boards since the COVID-19 crisis began *and* that their boards have been effective at helping the organization respond to COVID-19 (n = 143). Those who answered "other" or "don't know" are not shown.

peers (Exhibit 2), along with a range of other topics, among them: technological trends and topics that are more cultural or organizational in nature, such as corporate social responsibility, the company's purpose, workforce capabilities, and diversity of the leadership teams.

Exhibit 2

Nearly every topic the survey tested is more likely to be on the agendas of the most adaptable boards, compared with their peers.

Reported topics on the board agenda,[1] percentage-point difference, directors on most adaptable boards[2] vs others



[1]Out of 15 topics that were offered as answer choices.
[2]Respondents who reported at least one structural change, one process change, and one change to collaboration on their boards since the COVID-19 crisis began *and* that their boards have been effective at helping the organization respond to COVID-19; n = 143. For all other respondents, n = 268.

While directors on the most adaptable boards report a greater focus on the areas that will support their organizations’ future resilience—and on average cover more agenda topics than other boards—we know from experience that all of these strategic, risk-related, and organizational topics are critical to a corporation’s success and should be discussed by all boards at least once a year. As more and more companies and economies begin to recover from the COVID-19 crisis, now is the time for boards to engage deeply in these issues, support their management teams, and ensure that their organizations remain resilient and competitive through—and beyond—the pandemic.

Celia Huber is a senior partner in McKinsey’s Silicon Valley office, **Frithjof Lund** is a senior partner in the Oslo office, and **Nina Spielmann** is a senior expert in the Zurich office.

This article appeared on McKinsey.com in August 2021.

Growth and prosperity: A conversation with economist Dambisa Moyo

From stronger public- and private-sector collaborations to broader corporate-board intentions, the time for stakeholder capitalism may be upon us.

Calls for reform on the American form of capitalism had already begun prior to the COVID-19 pandemic. Faced with growing inequality and inequity across society, disproportionate workforce changes affecting the most vulnerable groups, and growing existential challenges, such as climate change, people around the world are poised for a global shift on how they think about growth and prosperity well into the future.

McKinsey's Astrid Sandoval recently sat down with Dambisa Moyo, global economist, board member, and author of the book *How Boards Work: And How They Can Work Better in a Chaotic World* (Basic Books, May 2021), to discuss that shift. Their conversation covered the macroeconomic trends shaping the global economy, the rising interest in stakeholder capitalism, and how boards can influence the move to a more inclusive and diverse future.

As a native Zambian and one of the youngest women to join the boards of Fortune 500 companies across multiple regions and sectors, Moyo offers a unique perspective on how the world can begin to rebuild. From her vantage point as a current board member for 3M, Chevron, Condé Nast, and the University of Oxford investment committee, Moyo has navigated through the corporate, economic, and social uncertainties brought about by the COVID-19 crisis and shares firsthand understanding of how to drive enduring change—and what may come next. The following is a condensed and edited version of her conversation with Sandoval.

Accelerating macroeconomic concerns

The arrival of the COVID-19 pandemic was an accelerator of many of the downside scenarios that economists like myself, but also people focused on investing, were concerned about: worsening economic growth, the growing impotence of public policy, and catalyzing existing economic headwinds.

Starting with the trajectory of low economic growth, many countries—both large and small—were already struggling to meet the minimum 3 percent rate of growth needed to double per capita incomes in a generation. Add to that the aftermath of the 2008 financial crisis and what it meant for monetary and fiscal policy. We were already seeing negative interest rates combined with enormous debts and deficits that governments, in particular, but also corporate balance sheets and households, were already carrying.

Combine these concerns with a multitude of economic headwinds, including the risk of technology advances leading to a jobless underclass, the growing demographic shifts, and the ongoing challenges to living standards worldwide, and it's no surprise that, before the COVID-19 crisis, we were already beginning to see a move away from the principles of globalization, as well as a reduction in growth and trade. We've seen protectionist measures emerge that limit the flow of capital, and we've seen a growing challenge to immigration. We've also started to see real concerns about a split internet—the idea that within the next decade, we may see competing intellectual-property platforms by region: one China led and another US or Western led. The pandemic has accelerated and potentially reinforced some of these trends.

As part of the great reset after the COVID-19 crisis, public-policy makers, investors, and economists may need to reevaluate and refresh how we think about the best models for growth—from perhaps a less ideological perspective and a more pragmatic lens.

Progressing to stakeholder capitalism

We are in desperate need for solutions from governments and businesses alike, not just to sort out these large public-policy problems of education, healthcare, and infrastructure but also to continue to grow the so-called GDP pie.

To help address the multitude of challenges we face, we need to be much more focused on what I'd call "broadening the utility function." This is about moving beyond Milton Friedman's worldview that corporations exist to serve shareholders above all others toward a wider role and responsibility for their staff, customers, and communities, as well as toward being a partner to governments and to nongovernmental organizations.

As a practical matter, corporations are already moving away from ring-fenced departments for corporate social responsibility and a pure financial-shareholder model. They are moving toward more integrated reporting on issues about the broader community and stakeholders. For example, corporations are refining metrics that gauge progress in combating climate change and supporting diversity and inclusion.

Debating the trade-offs of public- and private-sector collaborations

The most important thing is to "level set"—to better understand the complex trade-offs that need to be made to meet the global challenges we face. For example, like most complex challenges, the COVID-19 crisis is multifaceted, multidimensional, and multiperiod. Originally defined and characterized in a very unilateral way as a healthcare challenge, it quickly became clear that there are many knock-on effects and economic offsets from the decisions made around the healthcare response.

We have social issues—everything from domestic violence to children's welfare and how society will continue to move forward—that are important aspects of addressing a pandemic that I don't think were at the table at the very beginning. If you go further than that, there are real implications for how society will emerge from this crisis.

So it's these trade-offs that become the foundation for any kind of execution plan. The approach has to be sensible and have all the different actors at the table to offer their perspectives. Public- and private-sector partnerships may help deliver the economic outcomes needed, as they have in the past—for example, in supporting infrastructure development. In the United Kingdom, the government is helping train young people with life skills, an important input to the private sector.

Derisking the future with new metrics

We live in a technology-driven world that allows us to capture more information and inputs from a broader array of stakeholders than ever before. Corporations now need to think about where they get their information, how they get their information, and indeed, what kind of information they're receiving.

Traditionally, corporations are interested and driven by metrics such as returns and cost of capital, but there are new metrics available that can help guide capital allocation and risk mitigation as the role of the corporation becomes much broader. For example, new social platforms can provide additional insights about what employees, both current and former, think about the operations at an organization. Other technology platforms can offer information to customers on the provenance of items. These new feedback loops from a broader set of stakeholders are increasingly more important to corporations in terms of how they think about mitigating for risk but also for spotting where opportunities may lie.

However, we need sensible conversations about this notion of trade-offs and the nuance of the challenges that corporations, boards, and many other decision makers in public policy have to contend with in order to land in the right place. The real challenge is going into the details and looking at the metrics and how boards are operating to help deliver the necessary outcomes—for example, how a company is using technology to better allocate human and financial capital.

Delivering change through board actions

Fundamentally, we should take pride in the fact that we have a global system in which goods and services can be delivered in the best of times but also even in times of crisis. We've been able to work together in a constructive way, with the help of corporations, to address the challenges presented by the COVID-19 crisis. This gets to the heart of what the role of a board is, what levers a board has to implement change, and the opportunity and scope there is for boards to reinvent themselves.

‘Beyond managing the downside risks of a more balkanized world order, boards are also trying to spot economic opportunities.’

From my vantage point, boards’ responsibilities are threefold. Boards are responsible for overseeing the strategy of corporations, the hiring—and indeed, firing, on some occasions—of the CEO, and company culture. More and more, certainly in the past ten years that I’ve been a board member, boards are now expected to opine and to provide oversight on what I would call the “cultural frontier.”

Beyond the nonnegotiables, such as excellence and professionalism in the workplace, the cultural frontier includes the more current cultural issues around data privacy; environmental, social, and governance issues; pay equity; gender and race diversity; worker advocacy; geopolitical tensions; and concerns about short-termism, to name a few. Boards need to navigate through this long list of challenges and how they hold management accountable for the important and expanding role that purpose plays in corporations.

As a handful of individuals with the skill sets and abilities to think about the larger, more systemic societal questions, boards don’t tend to dictate specifics on *how* it should be done. Rather, they engage with and discuss the trade-offs, limitations, and levers, as well as opportunities for corporations to act and engage. Beyond managing the downside risks of a more balkanized world order, boards are also trying to spot economic opportunities.

Understanding what may come next

Over the past several months, as we’ve continued to think about a reset to a more equitable future, I’ve looked for clues in recent history that can guide our thinking to what comes next. The best guide I’ve found was from the Gilded Age in the United States, a period between 1870 and 1900 defined by high economic growth, globalization, trade in capital flows, immigration, and relatively small government action on the economy.

It was also a period of deep income inequality followed by dramatic global events that changed the world materially: World War I, the Spanish flu, and the financial crash of 1929. The Dow Jones Industrial Average in 1929 peaked at 381 points. The next time it reached 381 points was 25 years later in 1954. That really underscores the scale of what we may be facing today.

We had the financial crisis of 2008 followed now by an economic, as well as healthcare, shock with the COVID-19 pandemic. What the Gilded Age and the subsequent challenges of the early 1900s tell us is that we may be in for a period of more progressive politics and more government action to manage debt and deficits in terms of taxes and antitrust issues. On a relative basis, we may face greater deglobalization, more aggressive regulation, and potential challenges to many oligopolies in different sectors from the banking, pharmaceutical, airline, energy, and technology industries.

In a world of low—and maybe even no—economic growth and deteriorating equity returns, corporations will be more challenged. But I suspect that there will also be great things to come, including a period of great innovation. We are seeing China take on a bigger role on the global stage. Technology has done enormous things for retail and communication. We have not yet seen what digital technology is capable of in terms of healthcare, education, and other big, global public goods. There is real scope for massive transformation in how we live and the things that we do.

I am fundamentally an optimist, but I'm also very much a realist. I think we need to be sensible. And we do need to work together, most critically, across nations, across industries, and across education backgrounds in order to help solve these big world challenges.

Dambisa Moyo is an economist, a member of several boards, and the author of the book *How Boards Work: And How They Can Work Better in a Chaotic World* (Basic Books, May 2021); **Astrid Sandoval** is an executive editor in McKinsey's London office.

Comments and opinions expressed by interviewees are their own and do not represent or reflect the opinions, policies, or positions of McKinsey & Company or have its endorsement.

This interview appeared on McKinsey.com in December 2020.

How boards have risen to the COVID-19 challenge, and what's next

According to a new survey, the COVID-19 crisis has accelerated operational changes and stronger collaboration between directors and management that are key to a board's success.

For more than a year, the COVID-19 pandemic has disrupted and challenged organizations, lives, and livelihoods across the globe. The results from a recent McKinsey Global Survey of more than 800 board directors and executives confirm that while overall corporate performance has suffered during this time, boards were quick to rise to the challenge of navigating a global public-health *and* economic crisis.[1] That is especially true with regard to how boards operate; after many years of reports of only minimal improvements in how they work and their overall effectiveness,[2] the latest results suggest that the pandemic has triggered new and improved ways of working that may outlast the pandemic.

One such improvement is the collaboration between the board and management, which in many organizations has increased significantly during the crisis. Boards have also implemented new structures and processes, become more flexible in their agenda setting, doubled down on strategy, focused on corporate resilience, and, at the director level, committed more time to board-related work. Whether these changes—in particular, a more seamless relationship between the board and the management team—will remain after the pandemic is not fully clear. But when we look at the responses from boards that were most adaptable and effective in helping their organizations navigate the crisis, a few lessons emerge for what boards should do to maintain the positive momentum.

Boards before the pandemic

Our survey results from just before the COVID-19 crisis suggest the extent to which the pandemic caught organizations—and their boards—off guard. A few months before the initial outbreak in China, fewer than half of all respondents in our 2019 survey said that corporate resilience (for example, the ability to manage a downturn) was on their current board agenda.[3] And in 2019, only one-fifth believed that a lack of corporate resilience was a significant challenge for their organizations. Among respondents who said resilience was a challenge, nearly half said their boards were unprepared to manage it (Exhibit 1).

Our latest survey asked about the most significant operational challenges facing boards when the crisis began, and directors tend to say that their own boards had few established processes in place to guide them during the pandemic's early days (Exhibit 2). After the lack of in-person interactions and difficulty with remote-working tools, the most common challenges—a lack of crisis-management processes, the blurring of roles between the board and management team, and a lack of relevant capabilities within the board—suggest there were some early challenges to adapting the board's operations in a crisis environment.

At the same time, this environment created a unique opportunity for board directors to step up their game and provide critically needed guidance to their organizations by adapting decision-making processes and lending their crisis-management experience while in some cases also battling for the company's survival.[4] And the survey results suggest they have done just that.

Boards responded to the crisis—and quickly

According to the survey, boards have largely answered the call to help their organizations govern through crisis. To start, directors increased their overall time commitment. Between 2019 to 2020, respondents report a nearly 20 percent increase in the average number of days spent on board work, and they expect to increase their time spent even further between 2020 and 2021. Among directors who say their boards have been very effective at helping the organization respond to the crisis, they

[1] The online survey was in the field from September 15–25, 2020, and garnered responses from 846 participants representing the full range of regions, industries, company sizes, and board roles; of them, 417 were board directors and 429 were C-level executives. To adjust for differences in response rates, we weighted the data by the contribution of each respondent's nation to global GDP.
[2] "Governance since the economic crisis," July 1, 2011, McKinsey.com; "Improving board governance," August 1, 2013, McKinsey.com; "Toward a value-creating board," February 1, 2016, McKinsey.com; "A time for boards to act," March 26, 2018, McKinsey.com.
[3] The 2019 online survey was in the field from August 1–16, 2019, and garnered responses from 1,304 participants; of them, 1,041 were board directors and 263 were C-level executives.
[4] Martin Hirt, Celia Huber, Frithjof Lund, and Nina Spielmann, "Boards in the time of coronavirus," April 16, 2020, McKinsey.com.

Exhibit 1

In 2019, corporate resilience ranked low on the board agenda—and for boards that saw it as a challenge, few were prepared to manage it.

Topics on the board's 2019 agenda,[1] % of respondents

How prepared boards were in 2019 to manage a lack of corporate resilience within their organizations,[2] % of respondents

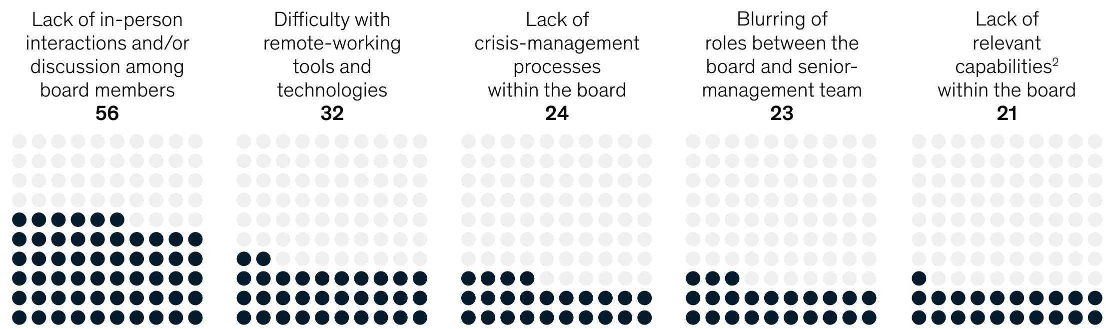
[1]Out of 15 agenda topics that were offered as answer choices.
[2]Question was asked only of respondents who identified "lack of corporate resilience" as a significant challenge that their organizations were facing; it was cited by 22%. Respondents who answered "don't know/not applicable" are not shown, so figures do not sum to 100%.

Directors have largely stepped up during the pandemic, improving collaboration, implementing new processes, focusing on resilience, and spending more time on board work.

Exhibit 2

At the start of the pandemic, boards had few established processes in place to guide them.

Most significant operational challenges for boards when the COVID-19 crisis began,[1] % of respondents



[1]Out of 11 challenges that were offered as answer choices. Question was asked only of board members, n = 417.
[2]For example, digital expertise, transformation experience, crisis-management skills.

already spent significantly more time than others precrisis—and now report much greater increases in their time spent on board work (Exhibit 3).

Implementing new structures and processes
Besides the increased time investment, the results suggest that nearly all boards made at least one change to their operating models to better manage the crisis (Exhibit 4). The most common change has been structural: investing in technology and tools to enable more digital collaboration and establishing ad hoc crisis committees. After that, directors most often cite changes to the ways that boards and management teams work together and the flexibility of their agendas. Among the least common changes so far have been to board composition—though perhaps not surprisingly, since adjusting the diversity of skills, demographics, or geographies represented on a board is a more complex change to make than others and also requires shareholder approval (see sidebar, “How to diversify your board of directors”).

Strengthening collaboration with management
According to the results, the pandemic appears to have triggered changes that, in past surveys, board directors cited as the best ways to improve their collaboration with senior management as well as the effectiveness of board meetings. In our 2019 survey, more than half of all respondents said that more constructive boardroom discussions between the board and senior-management team would most effectively improve their collaboration.

Indeed, better discussions and collaboration between the board and management team are among the most common changes made during the crisis. What’s more, 79 percent of respondents—including directors and C-level executives—say the collaboration between these groups has been effective or very effective during the pandemic, up from two-thirds who said so in 2019. And better collaboration correlates with a more effective COVID-19 response, according to the results: more than 90 percent of respondents reporting

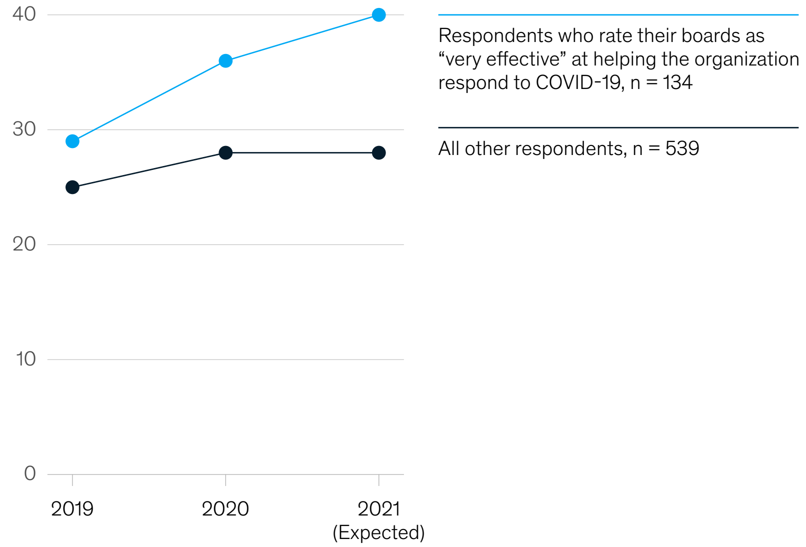
How to diversify your board of directors

At least in the near to mid term, we expect that most boards will continue to take a hybrid approach to their meetings, which loosens the requirement for directors to travel on-site for each meeting. The newly gained comfort with remote meetings—and evidence that they can be run well virtually—opens up a much larger pool of talented potential directors with relevant experience and insights that are in line with the strategic needs of a corporation (for example, geographic diversity) even if they are far removed from a company's geographic headquarters. These changing norms for meetings also give many boards the opportunity to diversify in several ways beyond geography—including social criteria and industry or topic-area expertise. We would strongly urge boards to start reviewing their diversity with respect to these issues: for example, seeking new members with experience operating in crisis mode who can effectively contribute to a broader scope of activities beyond traditional board responsibilities, such as workforce capabilities and sustainability. And beyond the composition of the board itself, boards should also explore ways to tap external advisers for their advice on rapidly evolving situations in a more systematic way than they may have done before the pandemic.

Exhibit 3

Directors have increased their overall time spent on board work, especially those reporting a 'very effective' response to the crisis.

Days per year board directors have spent on board work,[1] number of days

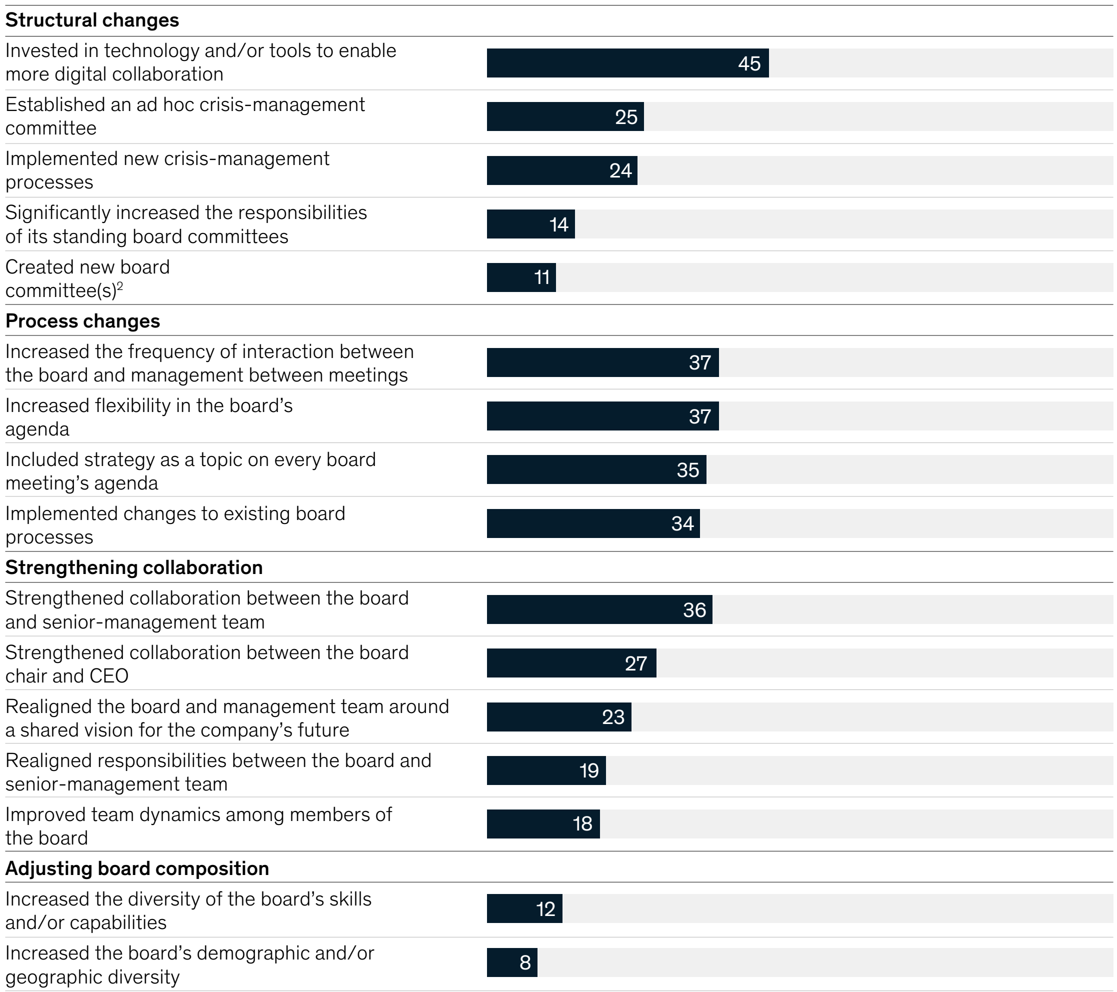


[1]Including board and committee meetings, preparation, training, and informal contact with the organization.

Exhibit 4

Nearly all boards made at least one change to their operating models to manage the crisis.

Changes made by the board since the COVID-19 crisis began,[1] % of respondents



[1]Question was asked only of board directors, n = 417; respondents who answered "none of the above" (8%) or "don't know" (1%) are not shown.
[2]That is, other than the ad hoc crisis-management committee.

an effective collaboration between the board and management also say their board's response to the crisis was effective—compared with only 60 percent of all other respondents (Exhibit 5).

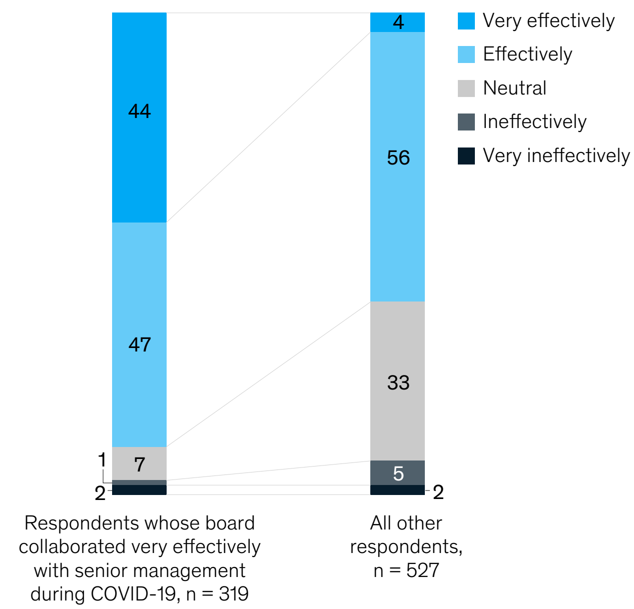
Creating a more flexible agenda

Over the past ten years, our research suggests that at a high level, boards have consistently focused on strategy over other items on their agendas, even throughout the crisis. Yet in a situation as extraordinary as the COVID-19 pandemic, respondents do report changes to more detailed topics on their agendas, and that an annual process for setting strategy—which was a long-standing norm for many boards in the past—is no longer sufficient. In the survey prior to the pandemic, only half of all board respondents said their boards were effective at either assessing whether their strategy

Exhibit 5

Better collaboration between boards and management teams seems to have supported a more effective COVID-19 response.

Effectiveness of boards in helping the organization respond to the COVID-19 crisis,[1] % of respondents



[1]Figures may not sum to 100%, because of rounding.

accounts for new or emerging risks or adjusting the strategy continuously, based on changing conditions. Here, too, boards have adapted in response to the crisis. Two of the top five changes respondents say their boards have made relate to the flexibility of their agendas: to discuss topics as they arise and to include strategy on the agenda of every board meeting—of which there were nine on average during 2020.

Increasing the focus on resilience

Compared with the results from the previous survey, respondents report a clear shift in the specific topics on their agendas (Exhibit 6). In 2019, boards were most focused on innovation and growth as well as technological trends. Innovation and growth remains the most common agenda item in the latest survey—though corporate resilience has risen in the ranks and become an almost equally important topic. And while boards seem to have shifted away from several people- and organization-focused topics (for example, the organization's culture, purpose, societal trends and changes, and workforce capabilities) in the past year to focus on their crisis responses, slightly larger shares of directors say such topics will be on the 2021 agenda.

Learning from the most adaptable boards

To get an even better understanding of the changes under way, and which of them might outlast the crisis, we took a closer look at responses from the most adaptable boards and the changes they made across structural, process-related, and

[5] We define "adaptable boards" as boards whose respondents report at least one structural change, one process change, and one change to collaboration on their boards since the COVID-19 crisis began *and* boards that have been effective at helping the organization respond to COVID-19 (n = 143). This analysis included only board directors and not respondents who identified as C-level executives and answered on behalf of their own company's board.

Exhibit 6

Compared with 2019, respondents report a clear shift in the topics on their boards' agendas.

Topics on the board's current agenda,[1] % of respondents

[1]Out of 15 topics that were offered as answer choices. 2019, n = 1,041; 2020, n = 846.

Innovation and growth remains the most common topic on the board agenda—though corporate resilience rose in the ranks and became an almost equally important topic.

interpersonal dimensions (Exhibit 7).[5] On average, respondents on the most adaptable boards are twice as likely as others to report any of the operational changes we asked about once the crisis had started. The biggest differences between the most adaptable boards and all others relate to collaboration between the board and senior management, as well as collaboration within the board. And compared with all other respondents, a significantly larger share of directors at the most adaptable boards say their boards' decisions and activities have a high or very high impact on the organization's value creation during the crisis.

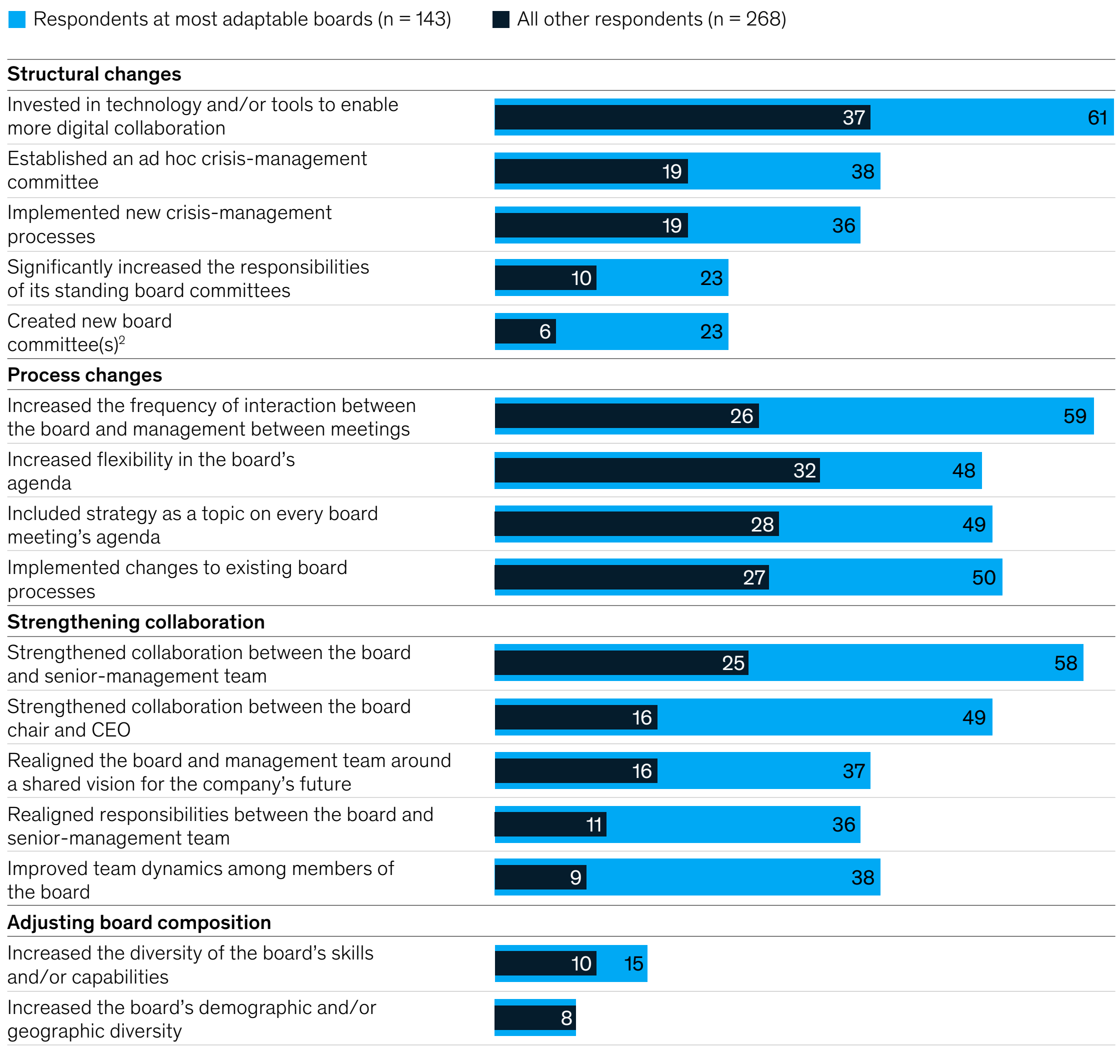
When looking closely at this group's responses, we see that they report significantly better performance on a number of other dimensions:

— *Time commitment.* At the most adaptable boards, directors reported the same average number of meetings in 2020 as did their peers on other boards. Yet their overall time spent on board work is much greater: these directors report a 50 percent higher number of days spent on board work in 2020, compared with all others. And while this group expects to spend one less day in 2021 than they did last year, that number

Exhibit 7

The most adaptable boards were much likelier than others to implement a range of structural, process, and interpersonal changes.

Changes made by the board since the COVID-19 crisis began,[1] by type of board, % of respondents



[1]Question was asked only of board directors; respondents who answered "none of the above" or "don't know" are not shown.
[2]That is, other than the ad hoc crisis-management committee.

(37 days) is still much higher than the days expected by all others (27 days).

— *The board's agenda.* According to respondents, their boards allocate a similar amount of their meeting time to specific topics (such as strategy, risk management, and finance[6]) as they did in 2019; but risk management has moved up in the overall ranking of topics, and boards now spend as much of their time on it as they do on organizational issues, such as talent management, organizational structure, and culture. Yet respondents at the most adaptable boards report slightly different priorities: for example, they spent significantly less of their time on performance management than others.

When looking at specific topics, the most adaptable boards appear to be faster at changing their agendas to meet the moment. According to directors on adaptable boards, they are much more focused on corporate resilience than their peers (69 percent say it's on the agenda, versus 54 percent), and they are almost twice as likely as others to cite disruptive business models. Fast forward one year, and the most adaptable boards expect the biggest increases in their focus on the organization's purpose; political, geopolitical, and macroeconomic risks; and the effects of climate change.

— *A new way forward.* Finally, the more adaptable boards are more likely to stick with the newer ways of working in the long term (Exhibit 8). Of 15 changes to the ways boards work, much larger shares of the adaptable directors say their boards will continue with eight of them; most notably, they will continue with changes that signal increased value-enhancing board involvement, rather than merely rubber-stamping decisions—for example, including strategy as a topic on every meeting agenda, strengthening collaboration, and increasing interactions between boards and management teams in between meetings. Indeed, almost 90 percent of respondents at the most adaptable boards say their collaboration with senior management was effective or very effective during the crisis.

In other ways, the adaptable boards and others are aligned on how boards will continue to evolve. Both groups of respondents agree on the most likely changes: their boards will continue running at least some meetings remotely (62 percent of all respondents say so), and their use of technology and digital tools to collaborate will increase (50 percent).

While it's not clear yet which of the substantial changes that boards made during the COVID-19

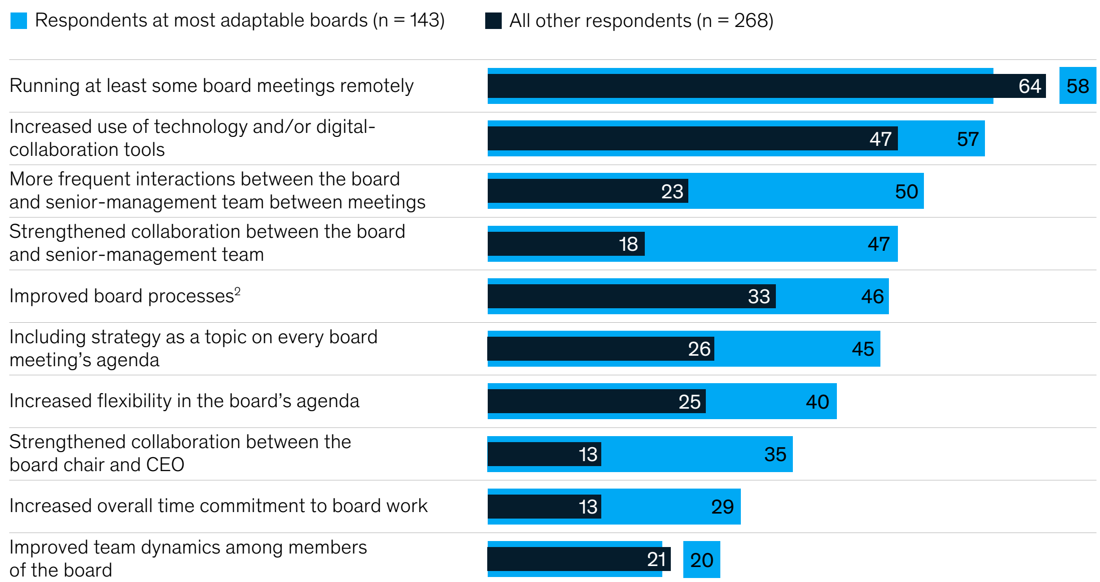
Adaptable directors say their boards will continue with changes that signal value-enhancing board involvement such as strengthening collaboration.

[6] The survey asked about the following topics and how respondents' boards allocate their time to each one during their meetings: strategy; performance management; finance and accounting; risk management; organizational structure, culture, and talent; investments and M&A; core governance and compliance; and shareholder and stakeholder management.

Exhibit 8

Over the long term, adaptable boards are more likely to stick with many newer ways of working.

Changes to a board's ways of working that are most likely to remain over the next 3 to 5 years,[1] by type of board, % of respondents



[1]Out of 15 changes that were offered as answer choices. Question was asked only of board directors; respondents who answered "none of the above" or "don't know" are not shown.
[2]For example, more frequent updates on company insights, shorter reports.

crisis will continue to gain momentum, there is a general consensus that the ways boards work in the future will look quite different. Based on our experience, boards can keep the momentum going and serve as catalysts for change by doing the following: taking a more flexible and agile approach to agenda setting, which will help boards account for timely or emerging topics (for example, corporate purpose and environmental, social, and governance issues), new risks to the business, or strategic alternatives as the need arises; dedicating their additional time spent on board work to value-enhancing activities outside of formal meetings (for instance, pre-reading of materials; attending training and development sessions; or participating in one-on-one meetings with other board directors, key executives, or other company stakeholders); and interacting more often with the executive team through formal and informal one-on-one interactions (for instance, having the chair of the audit committee coach the company's CFO).

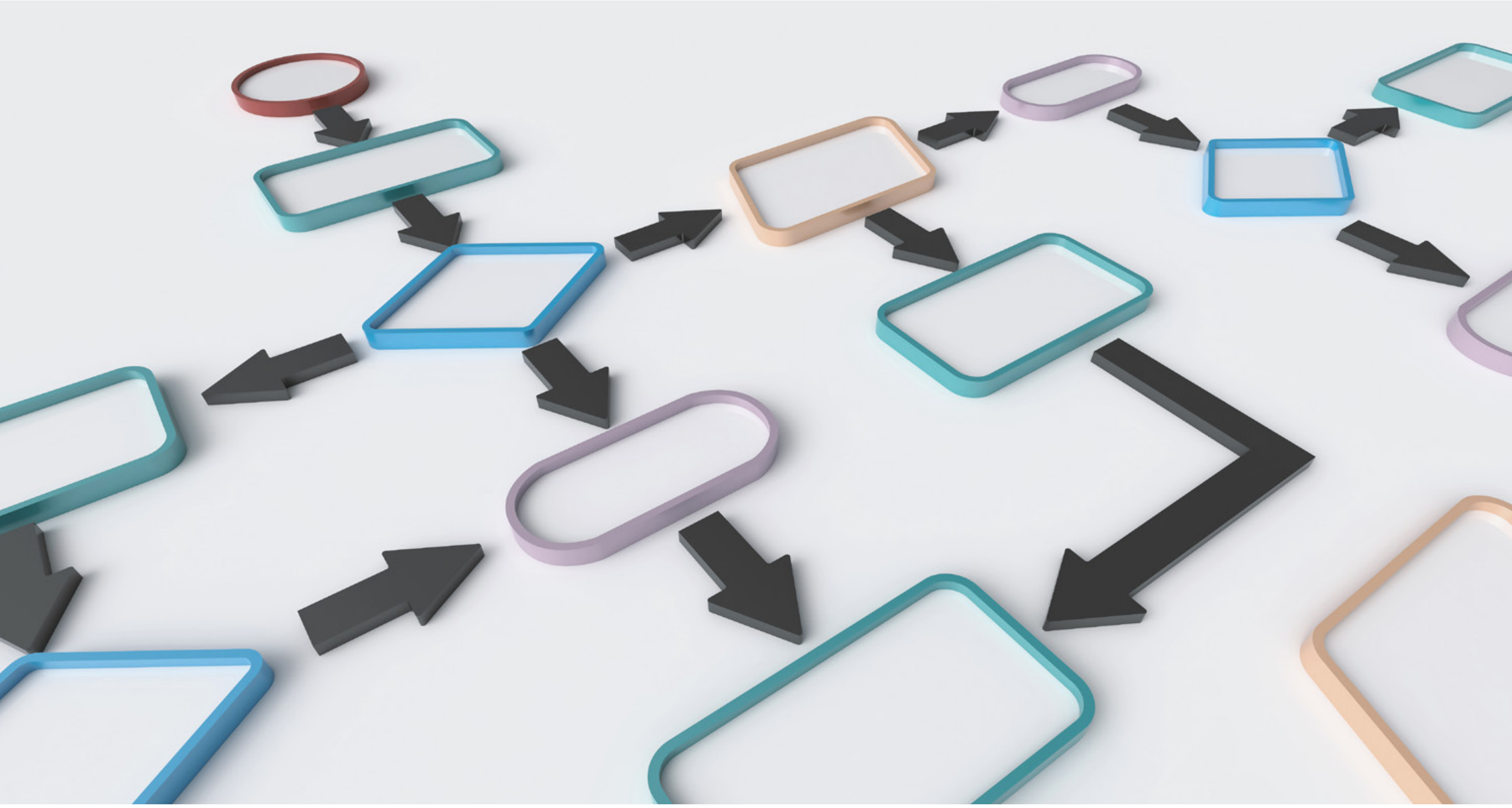
The survey content and analysis were developed by **Celia Huber,** a senior partner in McKinsey's Silicon Valley office; **Frithjof Lund,** a senior partner in the Oslo office; and **Nina Spielmann,** a senior expert in the Zurich office.

The authors wish to thank Minna Schmidt for her contributions to this article.

This article appeared on McKinsey.com in April 2021.

Boards and decision making

What the pandemic has taught board directors about high-consequence, low-probability decisions.



© Infografx/Getty Images

This episode of the *Inside the Strategy Room* podcast tackles the topic of decision making in the boardroom. It's the third in our continuing series on board perspectives around the most important issues facing organizations. In this session, Frithjof Lund, the leader of our board services work, leads a discussion with three experts. Aaron De Smet, who helps organizations improve their performance and agility, and senior expert Leigh Weiss are co-authors of a recent article about decision making in uncertain times. Suzanne Nimocks is a director on the boards of ArcelorMittal, Owens Corning, Ovintiv (formerly Encana), and Valaris (formerly Ensco Rowan), as well as a former senior McKinsey partner. You can listen to the episode on Apple Podcasts, Spotify, or Google Podcasts. This is an edited transcript of the discussion. For more conversations on the strategy issues that matter, subscribe to the series on Apple Podcasts, Spotify, or Google Podcasts.

Frithjof Lund: The quality of the decisions that boards make is, in large part, a measure of those boards' effectiveness. Suzanne, can you tell us about the decision-making processes on the boards you are involved in?

Suzanne Nimocks: Sure. I think board decisions fall into four categories. There are HR-related decisions around CEO succession, board succession, and executive compensation. There are financial decisions related to capital allocation, balance sheet management, and dividend policy. Then there are strategy- and M&A-related decisions around the purchase and sale of assets or businesses. Finally, you have governance-oriented decisions around structure, processes, and decision rules. Because boards of directors don't usually do their own analyses but rely on management teams to present them, the decision-making processes focus on asking challenging questions, playing devil's advocate, and helping management come up with alternatives.

Frithjof Lund: What do you see as the key pitfalls that boards can experience when making decisions?

Suzanne Nimocks: Relying entirely on presentations that management pulls together without probing for additional information is definitely one. Another pitfall is groupthink, when everyone has a similar point of view. It is important to have diversity of thought in the boardroom so people with different perspectives can challenge the ideas. And the third one is making decisions too quickly, without enough information.

Frithjof Lund: Aaron, which of the elements Suzanne mentioned do you think are most critical for board-level decisions?

Aaron De Smet: A lot of the decision-making issues that crop up are just more acute for boards. If you have a groupthink problem, for example, the board has nobody above it to keep that in check or ask, are we all too much on the same page? Similarly, if the board gets into a habit of rubber-stamping decisions brought to it, there is no governing mechanism that comes into play to correct it—until something potentially catastrophic happens that shows a lack of checks and balances.

Leigh Weiss: What is clear from the research is that for high-consequence decisions that the board and the executive team make together, the number-one predictor of these decisions being made fast and leading to better performance is the quality of the debate that goes into them. And one of the hallmarks of a high-quality debate is the diversity of perspectives brought to bear. Boards and management teams that are best able to manage high degrees of uncertainty and risk are those that bring in experts one would not normally find within the organization. For example, you would not expect a bank to have an expert at dealing with natural disasters, but as financial institutions increasingly handle mortgages on properties exposed to floods, that may be an important consideration.

Aaron De Smet: Some boards are very good at certain types of decisions and not so good at others. For example, many are good at fiduciary and financial responsibilities because it is standard practice to bring in both internal and external experts in those areas, but they may not do the same on strategic matters. And some management teams don't always welcome healthy dialogue and debate with their boards. If they look to the board to merely review and approve, they are missing an opportunity. For their part, boards can fall into the trap of asking a few tough questions but then

‘A lot of the decision-making issues that crop up are just more acute for boards. If you have a groupthink problem, for example, the board has nobody above it to keep that in check.’

—Aaron De Smet

effectively rubber-stamping the decision the management wants no matter what.

Frithjof Lund: Making big decisions is challenging under normal circumstances, but during the pandemic the frequency of such decisions has grown. Aaron, how are organizations and boards you advise reacting to this change?

Aaron De Smet: The first thing you notice is they are meeting with boards more often because more decisions are coming up with more uncertainties and higher stakes. We saw this happening incrementally even pre-COVID-19 because of the faster pace of change and more turbulent business environments, but the pandemic has turbocharged it.

Suzanne Nimocks: No question about that. Two of the boards I’m on are in the energy industry, which was hit by the perfect storm of a decrease in demand due to COVID-19 and the Russian-Saudi detente, which put further pressure on oil prices. It completely wiped out any planning, so we have been in all-out crisis mode since [last] March. Those boards have been meeting weekly since there was a clear risk of financial distress and therefore it was critical for the board to be closely attuned to the implications of the situation. In other industries, the frequency is lower but board engagement has still never been higher.

Aaron De Smet: Those high demands mean it is important for the board to engage on the right decisions at the right time in the right way. One of the lessons we have learned about decision making is that you can’t treat all decisions the same. Bylaws may require management to notify the board of certain things, but that does not mean the board has to be involved in those issues. If you are satisfied that management is taking care of them, you can reserve your time for decisions that need board engagement.

One board I worked with could not get through any agenda because they were spending time on everything. It was a large healthcare system whose bylaws required that the board be notified of any patient death where human error might have been involved. The board would discuss these issues for 45 minutes and change nothing, make no decision other than the management team should continue on its path. Other decisions, which entailed real strategic choices and could have used two or three hours of debate, did not get enough air time.

Suzanne Nimocks: That is where committee structures and clarity around what should be decided within committee versus the full board become very important. There needs to be real discipline in how committees operate.

Frithjof Lund: Leigh, you and Aaron recently did research on effective decision making. Can you share some insights from that work?

Leigh Weiss: We were interested in finding out what organizations that make both fast and good decisions do differently and whether that had performance implications. The research showed that those organizations outperform their peers by two times. The findings most germane for boards are around the big-bet, high-consequence decisions that are not made frequently. There, as we discussed, diversity of perspectives plays a big role. But how do you do that and move quickly? The second insight is that you need to distinguish between those with a vote and those with a voice. You can bring in diverse voices as long as you don't leave the impression that anybody who is sitting around the table also has a vote.

Suzanne Nimocks: I agree. The quick, agile decisions the management team can make. The big-bet decisions should not be made quickly and normally are made over a series of meetings and discussions. Most savvy CEOs know never to surprise their boards with a need to make a quick decision around a big bet.

Leigh Weiss: There are a number of best practices that can help with that, both in what is done ahead of a board meeting and during the meeting. Sometimes we see pre-syndication or a road show of a decision that needs to get made—and that's not helpful because it undermines debate. Instead, it's useful to consider multiple options during the board meeting, maybe assigning devil's advocates to different positions and exploring assumptions. We also found that higher-functioning boards tend to have trust between the board members and management, a degree of psychological safety where the executives feel comfortable bringing up mistakes.

Suzanne Nimocks: That last point is very important. You cannot be a high-functioning board without the management team feeling comfortable so that they feel safe to raise bad news. When doing post-completion reviews on major capital projects, for example, boards should recognize that the reason for these reviews is not to poke management in the eye about things that went wrong but ensure that management teams are learning from mistakes.

Aaron De Smet: Even how you manage the board agenda and what you engage on and with whom matters. The agenda would typically have a set of items you need to inform the board about and give them a chance to ask questions, but the trick is to not spend a lot of time on that. A second type of agenda item is where you need approval but you don't need debate—bylaws, regulations, governance. To create more time for the other issues, we often use a consent agenda that is sent out in a pre-read and the chair of the board would just ask in the meeting, "Does anybody disagree?"

That frees up time for discussion and guidance. Before bringing any big decision to the board, you need to have several conversations, as Suzanne mentioned, so these discussions and guidance shape where you are headed and what options you consider.

Suzanne Nimocks: The other thing I would add is that you need to make sure there is enough time set aside, both at the front end and the back end of the board meeting, to have executive sessions with just the directors, because you are much more likely to get an open dialogue in that environment. Normally, that executive session is saved for the end, but I find it helpful to start with an executive session, as a way to foreshadow where the more difficult debate is likely to be, and end with another.

Aaron De Smet: I have applied those very guidelines for senior executive teams, for the same reason. Most decisions and analysis are being brought in by people lower in the organization. The executive committee might not be close enough to the data and that committee operates, in many ways, like a board, so you get the same dynamics. A more junior team closer to the business or operational issue briefs the committee, asking for approval, and can make the same mistakes of not separating the rubber-stamp areas from those that need debate or not bringing in multiple options for the committee to consider.

Frithjof Lund: On the need to bring in different perspectives, how do you practically do that?

Aaron De Smet: There are quite a few ways. A board could request a red team/blue team type of debate happen around a potential merger or acquisition, and those individuals don't have to be in the room when the decision is made, you just want to bring in their perspectives. Or you can appoint a panel of external experts with different points of view, hash it out, and then excuse the folks who are not decision makers from the room, letting those decision makers reach alignment.

Suzanne Nimocks: In a couple of situations where we were evaluating whether or not we should make an acquisition, we brought in a broad set of voices but individually, not together, and asked them, what is investor reaction likely to be? What is the customer reaction likely to be? The competitor reaction, the employee reaction? We found that helpful to get more comfortable with a decision that initially we were not all aligned on.

Frithjof Lund: Aaron and Leigh, one thing you have studied in particular is high-stakes, low-likelihood decisions. What type of decisions are these typically?

Aaron De Smet: There are two flavors. One is things we think of as unlikely but if they do happen, the result would be catastrophic. These are often managed by a board risk committee that looks closely at such potential events and actions that could mitigate them. Because people do not have much experience with these situations, there is a lot of scenario planning, looking at trends, imagining what-ifs. The flip side, which boards tend to engage with less, are low-likelihood, high-consequence *positive* decisions. For example, an investment may be very unlikely to pay off, but if it did, that payoff could be so big that it would be worth a small investment. From a strategic perspective, boards should be more involved in these types of decisions.

Leigh Weiss: British investor Adam Sweidan coined the term "black elephants." They are a cross between black swans, which are highly unlikely and could not be predicted, and the elephant in the room, where there has been talk of something—like the global pandemic or the 2008 financial crisis—but it was seen as low-probability. When those happened, they did not come out of nowhere.

Suzanne Nimocks: We all had pandemics on our risk registers, right? But how many companies and boards had thought about the implications for supply-chain disruption from border closures, having employees stuck in various places, and needing to quickly rework budgets? How deeply had anyone thought through the second- and third-order implications of these things?

Leigh Weiss: What makes it hard is the high number of potential low-likelihood, high-consequence predictable surprises, or those black elephants. How does a board prioritize which ones to pay attention to? You need to think through, on one axis, the scope of potential impact, then on another axis consider the level of certainty that this impact would happen. The degree of certainty will affect where boards need to get involved, because if the event has a lower certainty and would not be existential for the company, the board can leave that to the management to deal with.

Aaron De Smet: I will give you an example that highlights this. Some boards may have covered pandemic strategy in 2019, although that was probably luck because you would never know when a pandemic could hit. Some boards did not meaningfully engage on pandemic strategy until

'We all had pandemics on our risk registers, but how many boards had thought about the implications for supply-chain disruption from border closures and having employees stuck in various places?'

—Suzanne Nimocks

‘There is a high number of potential low-likelihood, high-consequence predictable surprises, or “black elephants.” How does a board prioritize which ones to pay attention to?’

—Leigh Weiss

March or April. And then there were some that saw the news in January and jumped on planning then. At that point, the likelihood of large impact had risen. Some of those boards knew of mining companies in Africa during Ebola outbreaks and brought in people who had helped the organizations deal with those crises and asked them what they learned and how they wish they had prepared. And those boards started shaping pandemic preparations with management in January. Most boards didn’t. When did your boards start pandemic planning, Suzanne?

Suzanne Nimocks: Two of the boards I am on engaged in early February. Interestingly, one had been through the Ebola experience and recognized the signposts. The other had many people in China and the management team saw the signals, knew this was a big risk, and so started talking to the board about preparation strategies. These management teams briefed the boards—here is what we don’t know, here is what we would do if this happens, here are the remaining uncertainties—and asked for input or things they might have missed in terms of possible implications.

Aaron De Smet: What a great relationship to have with the board if the management values the board’s engagement enough to approach them for input that early! Most boards I am aware of had those conversations a month later, and there is a lot you can do in a month. What you describe, Suzanne, strikes me as management inviting the board to help shape the decisions by asking questions. In a period of great turbulence and uncertainty, probably the best way the board can help shape better actions that will have to be taken on the fly is to prepare the management team by posing different scenarios.

Frithjof Lund: The past nine months have changed the dynamic between boards and management in many organizations. How do you see that relationship evolving in the future?

Suzanne Nimocks: I think we will see an increased frequency of communication. Historically, boards met six times a year in person. I think we will see a hybrid model of some meetings via videoconference and some in person, and boards will think through both the right frequency and mode of interaction. I must say, I see a degradation in the quality of the discussion in the virtual format. While it’s been fine for this period, it is difficult to onboard new directors effectively or build trust with management this way. I think the frequency of interactions has to be at least four times a year, but with more frequent virtual discussions that are shorter, to communicate and update. The current pace is not sustainable.

Aaron De Smet is a senior partner in McKinsey’s New Jersey office. **Suzanne Nimocks** is a board member of ArcelorMittal, Owens Corning, Ovintiv, and Valaris, as well as an alumna of McKinsey’s Houston office. **Leigh Weiss** is a senior expert in the Boston office. **Frithjof Lund** is a senior partner in the Oslo office.

Comments and opinions expressed by interviewees are their own and do not represent or reflect the opinions, policies, or positions of McKinsey & Company or have its endorsement.

This edited transcript of *Inside the Strategy Room* appeared on McKinsey.com in April 2021.

McKinsey & Company

NACD | ELEVATE BOARD PERFORMANCE

Building board–management dynamics to withstand a crisis: Addressing the fault lines

Crises can strain relationships at the top of organizations to the breaking point. Improving the dynamics between board members and senior executives can make recovery from crisis more successful.

by Robyn Bew, Linda Liu, and Friso van der Oord

Introduction

A corporate crisis has become a modern-day rite of passage for the board directors and senior executives of many companies. Everyone knows by now that crises are an ever-present threat that can strike any organization, no matter how apparently well run. Crises can emerge from a clear blue sky, escalate within hours or even minutes, and threaten an organization's viability. They may also arise when long-simmering issues spiral out of control. Institutions have paid the price: huge regulatory fines or legal settlements, shattered reputations, lost trust, and decimated share prices.

Less discussed are the significant personal costs. Crises are emotional events that severely stress the relationships between the CEO, the senior-management team, and the board of directors. Crises can end careers. Such stresses can make the response to the crisis less effective and severely impair an organization's ability to emerge strengthened from it and return to a path of profitable growth.

Yet how many companies can truly say they are prepared for this dimension of a crisis? How much of the work of crisis preparedness fully considers interactions within the board and between the boardroom and the executive suite? What is the best way to identify and address the risk of deteriorating organizational dynamics—ideally, before a crisis?

Looking beyond the contents of conventional crisis playbooks, we probed some of the most sensitive fault lines that a crisis rapidly exposes to devastating effect. Drawing on in-depth interviews with battle-tested board directors and senior executives who have experience serving on boards of or as senior executives at more than 80 US and UK institutions, we explore the lived reality of such events as seen from the top, exposing lessons learned from both failures and successes. And we suggest some ways for boards and senior executives to equip themselves ahead of time to work together more effectively. While board governance may differ by region, and thereby affect some of the issues covered in this article, certain lessons are applicable broadly—though they may need to be modified to some degree.

Our joint research and experiences have led us to believe that correctly calibrating the dynamics of the boardroom, and the interactions between the board and senior management, is an essential and often-overlooked ingredient of crisis preparation. We believe that the act of identifying and redressing the fault lines in board–management dynamics is not just a matter of prudent self-defense in moments of crisis. By strengthening their governance, collaboration, and culture, senior executives and board members are likely to create healthier and better-run organizations—in conditions not only of crisis but also of business as usual.

Crisis: The new normal

A crisis is a "low-probability, high-impact event that threatens the viability of the organization and is characterized by ambiguity of cause, effect, and means of resolution, as well as a belief that decisions must be made swiftly."[1] Crises may occur when an institution cannot resolve an apparently serious (and often publicly known) problem quickly and straightforwardly or when serious misconduct that defies any rapid solution comes to light. Or a crisis might result from slow-boiling risks that compound over time until they escalate past the point of no return. Whatever the cause, a crisis creates moments of truth for an organization. Sometimes it is existential.

Of course, such mishaps are not new: they have become an unfortunate staple of business life for organizations of all sizes and sectors, including both for-profit and nonprofit institutions. On the corporate side alone, the total amount companies paid out for US regulatory infractions grew more than fivefold, to almost $60 billion a year, from 2010 to 2015.[2] From 2010 to 2017, headlines with the word "crisis" and the name of a top 100 company (as listed by *Forbes*) appeared 80 percent more often than they had in the previous decade.[3]

[1] Judith A. Clair and Christine M. Pearson, "Reframing crisis management," *Academy of Management Review*, 1998, Volume 23, Number 1, pp. 59–76, journals.aom.org.
[2] Sanjay Kalavar and Mihir Mysore, "Are you prepared for a corporate crisis?," *McKinsey Quarterly*, April 2017, McKinsey.com.
[3] Ibid.

According to the 2018–19 public-company governance survey of the National Association of Corporate Directors (NACD), 97 percent of US board members expect the frequency of crises to increase or stay the same, and 98 percent expect the severity of crises to increase or stay the same over the next three years. In addition, 81 percent of the respondents rate improved board preparedness for a corporate crisis as a moderate to very important priority over the next 12 months.[4]

The nature of contemporary business makes crises not only more likely but also more prone to escalate dangerously. This problem reflects the complexity of global supply chains, the heightened interconnectedness of operating relationships, and the requirement for speed. It reflects changes in stakeholder expectations, as governments, customers, or victims are more likely to seek redress. It is fueled by the culture of instant communication and fragile trust in for-profit, nonprofit, and government institutions alike, meaning that negative narratives frequently seize the public imagination with alarming speed. This confluence of factors explains why crises have become such existential events—especially, perhaps, for large organizations with brands and reputations to defend.

A stress test for boards and management teams

A crisis scenario, whatever its origins or specific circumstances, is the ultimate test of resilience for any institution, its board, and its top executives. Senior executives and directors of a stricken organization can find themselves exposed to unrelenting external scrutiny from the media, the legal profession, regulators, and other stakeholders for months or even years. As individuals and as a team, top executives and board members are under the most intense pressure to make rapid decisions, statements, and actions to mollify or reassure anxious or angry stakeholders. Yet by definition, they are not in command of sufficient information to feel fully confident about any particular course of action.

Relationships between managers and those who oversee them become frayed; information flows are found wanting; existing tensions and dysfunctions within the board and the C-suite—problems that may have seemed tolerable in normal times—become inflamed; and relationships break down. In the worst cases, a vicious cycle of blame and mistrust establishes itself at the highest level of the company, causing it to make serious missteps or to become paralyzed.

Are organizations really prepared? According to NACD survey data, most companies have comprehensive and regularly updated crisis-contingency plans, and many also undertake regular management-crisis exercises. Yet the data also show that only in a small minority of cases—8 percent—did boards participate in crisis-simulation exercises with management. And while 88 percent of directors say they know what their roles and responsibilities will be during a crisis, fewer than 25 percent actually had explicit discussions, in the preceding 12 months, about the board's crisis roles and responsibilities. Fewer than 10 percent had participated in postcrisis assessments.[5]

A comment from one senior director and company chairman we interviewed captures the issue: "Preparation is useful and important—establishing processes, roles, communication plans; identifying advisers; and so on. But personal relationships and emotions can't be predetermined or rehearsed. CEOs and board leaders need to get granular about emotions as well as tactics in considering crisis response. Recognize that no matter how realistic the crisis-simulation exercise is, everyone is going in [to it] with a collaborative mindset, so it's not likely to expose tensions or issues with team dynamics."

Another director agreed: "Most companies probably have some sort of crisis plan or playbook—but to what extent is it check-the-box and going through the motions? Does anyone stop and ask, 'How do we take this beyond words on paper?'" This amounts to an argument for more proactive board–management engagement on crisis preparedness than is currently visible—and for a greater focus on the relationship between the CEO and the board,

[4] "2018–2019 NACD public company governance survey," National Association of Corporate Directors, nacdonline.org.
[5] Ibid.

information flows between management and the board, and leadership roles and relationships within the board.

Altered dynamics

The point many of our interviewees underlined is that crises fundamentally change the terms of engagement between boards and senior management. People in both groups must often make difficult decisions, including whether major changes are needed on the senior-executive team or the board itself (see sidebar "The ten tough calls"). Just as a major storm or earthquake can expose long-standing structural flaws in a building, so a crisis can reveal and inflame existing weaknesses and dysfunctions at the top of a company. All the more reason, then, to recognize and resolve such issues in calm times.

As more than one of our interviewees pointed out, improving these dynamics will also enable a company to make correct, well-informed judgment calls on the true nature of a crisis, as well as when to declare that it is over. An organization may take years to recover, and while it may continue to operate in the immediate aftermath of the crisis, second-order effects such as litigation can last for years and pose a complex long-term challenge. That becomes even more difficult when issues keep getting uncovered and eventually reveal that the problem of the company is systemic. In those cases, it will often undergo wholesale change in management and staff. As one director put it, "Then it's not 'change management'; it's 'change the management.'"

Critical fault lines

Our interviewees identified a few critical fault lines in boardroom dynamics. In their experience, these pose a serious threat to an effective crisis response.

Fault line 1: Overreliance by the board on the CEO or senior management

Several interviewees said that boards on which they had served were sometimes insufficiently willing to check or challenge senior management. These interviewees identified various causes. One was concern about going beyond mandated roles and crossing the line into operational activities that are the executive team's responsibility. As

The ten tough calls

In McKinsey's experience when organizations go through major crises, boards must sometimes make difficult decisions, many relating to senior management or to the board itself. Here, from McKinsey's Crisis Response and Preparedness Practice, are some of those tough calls.

1. In an organization where several negative events have occurred, should it pivot toward "crisis mode"?

2. If establishing a central crisis response is the right call, who should lead this team?

3. What decision authority should the crisis-response team have to ensure the right balance of speed and oversight?

4. Do we publicly support management and endorse its response to the crisis?

5. Are major changes in the senior-executive team necessary?

6. Does the board need to hire an additional, independent member to help the company respond and recover?

7. What immediate shifts within the board must we make to enable the right governance? How extreme might some of these shifts be—for instance, splitting the roles of chairman and CEO?

8. Is the board's broader composition right?

9. Should the board start an independent investigation to find out what happened?

10. Does the board need to establish the guiding principles that will provide the guidepost for the organization's response and recovery?

one interviewee pointed out, directors often don't want "to push too hard on management, because they feel [key decisions] are management's call, but it's a tough line." Many boards struggle to find the right balance between support for management and constructive skepticism. "We happen to have a fantastic CEO," said one director we spoke with, and that can lead to "the board being almost beholden to management's point of view."

Challenging discussions with management are a necessary element of proper corporate governance. Failure to make such candid conversations the norm inside the boardroom leaves directors complicit in poor judgment calls by management and less able to take an independent stance when a crisis comes.

Personalities or broader cultural issues can also undermine candid discussion. Directors may be reluctant to speak their minds for fear of being seen as "difficult." CEOs might adopt a domineering or dogmatic style in dealing with the board, restrict discussions, or fail to listen adequately. "A lot derives from the tone that the CEO sets with the board," said one director. "If he or she is confident and has an open relationship with the board—sees the board as an asset—senior management will follow that lead. If the CEO views the board as an encroachment on his or her authority and takes an approach of carefully rationing the information that's shared with the board, then it's easier for things to go south in a crisis."

A particularly acute difficulty arises in whistle-blowing cases if a board is too slow to take appropriate measures when accusations are made against senior or other high-level executives, said one director. "I think boards often take too long to react and find it difficult to form an objective point of view. Too often there's a bias that the accuser can't possibly be right."

Fault line 2: Micromanagement by the board

An equally significant and opposite problem is micromanagement by the board—for example, when board members seek a direct say in the management process, in a reversion to the "muscle memory" of their prior executive positions, or simply because they don't understand or appreciate the respective roles of boards and senior managers.

"Boards can be afraid of appearing tone deaf in a crisis," one long-tenured director observed. "There is a natural desire to act quickly and decisively, but we need to remember our oversight role and calibrate our response carefully."

In crises, board members must reserve the right to step in and steer the organization, especially if it becomes apparent that the leaders are conflicted or complicit. In those instances, boards are expected to take on some operational responsibilities and to make decisions that would otherwise fall within management's purview. But in the absence of such circumstances, said one director, boards must hold back: "If directors are overly intrusive on good management teams, it creates a muddle in terms of crisis management. If the board is more than a thought partner with the CEO and other managers ... and instead [is] trying to be the CEO or a management member, it's a recipe for disaster."

Fault line 3: Problematic dynamics within the board itself

Crises can exacerbate existing board dysfunction or expose a lack of clear leadership. Too often, said our interviewees, boards have simply not devoted enough time or effort to considering and addressing these issues before a crisis comes.

"If there are any preexisting tensions or poor dynamics, it will be much more difficult to be successful in a crisis," said one director. "Directors come into the board as individuals, from different backgrounds, and we only meet in person five times a year. If poor dynamics exist, lots of time will be wasted in unproductive conversations—there's likely to be a lack of trust and uncertainty about different directors' strengths and weaknesses."

Strong board leadership—either an independent chair or, if the chairman is also the CEO, a lead independent director—is indispensable to facilitate the right dynamics. However, according to at least one interviewee, "if the lead director is not particularly strong, and the CEO is the one who's really in charge, that's a problem. The voice of the independent directors might not be heard—they'll be kept more at bay."

Fault line 4: Poor information flows between management and board

Determining the appropriate volume and type of information that flows from senior management to the board can be challenging in calm times. It is all the more so when an organization's leadership focuses on managing a crisis. Particularly at such times, "there's a tension arising from the board that wants more data because of their fiduciary duty of staying informed in order to make decisions and demonstrate duty of care," said one director. "On the other hand, board communications take a significant amount of energy and time on the side of management." During a crisis, "it's extremely challenging for the management to simultaneously fix the problem and [also] spend enormous time giving the board the play by play."

Inconsistent or poor information flows, which may be a preexisting problem between boards and management teams, can be exacerbated by (or an outgrowth of) the other relationship fault lines described above. A senior executive recalled a personal experience when "things were disorganized—and in the immediate crisis, it became [even] harder for us to meet the reporting requirements of the board. The board was meeting every day, so you're working 20 hours a day and try[ing] to prepare for board meetings—you must stop doing the day job to report to the board. We were doing it the hour before the meeting, so information was sometimes inconsistent."

On the other hand, an overly restrictive approach to information flows from management to the board can also accelerate the erosion of trust during difficult times, exacerbating all the other fault lines. One director told us about a long-serving chairman and CEO who sought to maintain tight control of board communications in a crisis. "There was a long-established cadence for board communications, [and] when the crisis started to unfold, the CEO kept control of that cadence." Insisting that wider discussion was possible only once the facts had been established, he spoke solely to the lead director as the crisis unfolded. The full board did not meet to consider the issues until the situation was already far advanced—and not surprisingly, by that time, the board was so suspicious that it felt the need to become heavily involved.

A question of trust

It is not difficult to see how these cultural, structural, and personal fault lines can crack open in a crisis and combine to create a chasm. In essence, they all indicate insufficient trust between board members and senior managers. That may simply be frustrating in calm times but escalates rapidly once a crisis starts. It is striking how often these issues came up in our conversations with directors. The point they all made, in different ways, is that a lack of transparency and trust too often hampers the effectiveness of board–management dialogue even in normal times. In a crisis, poor relationship dynamics can prove fatal.

One director described the dynamic as follows: "From the board's perspective, once you feel like the management wasn't open with you, then there's a breach of trust, and it's hard to overcome that. In those situations, the board's antennae are going to be up; there's always going to be an air of 'I'm going to figure out what you're not telling me.'"

An experienced board member summarized these issues by dividing board–management dynamics into three categories. In the best case, management not only engages the board on a regular basis about key risks and preparedness but also proactively drives those conversations. Scenario planning is on the agenda, and communications are open and transparent—including early-stage issues where management might say, "We don't have all the answers yet, but we're looking into it." There are few to no surprises, and the board feels confidence in the organization's ability to withstand and respond to unexpected events.

In many organizations, however, the management team is less proactive, so the bar to establish transparency is higher for the board. As directors, "we have a sense that if we do not ask [just] the right questions, we might not get the information we need." In these "middle of the pack" situations, said the director, management teams are ultimately responsive to board members' questions and requests, and productive dialogue can occur, but that requires more effort. Good directors "will ask the questions, but it's better if the onus is not always on us."

Worst of all, said this director, are instances where "management remains uncommunicative, and the board ends up with unpleasant surprises. We hear: 'Yes, we've got it under control; we'll bring an update to the next meeting'—then something goes awry, and it turns out it was a much bigger incident than initially thought. Or it was something management discovered months ago but didn't want to bother the board with it." These situations fundamentally—and often permanently—erode the board's trust in the management team. "When the board gets surprised, our reaction is negative and swift," said that board member. "This can create a negative spiral—our reaction as directors can reinforce management's tendency to keep things from the board; that in turn causes the board to push even harder, and so on."

Addressing the fault lines before a crisis

These anecdotes, together with the evidence about the increasing intensity of corporate crises, make a powerful case for rethinking board–management relations. What's needed is a clear-eyed assessment of existing relationship dynamics to prepare organizations to face highly disruptive circumstances more effectively. Senior executives and nonexecutive directors need to have much more transparent, rigorous discussions about their relationships and governance processes and to explore the health of the company's culture at the top of the house much more deeply than they would normally do. Our interviewees shared several complementary approaches, summarized below, that would not only address the fault lines that hamper crisis responses and help organizations to recover more quickly but also enable them to function more effectively in normal times.

Remedy 1: Establish shared expectations about roles in a crisis

Well-developed crisis playbooks typically not only include details such as a designated crisis-response team and operating protocols but also establish clear responsibility for internal and external stakeholder management and communications in various scenarios. Regularly reviewing these playbooks and plans with the board, and sharing the results of simulation exercises, strengthens directors' confidence in the organization's leadership and can mitigate the desire to micromanage.

Another indispensable element of expectation setting, said one director, is candid discussion between the board and management about what their respective roles should be in a crisis—bearing in mind that those roles will necessarily evolve as it unfolds. "The CEO should want to lean on the board, draw on their expertise, and use [directors] as a sounding board, especially in crisis situations. If management's view is that the board's just another constituency to be managed—or, in the worst case, a necessary evil—that's a big problem."

Even if these discussions have not taken place during peacetime, it is still possible to change an unproductive board–management dynamic while a crisis unfolds. One interviewee told of a crisis when the nonexecutive chair, who had retired from executive roles and could spend significant time at the company, stepped in at a critical moment in a leadership capacity. "He essentially said to management, 'I'm going to be in these meetings; here's the information I want; copy me on communications.' He took the reins with the external advisers and kept the rest of the board members informed. The latter was critical, because when it came time to vote on key decisions, everyone felt appropriately informed. It was extremely uncomfortable, at first, but then we started to see behaviors change—the CEO began reaching out to board members proactively to tap their expertise, and information started to flow more freely from management."

Remedy 2: Make the role of leadership within the board crystal clear

Strong, effective board leadership—from a nonexecutive chair, a lead director, or both, as well as the leaders of board committees—is a fundamental tenet of good corporate governance. Whatever structure the board chooses to use, it should clearly define in writing the responsibilities and expectations for key leadership roles, along with the criteria for selecting and evaluating those who assume them.

In particular, the nonexecutive chair or lead director needs to take the initiative in establishing a collaborative environment and managing board dynamics, both inside and outside board meetings.

One of the board leaders we spoke with suggested several questions that nominating and governance committees can ask about the role of the nonexecutive chair or lead director. “Is the leader maintaining focus; encouraging open discussions; and also managing the board dynamics outside the room—identifying where directors have concerns or questions? Is he or she taking into account the maturity of the board as a team?” Nonexecutive chairs also need to be capable of providing guidance to the CEO on engineering a course correction when a crisis is under way, and—should circumstances require—of stepping in as the organization’s voice if the executive leadership is compromised.

Remedy 3: Hardwire information flows into the boardroom

Once roles and responsibilities have been clarified, it is important to establish reasonable expectations and protocols about information flows and sources of information required by the board. Concretely, this means, first, establishing a plurality of sources in management reporting to the board, so the CEO does not become the sole gatekeeper. As one director put it: “Avoid having all the information to the board coming [from the CEO’s office]: this highlights the importance of strong and independent internal-audit functions, as well as the general counsel, the chief financial officer, and chief risk officer. All of these are channels for communication.” Another said: “As the chair of a key committee, I have strong relationships with various company executives. At dinner outside meetings or visits to company locations, I can have candid conversations with these executives.”

Increasingly, we see CEOs and senior-management teams scheduling interim updates for directors—the full board or a key committee or subcommittee, depending on the issue—between scheduled board meetings, to help board members stay on top of rapid changes in the business environment. These are often short, informal conference calls but go a long way not only to keep directors informed but also to establish the type of open, transparent dialogue that is the foundation of good board–management dynamics.

Including third-party perspectives from objective independent advisers as part of the information flow is also essential. “Management sometimes resists this notion,” said one director, except if it’s legally mandated—for example, the compensation consultant or external audit firm. “But there is benefit to directors having access to a point of view that’s neutral and well informed, with an understanding of the company and the situation. One of my boards didn’t bring in an independent counsel until midstream in a crisis situation; it took them a long time to get up to speed. On some issues, regular third-party reviews for the board can be beneficial.”

Hardwiring information flows means establishing protocols and ground rules well in advance of a crisis, so that when one strikes, nobody questions the cadence, frequency, or flow of information. Particularly useful in this respect, an interviewee pointed out, are executive sessions—meetings between independent directors and leaders from internal audit, risk management, finance, or legal, conducted without other members of management present. “When executive sessions are treated as routine agenda items, they’re [already] there if needed during a disruptive event.”

Directors also need to agree about the information they expect to get once a crisis hits—and to keep their expectations reasonable. Said one director, “The board has to have information in order to do our jobs—at some level, management has to just deal with that. But we don’t need 50-page [slide] decks; a 15-minute update over the phone is fine. If a foundation of a trusting relationship exists already, it makes this much easier. The CEO and CFO might do quick update calls for the board: simply, ‘Here’s what we know; here’s what we’re doing; here’s what we need.’”

Remedy 4: Conduct regular, rigorous self-assessments

Time for thoughtful self-evaluation is a critical ingredient of continuous improvement—an ethos that underpins high-performing teams of all types. Boards are no exception. Like the three remedies outlined above, assessments make boards more effective in good times and bad by prompting reflection about operating processes and the health of the board’s culture (see sidebar “Assessing boardroom culture and dynamics”).

One experienced director told us, “We’re explicitly discussing, in our nominating and governance committee, what does ‘being an effective team’ look like—how well are we aligned, as directors, about that? Then, how well are we doing? Good boards should be talking about this informally and also assessing it explicitly. It should be part of evaluations, and effectiveness here presumes that board evaluations are not just a paper exercise.” Moreover, a small but growing number of boards are including perspectives from management in their evaluation process. Leaders on these boards report that candid feedback from executives provides valuable input for improvements in the board’s governance policies and practices.

Self-assessments are especially important after a crisis to evaluate how the board and management performed and could have done better. Although such postmortems are universally acknowledged as helpful, only 9 percent of NACD survey respondents currently conduct them. Postmortems—a critical look at what worked and what failed—enable management and boards to surface the lessons learned from a crisis and to apply those lessons going forward, capturing institutional memory for the next crisis.

Conclusion

We share the view of the board members and senior executives we spoke with: healthy boardroom dynamics are crucial to help a company respond effectively in a crisis. Such corporate crises are becoming more frequent and more intense, and they are imposing unprecedented stresses on boards and senior management teams. In the worst cases, they can create a threat to a company’s very existence.

Board members and senior-management teams need to approach preparing for a crisis much more proactively (see sidebar “Related resources for further reading”). They should go beyond the conventional crisis playbook and simulation exercises by honestly assessing how well prepared they are to manage the turbulent dynamics of a crisis. That

Assessing boardroom culture and dynamics

This list is adapted from the report *Adaptive Governance: Board Oversight of Disruptive Risks*.[1]

Evaluation of the board

— All directors have an opportunity to speak and are encouraged to share their input, even if they have a different or dissenting opinion.

— There is an appropriate balance in board meetings between reviews of past performance and discussions about the future.

— Directors and management understand the thresholds for escalating information to the board.

Evaluation of the lead director, independent chair, and committee chairs

— The lead director maintains an appropriate level of constructive tension in boardroom discussions by building consensus without prematurely shutting down conversations.

Evaluation of individual directors

— Has the director actively participated in director-education activities during the past 12 months?

— Does the director take an inquisitive approach to bad news or to reports of poor performance, without punishing the messenger or looking for scapegoats?

[1] *Adaptive Governance: Board Oversight of Disruptive Risks*, National Association of Corporate Directors, NACD Blue Ribbon Commission Report, 2018, nacdonline.org.

means candidly discussing roles and responsibilities, while surfacing potential vulnerabilities in organizational dynamics well before a crisis hits and preemptively agreeing on the ground rules and remedies.

That will not only make companies more resilient when something goes seriously wrong but also help them function more effectively in meeting the challenges of business as usual.

Related resources for further reading

Sanjay Kalavar and Mihir Mysore, "Are you prepared for a corporate crisis?," *McKinsey Quarterly*, April 2017, McKinsey.com

Report of the NACD Blue Ribbon Commission on Adaptive Governance: Board Oversight of Disruptive Risks, NACD, October 1, 2018, nacdonline.org

Report of the NACD Blue Ribbon Commission on Culture as a Corporate Asset, NACD, October 3, 2017, nacdonline.org

"Toward a value-creating board," McKinsey & Company, February 2016, McKinsey.com

The Board Perspective—Numbers 1 and 2 (collections of recently published articles on boards), McKinsey.com

Linda Liu is an associate partner in McKinsey's New York office. At the time of the research, **Robyn Bew** was director of strategic content development at NACD. **Friso van der Oord** is director of research at NACD.

The authors wish to thank Kyra Blessing, Andrew Gowers, Mihir Mysore, and Nina Spielmann for their contributions to this article.

This report appeared on McKinsey.com in September 2019.

About McKinsey

McKinsey & Company helps organizations across the private, public, and social sectors create the change that matters. We have always helped our clients identify and set the direction toward their most important goals. Today, we go further: working together to turn these ambitious goals into reality. From the C-suite to the front line, we partner with our clients to transform their organizations in the ways that matter most to them. Our Risk Practice partners with clients to go beyond managing risk to enhancing resilience, creating value and building risk skills and assets by combining our extensive industry insights with deep technical capabilities. To learn more about McKinsey's Risk Practice, visit: https://www.mckinsey.com/business-functions/risk/.

About NACD

The National Association of Corporate Directors (NACD) empowers more than 20,000 directors to lead with confidence in the boardroom. As the recognized authority on leading boardroom practices, NACD helps boards strengthen investor trust and public confidence by ensuring that today's directors are well prepared for tomorrow's challenges. World-class boards join NACD to elevate performance, gain foresight, and instill confidence. Fostering collaboration among directors, investors, and corporate governance stakeholders, NACD has been setting the standard for responsible board leadership for 40 years. To learn more about NACD, visit www.NACDonline.org.

This McKinsey Practice Publication meets the Forest Stewardship Council® (FSC®) chain-of-custody standards. The paper used in this publication is certified as being produced in an environmentally responsible, socially beneficial, and economically viable way.

Printed in the United States of America

Spring 2022

McKinsey.com