The Evolving Role of Corporate Boards in Assessing Sustained Business Value

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Introduction

The dynamic global economy confronts business with a continuous set of new challenges. Presented with a convergence of market, social, economic and environmental business factors that can significantly disrupt operations and plans, leaders need the ability to sense the market, forecast the future, formulate strategies, be competitive, and empower employees to take action for the business to succeed. The duty of a corporate board is to provide independent fiduciary responsibility to the corporation, and to its shareholders in applying their knowledge and experience. The corporate board serves to protect company assets while simultaneously evaluating business risk as they support management on how best to position for competitive growth.

To remain profitable, respected, relevant, and trusted, the best businesses have to be responsive to the dynamics of the market and their customers.

As business has gone global, the requirements on business have magnified. Further, as the potential for reward is greater than ever in a global marketplace, so too is the risk of failure.

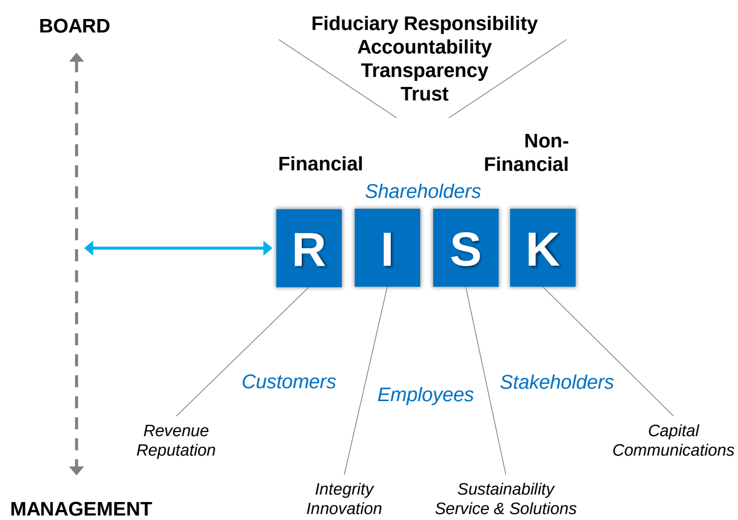
Today, market-shaping shifts are converging and placing greater demands on business. In many ways business is experiencing increased demand for accountability, transparency, reporting, and disclosures by consumers, shareholders, and regulatory agencies.

At stake is the reputation of the business in its pursuit of value creation for shareholders, stakeholders, and society. This responsibility requires a breadth and depth of experience, knowledge, and leadership from all members of a board. Traditionally, corporate boards were held to one standard of performance: financial results. While the pressure on corporate boards to provide oversight on financial performance has only intensified in recent years, the non-financial demands have increased, and not just for greater transparency and accountability. Recent past events demonstrate corporate boards have had to address a growing array of internal and external risks in a manner in which enhances accountably for financial and non-financial controls, performance, and impacts of the company.

Due to a range of converging issues, corporate boards have had to evolve their scope and level of accountability as they have been required to evaluate business risk and financial performance along a broader set of internal and external, financial and non-financial, indicators of business performance.

Converging Global Risks and Emergent Business Opportunities

Although they have been discussed as singular or isolated issues in the past, increasingly corporate boards are proactively engaging in dialog on how a diversity of topics are converging as risks and opportunities to the business including: sustainability, product stewardship, environmental compliance, health and safety, talent development, information and knowledge management, succession planning, social responsibility, global business growth, supply chain risk and risk management. This is compounded by ongoing financial disclosures and other reporting initiatives.



The global context by which business operates is in dynamic flux. The past decade has demonstrated that the business world has become more dynamic, uncertain, and rapid. As a result, converging risks and opportunities require greater assessment, evaluation, and oversight by corporate managers and boards. A sample of the primary converging business risks and opportunities for many business sectors that operate internationally include:

- Climate Debate
- Resource Scarcity
- Activist Shareholders, Citizens, Communities
- Economic Entropy
- Population Growth
- Urbanization of Global Population
- Geo-Political-Religious Conflict

- Scientific-Technological-Legal Ideological (*i.e.,* advent of 'citizen scientists,' climate, bioaccumulation of toxins, social media and accuracy of data/information, etc.)

These issues affect every business. However, how business chooses to internalize these risks and opportunities is a determinant in how well they will create business value.

Corporate boards need to assess and interact on material business risk more than ever.

Amid a sea of complex converging issues, 'citizen scientists,' and activist shareholders, boards now have to be proactive, yet ensure the right framework, policies, structure, and culture is in place to govern business with trust, accountability, and performance.

Boards are increasingly being asked, "...How are you deploying your resources? ...Where are you putting them?...What does that mean for growth and risk mitigation?"

The ability to create value is the primary objective of any business. Typically value is measured by financial indicators including revenue, earnings, dividends, and yields. But to get to financial measures, business has to first create a tangible value, a product/service, and/or a utility that consumers want to pay for.

The formula for financial success in business is relatively simple: create a value that customers will pay more for than what was required to create and deliver it. However, this is more easily said than done in practice, which is why so many businesses succeed at product launches, yet fall shy of growing and sustaining their business.

However, the skills required for assessing, prioritizing, and managing risk and opportunity at a corporate-level are fundamentally different than those required to create business value at a product or service level. However, there is tremendous value creation potential in board-level governance and its role to ensure fiduciary responsibility by addressing business risk in a holistic and integrated manner. Ultimately, successful business growth and value creation is achieved when disciplined management and governance structures are combined, synthesized, and converted into strategy and actionable plans.

The Need to Evolve Corporate Governance and Boards

Not all change is created equal, and the business environment is always changing. Some changes impact business with greater force and speed than others. In an increasingly connected world businesses now operate with a new set of market and operating realities. The speed and accessibility of data, information, communications, and all types of media are provoking and stoking a new generation of 'citizen scientists' and activist shareholders. According to recent studies[i] and reviews[ii] by The Conference Board, EY, and others, approximately half of the shareholder proposals submitted in the 2014 proxy season sought more information on environmental and social issues.

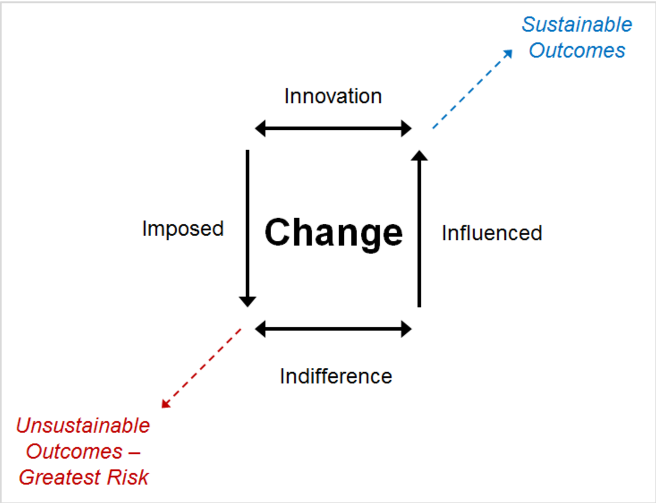
As businesses have become more transparent, they have also opened themselves up to more analysis, scrutiny, and vetting. While businesses would like to see objective, independent, and fact-and-science based reviews of their performance, the reality is that 'citizen scientists' and activist shareholders have become more organized, knowledgeable, and leveraged as they use more-and-more sophisticated resources and techniques to influence businesses.

External pressure from consumers, citizens, and shareholders is nothing new. What is new is how quickly consumers and activists can mobilize resources and have far-reaching influence (positively and negatively) on the reputation of the business. Armed with information and data, external forces can swiftly spin the power of story to evoke emotion and draw attention. Organized, focused, and strategic in their personalized pursuit of change, external forces now influence businesses enterprise wide.

Business risk is shaped by many things. The convergence in regulatory, economic, environmental, market, and societal needs is driving new requirements on business risk, strategy and performance. This convergence is about addressing shifts in market requirements and balancing the trade-offs between best options for innovation and business growth. Because this convergence is swift, it requires organizations to more readily access and integrate expert knowledge with critical insights across a broad range of business priorities. Drill down further and you can see that the convergence is really about addressing shifts in market requirements and balancing the trade-offs between competing options for growth. The convergence involves simultaneous assessment, analysis, and action on material risks to the business.

How can a business be prepared for the unknown? This fundamental question is essential dialog for corporate boards, particularly in the wake of recent external events which have had profound impacts on many global businesses such as: Superstorms like Katrina and Sandy, health scares like Ebola and Avian Flu, and terrorist events including 9/11 and the Boston Marathon Bombing.

Change is imminent for every business and organization. Understanding risk in the context of change is s shared responsibility for all employees of a business. However, the corporate board and management are charged with setting the tone, direction, policies, and framework for creating a culture that embraces change and proactive risk management.



Too often businesses view change as something that is imposed upon them. Change is prevalent in every aspect of the business, for example in regulatory requirements, consumer preferences, advancement of technology, environmental conditions, vitality of capital markets, and natural resource availability.

There are several responses to change. When viewed with indifference or as an imposed requirement on the business, change can feel limiting, posing a great deal of business risk, and result in unsustainable outcomes. However, if the organization accepts change and chooses to take a proactive stance influencing the business and innovating around change, the risk of the change can be reduced yielding more sustainable and business favorable outcomes. This simple example of how change is viewed within a company can make all the difference between a business that is prepared to deal with risk, and one that is not. Ultimately organizations must “right size” their risk management to their company’s strategy, employees, markets, products, stakeholders, and plans for sustainable growth.

Risk: Missing the Business Cycle

Mature businesses follow a business cycle. Sectors including aerospace, automotive, chemicals, mining, railroad, energy, agriculture, consumer product, and electronics each have business cycles linked to when they launch products, report earnings, announce breakthroughs, and shape their growth.

Although business cycles can be planned for, riding the wave of the cycle has become more challenging as the duration, occurrence, speed, and impact of the cycle is more volatile and less predictable in the past. The reasons for this are many. In the simplest terms, there is greater unpredictability and vitality the marketplace. For example, consumer taste and preferences, regulatory controls, the speed of business, the accessibility of data and information, just to name a few, converge at greater frequency and force than in the past. Individually, each of these forces influences business in their own right. When converging at once, these unexpected forces can immediately overwhelm underprepared businesses.

Failure to act can cripple a business. Yet amid the onslaught of asymmetric and complex risks businesses have to contend with, corporate boards and management can feel that it is less risky to take no action than to assess the challenges and take action in fear of making the wrong decision. But as some business sectors and companies have seen, the financial impact of taking no action or missing the business cycle can have profound consequence on the business.

Example: The Organic Foods Industry

Armed with greater access to data and information, consumers have more power in the market than ever before. Citizen scientists, those that challenge conventional wisdom and seek truth from business and government, have become more main stream. No longer is there a linear path for marketing and product information. Today, consumers obtain their own data and information, and rely on their peers and public opinion as much as they do on independent scientists and research.

The result is a highly informed and increasingly skeptical citizenry. This poses risk and opportunity for corporate boards. More than ever, every decision and action by the board is reviewed and scrutinized, not only by traditional financial analysts and experts, but by citizen scientists that want the best for their families, their communities, and their pocketbook. The stakes for business are greater than ever. Twenty or thirty years ago it was well enough to compete on quality products, fair prices, decent wages, and economic growth. The values which drove leadership in business three decades ago are baseline expectations today. Consumers now expect the brands they value, the business they deal with, and the products they purchase to be of unequivocal integrity, while being delivered with a sense of urgency and purpose which mirrors their morals and values.

Take for example the evolution of organic foods. In the past 10 years many new organic foods brands have been nibbling around the edges of the grocery stores, out shelved and out sold by classic brands that generations of people have grown up with. But as consumers have become more aware of what's in their foods, and where they are sourced from, the organic selection of many retail stores has expanded in step. The organic foods segment of grocers now exceeds a $35 billion market[iii], three times its size just a decade ago.

As consumers pay more for organic products, and seek more organic foods options, retailers respond to the demand by stocking more selections. This has had profound impact on the business of global companies such as Kraft, Coca-Cola, General Mills, and Kellogg Co. Additionally, once niche retailers such as Whole Foods and Trader Joe's have expanded their retail outlets and become more established household names. These grocers are leveraging consumer demand for better foods with growing availability and choice in organic and responsibly sourced foods. Big brands including Coca-Cola and Kellogg Co. are acquiring smaller but growth oriented organic foods companies in an attempt to diversify their products and evolve with rapidly changing consumer palates.

Citizen scientists are demanding more accountability, transparency, value, and sustainability from foods suppliers at each end of the supply chain. Whether it's upstream farms and growers, manufacturing, wholesale packaging and distribution, or retail, consumers are becoming more actively engaged in the farm-to-fork value chain. Consumers are trying to understand where their foods come from, how nutritious it is, and what's really in it.

As issues such as water scarcity, climate, GMOs, and numerous human health concerns linked to certain diets and foods ingredients have been made more public, consumers have become more aware of their diets and the impact their food consumption has on their personal health, as well as their impact on the environment. The interconnectedness of individual consumption behaviors on global sustainability issues has become more transparent and pronounced. Many consumers, like government and business, are looking at this evolving paradox of how to care for a growing global population while simultaneously address rising demand for the earth's finite supply of natural resources.

Personal health is now emerging as a primary value for consumers. Fearful of non-organic ingredients, too much artificial sweetener, genetically modified organisms (GMOs), where foods are sourced, risks associated with certain food additives and endocrine disrupters, and along with a plethora of other human health and environmental issues, many consumers are restructuring their diets and food purchasing budgets to align with more natural, organic, and verifiable food sources. Citizen scientists are educated, knowledgeable, and representative of a growing consumer base that understands advocacy, but also is using the power of their pocketbook to sway businesses to serve a new, more sustainably-minded market.

Some companies, including Illinois-based Enjoy Life Foods and Vermont-based Green Mountain Coffee Roasters have built their brand and business on serving this growing segment of conscious food eaters. Enjoy Life Foods, for example, produces foods that are allergy-friendly (free-from the “top eight” allergens), gluten-free, non-GMO, and that have no artificial ingredients.

According to Food Allergy Research and Education[iv] (FARE), more than 15 million Americans have food allergies and 1-in-13 children under the age of 18 has food allergies (nearly 2 children per classroom in America). Further, the Center for Disease Control and Prevention (CDC) released a 2013 study that food allergies among children increased 50% between 1997 and 2011. The economic cost of children’s food allergies in America is estimated to be $25 billion annually[v]. Targeting consumers that both want more natural foods as well as a growing population of people that have food sensitivities, Enjoy Life Foods is an example of how many smaller companies have sensed the shift in consumer needs and values, and have created their own growth oriented business in response.

Societal needs and values are shifting. Consumers are demanding much from business, akin to being all things to all people. Where government and even religion have had their own recent societal challenges regarding trust, integrity, and accountability, business has been left to broaden its appeal and deepen the value it can deliver to society, perhaps in ways that fill a void unfulfilled by other institutions.

This poses great challenge to businesses and corporate boards. The creation of value has always been the calling card for business. But as the definition of value shifts, strategic assessment and advisement on risk and opportunity is required to ensure the values of business align with the value consumers now expect to be delivered. The convergence of risk and opportunity is happening across many markets, and for some companies it is more acute and transparent. The reality for corporate boards and management is to quickly triangulate what’s happening internally, externally, and what it means for the business. Corporate boards simply cannot afford to miss the business cycle.

Summary: Assessing Sustained Business Value

Businesses now operate in a more dynamic and fast-paced global economy. Business cycles are being disrupted by technology, information, and people. Today’s business is influenced by a workforce, customer-base, and shareholder that are more engaged and discerning than ever before.

To remain competitive, corporate boards and management have to assess and assimilate a broader range of risks that pose a material impact to the business. To assure the business cycle is not missed, the best corporate boards are evolving their structure and adopting innovative approaches. Some of the best practices corporate boards are adopting to proactively assess change and converging risks include:

- **Evaluating Board Composition –** The best companies are looking at the composition of their board to determine if they have the right balance of diversity, knowledge, experience, and perspective. Some companies are putting major customers and users of products/services on their boards to deepen their understanding of the market and customer points-of-view.

- **Capital Resource Efficiency and Allocation** – The board's review of how the business allocates resources is not new. However, the best corporate boards are asking management how they are deploying their resources in light of material business risks and goals for business growth.

- **Assessing Material Business Risk through the Lens of Sustainability** – By adopting a broader definition of sustainability, a wider-array of converging risks and opportunities can be accounted for by corporate boards, management, and risk managers. As a result, corporate boards can more effectively understand and assess risk, and work with management to enhance business and shareholder value. By capitalizing on the inherent opportunity presented within a more integrated assessment of true economic, environmental, and social developments, sustainability provides another lens by which corporate boards and management can view the world, emerging markets, and existing businesses; a lens that allows one to assess change as it occurs, and the trade-offs and benefits of different choices.

What a context on sustainability and risk can mean to those in the boardroom…

Sustainability Can Be a Strategic Risk Management Approach

The best companies are evolving their corporate boards and governance structures to be more attuned to risk, better balanced in critical expertise and in the diversity of its composition, and more agile in structure. Those which embrace pragmatic and integrated risk management approaches and adopt a more holistic and "systems-oriented" framework of assessing business critical factors are ultimately better positioned to evaluate material risks and opportunities.

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ABOUT THE AUTHORS

Convergence Mitigation Management (CMM) is a high-value business intelligence, strategy, and management consultancy providing custom advisory services to business, government, applied research, and non-governmental organizations. Learn more at www.cmm-insights.com.

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Mark Coleman is the President of Convergence, Mitigation, Management (CMM) LLC, which provides custom business intelligence and advisory services for business, government, applied research, not-for-profit, and non-governmental organizations. Mr. Coleman has advised hundreds of organizations in the areas of sustainability, risk, innovation, operational effectiveness, and business strategy. Mark is a recognized voice, business advisor and consultant on the convergence of sustainability, environmental stewardship, energy, technology, and innovation. As the author of recent book release, *Time to Trust: Mobilizing Humanity for a Sustainable Future* and previous book - *The Sustainability Generation: The Politics of Change and Why Personal Accountability is Essential NOW!* , Mark is advising businesses and inspiring audiences with his expertise, wit and wisdom. Mr. Coleman holds a Master of Science in Environmental Management and Policy from Rensselaer Polytechnic Institute and two Bachelor of Arts in Environmental Studies and Geography from Binghamton University. Mr. Coleman resides in the Finger Lakes region of New York with his wife Aileen and two sons, Owen and Neal.

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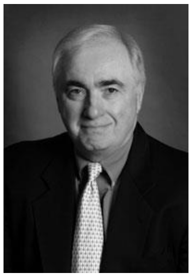
Dennis R. Minano is a former senior automotive executive and current consultant in environmental, energy, governance, and transportation infrastructure strategies. He serves as a board member, trustee, executive leader and senior advisor to companies, non-profit organizations, economic development organizations and health care institutions. This follows a career at General Motors, where he served as Vice president of Public Policy, Chief Environmental Officer and Vice President of Communications. At GM, he implemented cutting edge environmental and energy policies for its products and plants. He was responsible for GM's Public Policy Center, a consolidation of Environmental and Energy, Government Relations, Diversity, Corporate affairs, and the office of the Chief Economist. Earlier in his career, in GM's Office of the General Counsel, he managed high-risk legal matters that impacted product decisions. Mr. Minano holds a Juris Doctor degree and is a member of various Federal courts, including the U.S. Supreme Court, and was an adjunct Professor of Environmental Law at the University of Detroit Law School.



NOTES

[i] Source: The Conference Board, http://www.conference-board.org/retrievefile.cfm?filename=TCB_DNV6N16_Soc_Environ_Issue1.pdf&type=subsite

[ii] Source: EY, http://www.ey.com/Publication/vwLUAssets/ey-proxy-season-review/$FILE/ey-proxy-season-review.pdf and Source, EY, April 2014. Issue 2. *"Let's Talk Sustainability: A new point of view for business leaders."* http://www.ey.com/Publication/vwLUAssets/EY-Lets-talk-sustainability2/$FILE/EY-Lets-talk-sustainability2.pdf

[iii] Source: Barr, Caelainn. December 9, 2014. Wall Street Journal. *"Organic-Farming Boom Stretches Certification System: USDA Farms Out Inspections, but Thoroughness Is Questioned."* http://www.wsj.com/articles/organic-farming-boom-stretches-certification-system-1418147586

[iv] Source: FARE, http://www.foodallergy.org/facts-and-stats.

[v] Source: Gupta R, et al. *The high economic burden of childhood food allergy in the United States.* Ann Allergy Asthma Immunol, 2012; 109: A1-A162. Summarized by FARE, http://www.foodallergy.org/document.doc?id=194