



ISSUE 128

# BOARD PERSPECTIVES: Risk Oversight

## WHAT DIRECTORS SHOULD BE ASKING RIGHT NOW

As companies emerge from lockdowns marked by unprecedented change and begin to look forward, boards should continue to ask the right questions.

As countries across the globe emerge from lockdown, discussions tailored to the evolving marketplace and issues around employee health and safety are needed in the boardroom. While the specifics will vary depending on the circumstances, we pose 10 questions meriting consideration for most industries during the COVID-19 recovery.

**1. What does our business look like going forward and what is our strategy for aligning with market realities?**

Companies will have to adjust to the pandemic's impact on the market's demand for their core products and services. Organizations that can digitize their offerings will have to commit themselves totally to compete with digital leaders.

Businesses dependent on herding, gathering and concentration of people, however, need to revisit their strategies. Looking forward, companies must consider the varied reopening policies in different parts of the countries in which they operate and potential prescriptive and restrictive regulations that could consequently be implemented.

Given that resiliency will likely prove to be indispensable during the recovery, it may help to break down planning periods into smaller increments so that management can evaluate the market as it evolves, recalibrate operations and pivot accordingly. Most companies should also assess whether their liquidity and capital structure need strengthening given the uncertainty around the potential alternative scenarios they face.

For industries requiring physical interactions with the customer, every aspect of these interactions should be considered from the perspective of the customer's safety. This requires a different kind of segmentation — customers who are indifferent to the virus, customers who are wary of it but will engage physically under social distancing protocols, customers who are very reluctant to engage physically but may do so if reassuring measures are taken and communicated, customers who will not engage physically under any circumstances until traction is gained in the populace with a vaccine, and customers who have become comfortable doing business remotely and intend to continue doing so. Tactics to address each segment should be on the table, including such things (ranging from straightforward to demanding) as rigorous social distancing, sanitizing protocols, online shopping channels, contactless fulfillment processes, deep cleaning in common areas, health screenings and facilities redesign (including air circulation). The reputation and brand image implications of emphasizing safety in the aftermath cannot be overstated.

## **2. What are we doing to create an environment in which as many of our employees as possible can work safely?**

This question frames a duality with the previous one, especially in areas designated as so-called “hot spots.” The segmentation articulated above for customers applies to employees as well. Management has a choice: Do we treat everyone differently or the same? In the market, companies are taking different approaches based on the efficacy of the technologies and tools to facilitate remote work and the nature of the business. Some are implementing remote work options permanently, reducing their need for office space. Others are not planning to reopen physical locations until 2021. Still others are giving employees the choice to work remotely. And those that reopen are doing everything they can to preserve the health, safety and well-being of their people. We may even see a shift in some companies from “permission to work remotely” to “permission to work in the office.”

With respect to manufacturing and other operations requiring manual labor, what proportion of our workforce can return safely? What level of production activity (and volume) is realistic, given our safety protocols? What steps can we take to increase production levels? What are the maximum levels of production we can achieve and do these levels align with the opportunities we see in the market? From the standpoint of maximizing production, it may be necessary to keep certain people out of the office or plant environment to enable those who need to be physically present to work productively.

The challenge entails much more than social distancing, washing hands and wearing masks. Consideration should be given to office or plant design; ventilation systems; health implications of reopening shut-down buildings; meeting protocols; how people who work remotely remain engaged; and managing the safety of common areas such as employee cafeterias, restrooms and elevators. In addition, a safe office or plant environment may not be enough; in cities dependent on highly concentrated transportation systems, employees must be able to get to and from work safely.

Management should approach decisions to reopen with a “zero defects” mentality and empower employees to speak freely so that careless mistakes are avoided. Throughout the reopening, management should reassure employees that their health, safety and well-being are the organization's top priority.

## **3. Have we analyzed the customer experience to ascertain whether we should evolve our product/services portfolio to sustain and increase top-line revenues?**

The most successful companies focus on transforming and pivoting the business as the market evolves to sustain their relevance to customers, even if it means doing something very different from what they have done traditionally. This is a vital, differentiating skill for competing in a market characterized by rapidly changing customer habits

and ever-shifting consumer preferences. Does management have a clear view of the future as to how the company will optimize the customer experience? Is the organization committed to management's vision and does it have the right people and skills to make that vision a reality? For example, are employees being challenged to innovate and are they competent to deliver on that challenge? This focus reaches beyond the digital world to the physical, as it includes speed to deliver and the safety aspects of the purchasing and delivery experience. Winners and losers will likely be delineated by how much they know about their customers and the agility with which they align themselves with changing expectations.

#### **4. How do we alter our supply chain to minimize disruptions experienced during the pandemic and to ensure reliability?**

This is a common topic in many boardrooms, as the pandemic has clearly exposed supply chain disruption risk such that failure to address it opens directors and executives alike to harsh criticism. Companies should give more weight to disruption risk considerations as they evaluate the elements of quality, cost and time performance. As they do so, they may have to face changing customer preferences and new regulations necessitating domestic or regional suppliers.

#### **5. Is our directors and officers (D&O) insurance coverage sufficient given current and future COVID-19-related risks?**

As companies and their boards work with medical, building management and other experts to initiate reopening, there is no assurance that there will not be infections. In spite of all the research being funded, the most remarkable thing about COVID-19 is how little we know about it. In addition, how effectively can the company enforce the guidelines and protocols its policies set down? Some employees may think that management's policies for creating a safe work environment are an overreaction and choose to ignore them. Enforcement in these instances will prove difficult and needs careful consideration.

No matter how extensive management's due diligence, savvy directors realize that reopening brings a risk of employees or customers getting infected, creating an environment ripe for class-action lawsuits. Advice from counsel may be useful to ensure the board is fulfilling its oversight responsibilities in this unique environment. Some insurers may have included effective exclusionary language in existing D&O coverage or may include such language when policies renew, requiring consideration of alternative coverage options (e.g., a captive).

#### **6. During the lockdown, what have we learned about our organization and from digital leaders who were more successful in navigating the pandemic? Going forward, which learnings should we inculcate?**

It is amazing how so many organizations have persevered during the crisis through a more innovative, empowering and "get it done" culture. New innovations, revenue sources and technologies as well as flatter organizational structures have led to increased connectivity with customers, employees, suppliers and ecosystem partners that may not have existed pre-pandemic. So, what have we learned, and what takeaways should be incorporated into our company culture and business model going forward? Are we embracing change? Are we taking appropriate risks to spur disruptive innovation? Are we thinking and acting digitally at the core? Do the reductions realized in selling, general and administrative expenses during the lockdown warrant a perpetual "haircut" through reduced travel, increased demand for virtual conferences, and revisiting present expansion plans and lease arrangements?

Another aspect of learning extends to digital leaders who have prospered during the pandemic relative to digital followers and beginners. The pandemic illustrates the importance of going head-to-head with digitally advanced competitors who manage costs through highly automated and easily scalable processes in

response to the market. Their hyperscalable business models accommodate rapid growth with a lower fixed-cost base and reduced dependency on people. With a business built to be run from anywhere, their technology enables a remote workplace and the ability to reach more customers by design in a lockdown or when social distancing. So, what parts of our business are or should be hyperscalable, and what parts require a thoughtful revisit in terms of opening digital channels, repositioning within the end consumer's value chain, evolving product and service delivery in a contactless world, improving customer engagement, reskilling and upskilling employees, and de-risking the supply chain?

#### **7. How are evolving market expectations affecting our environmental, social and governance (ESG) strategy?**

Directors are well aware of the shots across the bow by institutional investors and asset managers regarding the importance of ESG matters in addition to acceptable financial performance. As ESG funds have thus far outperformed non-ESG funds during the pandemic,<sup>1</sup> boards can expect continued stakeholder focus on relevant ESG metrics. Interestingly, many investor calls are covering the social aspects of ESG with specific emphasis on how companies are supporting their stakeholders now and in the reopening.

#### **8. How confident are we that our internal control over financial reporting remains effective amid the changes occurring in our business?**

History indicates that severe economic downturns breed financial reporting misstatements. Layoffs, furloughs, process changes, transitioning to a remote workplace, transitioning back to the

office and initiatives to focus on the customer can create, individually or collectively, opportunities for internal control deficiencies and fraud. Given the unusual issues around asset impairments, government funding, going concern and new risk factors, audit committees should exercise increased vigilance in this environment. Financial reporting soft spots involving asset valuations, estimating reserves and loss contingencies, as well as critical audit matters raised by the external auditor, warrant attention.

#### **9. Have we strengthened our cybersecurity practices to address new threats arising from technologies we've leveraged to transition our workplace and business model?**

Security and privacy questions remain as relevant to emerging from lockdown as they did in transitioning to a remote workplace. For most, at least in the near term, the work environment will remain distributed and business models will place more emphasis on reimaged processes, automation and hyperscalability. The conversation should encompass the technical and human perimeters, as bad actors target both.

#### **10. How prepared are we for a resurgence of COVID-19 infections, including a return to lockdown in specific markets?**

Unfortunately, flare-ups and possibly even another outbreak of the virus can and likely will happen in some areas. What lessons did we learn from being unprepared for the first outbreak? Have we conducted a postmortem? Have we revisited all tiers of the supply chain? Do we have all of the tools we need to function remotely without missing a beat? Has our contingency plan been updated?

<sup>1</sup> "Have ESG funds outperformed non-ESG funds during the crisis?", Dr. Nisha Long, Citywire Selector, April 6, 2020, available at <https://citywireselector.com/news/have-esg-funds-outperformed-non-esg-funds-during-the-crisis/a1343642>.

## Questions for Boards

While many of the above questions apply across industries, more specific questions may be relevant to directors in different sectors. Accordingly, we have prepared illustrative industry-specific questions for boards to consider in the following industry groups:

- Consumer Products/Retail
- Hospitality
- Airlines
- Energy and Utilities
- Financial Services
- Healthcare
- Manufacturing and Distribution
- Technology, Media and Telecommunications

## How Protiviti Can Help

As the COVID-19 pandemic continues to disrupt business activity across the globe, organizations are reconfiguring the workplace and adopting new business practices to align with social distancing, stay-in-place directives and other public health protocols as well as changing market realities. As they do so, they are confronting questions related to their resiliency in sustaining customer engagement, shifting to a distributed workplace, adopting appropriate security measures around the enabling technologies they deploy, and implementing ongoing changes in business models and processes.

Protiviti has the experience, know-how and expertise to help companies navigate these

challenges. We can provide companies with access to industry, digital and innovation talent who can bring disruptive thinking to the table in helping them rethink their business, not just in the short term, but also in the medium to longer term. Companies can benefit from working with our professionals who share their values, have knowledge and understanding of the technologies they deploy, and are able to draw on a risk perspective. Our people are fully operational while our firm functions remotely as one office during this crisis and reopens in the aftermath of the crisis in accordance with public health protocols. So, we're with our clients all the way — now, in the next phase and when there is eventual equilibrium in the market.

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Protiviti partners with the National Association of Corporate Directors (NACD) to publish articles of interest to boardroom executives related to effective or emerging practices on the many aspects of risk oversight. As of January 2013, NACD has been publishing online contributed articles from Protiviti, with the content featured on <https://blog.nacdonline.org/authors/42/>. Twice per year, the six most recent issues of *Board Perspectives: Risk Oversight* are consolidated into a printed booklet that is co-branded with NACD. Protiviti also posts these articles at [protiviti.com](http://protiviti.com).