

## Adapting your board to the digital age

Many directors are feeling outmatched by the ferocity of changing technology, emerging risks, and new competitors. Here are four ways to get boards in the game.

*by Hugo Sarrazin and Paul Willmott*

“**Software is eating the world,**” veteran digital entrepreneur Marc Andreessen quipped a few years back. Today’s boards are getting the message. They have seen how leading digital players are threatening incumbents, and among the directors we work with, roughly one in three say that their business model will be disrupted in the next five years.

In a 2015 McKinsey survey, though, only 17 percent of directors said their boards were sponsoring digital initiatives, and in earlier McKinsey research, just 16 percent said they fully understood how the industry dynamics of their companies were changing.<sup>1</sup> In our experience, common responses from boards to the shifting environment include hiring a digital director or chief digital officer, making pilgrimages to Silicon Valley, and launching subcommittees on digital.

Valuable as such moves can be, they often are insufficient to bridge the literacy gap facing boards—which has real consequences. There’s a new class of problems, where seasoned directors’ experiences managing and mone-

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<sup>1</sup> See “Cracking the digital code: McKinsey Global Survey results,” September 2015, McKinsey.com; and “Improving board governance: McKinsey Global Survey results,” August, 2013, McKinsey.com.

tizing traditional assets just doesn't translate. It is a daunting task to keep up with the growth of new competitors (who are as likely to come from adjacent sectors as they are from one's own industry), rapid-fire funding cycles in Silicon Valley and other technology hotbeds, the fluidity of technology, the digital experiences customers demand, and the rise of nontraditional risks. Many boards are left feeling outmatched and overwhelmed.

To serve as effective thought partners, boards must move beyond an arms-length relationship with digital issues (exhibit). Board members need better knowledge about the technology environment, its potential impact on different parts of the company and its value chain, and thus about how digital can undermine existing strategies and stimulate the need for new ones. They also need faster, more effective ways to engage the organization and operate as a governing body and, critically, new means of attracting digital talent. Indeed, some CEOs and board members we know argue that the far-reaching nature of today's digital disruptions—which can necessitate long-term business-model changes with large, short-term costs—means boards must view themselves as the ultimate catalysts for digital transformation efforts. Otherwise, CEOs may be tempted to pass on to their successors the tackling of digital challenges.

At the very least, top-management teams need their boards to serve as strong digital sparring partners when they consider difficult questions such as investments in experimental initiatives that could reshape markets, or even whether the company is in the right business for the digital age. Here are four guiding principles for boosting the odds that boards will provide the digital engagement companies so badly need.

## **CLOSE THE INSIGHTS GAP**

Few boards have enough combined digital expertise to have meaningful digital conversations with senior management. Only 116 directors on the boards of the Global 300 are “digital directors.”<sup>2</sup> The solution isn't simply to recruit one or two directors from an influential technology company. For one thing, there aren't enough of them to go around. More to the point, digital is so far-reaching—think e-commerce, mobile, security, the Internet of Things (IoT), and big data—that the knowledge and experience needed goes beyond one or two tech-savvy people.

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<sup>2</sup> See Rhys Grossman, Tuck Rickards, and Nora Viskin, *2014 Digital board director study*, January 2015, russellreynolds.com. Digital directors were defined as nonexecutive board members who play a significant operating role within a digital company, play a primarily digital operating role within a traditional company, or have two or more nonexecutive board roles at digital companies.

To stay relevant, boards must raise their

# Digital Quotient

## Close the insights gap

Boards need the technological chops to recognize breakthrough digital initiatives as well as any hidden security or data risks.

## Understand how digital can upend business models

Directors should focus more on digital fundamentals such as data assets or customer-experience quality.

## Engage more frequently and deeply on strategy and risk

Today's strategic discussions need to match the speed of disruption and respond to real-time market signals about digital shifts.

## Fine-tune the onboarding and fit of digital directors

New digital directors must be able to influence change within the culture of the board and to play well with others.



To address these challenges, the nominating committee of one board created a matrix of the customer, market, and digital skills it felt it required to guide its key businesses over the next five to ten years. Doing so prompted the committee to look beyond well-fished pools of talent like Internet pure plays and known digital leaders and instead to consider adjacent sectors and businesses that had undergone significant digital transformation. The identification of strong new board members was one result. What's more, the process of reflecting quite specifically on the digital skills that were most relevant to individual business lines helped the board engage at a deeper level, raising its collective understanding of technology and generating more productive conversations with management.

Special subcommittees and advisory councils can also narrow the insights gap. Today, only about 5 percent of corporate boards in North America have technology committees.<sup>3</sup> While that number is likely to grow considerably, tomorrow's committees may well look different from today's. For example, some boards have begun convening several subject-specific advisory councils on technology topics. At one consumer-products company, the board created what it called an advisory "ecosystem"—with councils focused on technology, finance, and customer categories—that has provided powerful, contextual learning for members. After brainstorming how IoT-connected systems could reshape the consumer experience, for example, the technology council landed on a radical notion: What would happen if the company organized the business around spaces such as the home, the car, and the office rather than product lines? While the board had no set plans to impose the structure on management, simply exploring the possibilities with board members opened up fresh avenues of discussion with the executive team on new business partners, as well as new apps and operating systems.

## **UNDERSTAND HOW DIGITAL CAN UPEND BUSINESS MODELS**

Many boards are ill equipped to fully understand the sources of upheaval pressuring their business models. Consider, for example, the design of satisfying, human-centered experiences: it's fundamental to digital competition. Yet few board members spend enough time exploring how their companies are reshaping and monitoring those experiences, or reviewing management plans to improve them.

One way to find out is by kicking the tires. At one global consumer company, for instance, some board members put beta versions of new digital products

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<sup>3</sup> See Kim S. Nash, "Morgan Stanley board pushes emerging area of tech governance," *Wall Street Journal*, March 26, 2015, [wsj.com](http://wsj.com).

and apps through the paces to gauge whether their features are compelling and the interface is smooth. Those board members gain hands-on insights and management gets well-informed feedback.

Board members also should push executives to explore and describe the organization's stock of digital assets—data that are accumulating across businesses, the level of data-analytics prowess, and how managers are using both to glean insights. Most companies underappreciate the potential of pattern analysis, machine learning, and sophisticated analytics that can churn through terabytes of text, sound, images, and other data to produce well-targeted insights on everything from disease diagnoses to how prolonged drought conditions might affect an investment portfolio. Companies that best capture, process, and apply those insights stand to gain an edge.<sup>4</sup>

Digitization, meanwhile, is changing business models by removing cost and waste and by stepping up the organization's pace. Cheap, scalable automation and new, lightweight IT architectures provide digital attackers the means to strip overhead expenses and operate at a fraction of incumbents' costs. Boards must challenge executives to respond since traditional players' high costs and low levels of agility encourage players from adjacent sectors to set up online marketplaces, disrupt established distributor networks, and sell directly to their customers.

The board of one electronic-parts manufacturer, for example, realized it was at risk of losing a significant share of the company's customer base to a fast-growing, online industrial distributor unless it moved quickly to beef up its own direct e-commerce sales capabilities. The competitor was offering similar parts at lower prices, as well as offering more customer-friendly features such as instant online quotes and automated purchasing and inventory-management systems. That prompted the board to push the CEO, chief information officer, and others for metrics and reports that went beyond traditional peer comparisons. By looking closely at the cycle times and operating margins of digital leaders, boards can determine whether executives are aiming high enough and, if not, they can push back—for example, by not accepting run-of-the-mill cost cuts of 10 percent when their companies could capture new value of 50 percent or even more by meeting attackers head-on.

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<sup>4</sup> Our colleagues have described how boards also need to develop a shared language for evaluating IT performance. See Aditya Pande and Christoph Schrey, "Five questions boards should ask about IT in a digital world," *McKinsey Quarterly*, July 2016, McKinsey.com.

## **ENGAGE MORE FREQUENTLY AND DEEPLY ON STRATEGY AND RISK**

Today's strategic discussions with executives require a different rhythm, one that matches the quickening pace of disruption. A major cyberattack can erase a third of a company's share value in a day, and a digital foe can pull the rug out from a thriving product category in six months. In this environment, meeting once or twice a year to review strategy no longer works. Regular check-ins are necessary to help senior company leaders negotiate the tension between short-term pressures from the financial markets and the longer-term imperative to launch sometimes costly digital initiatives.

One company fashioned what the board called a "tight-loose" structure, blending its normal sequence of formal meetings and management reporting with new, informal methods. Some directors now work in a tag team with a particular function and business leader, with whom they have a natural affinity in business background and interests. These relationships have helped directors to better understand events at ground level and to see how the culture and operating style is evolving with the company's digital strategy. Over time, such understanding has also generated greater board-level visibility into areas where digitization could yield new strategic value, while putting the board on more solid footing in communicating new direction and initiatives to shareholders and analysts.

Boardroom dialogue shifts considerably when corporate boards start asking management questions such as, "What are the handful of signals that tell you that an innovation is catching on with customers? And how will you ramp up customer adoption and decrease the cost of customer acquisition when that happens?" By encouraging such discussions, boards clarify their expectations about what kind of cultural change is required and reduce the hand-wringing that often stalls digital transformation in established businesses. Such dialogue also can instill a sense of urgency as managers seek to answer tough questions through rapid idea iteration and input gathering from customers, which board members with diverse experiences can help interpret. At a consumer-products company, one director engages with sales and marketing executives monthly to check their progress against detailed key performance indicators (KPIs) that measure how fast a key customer's segments are shifting to the company's digital channels.

Risk discussions need rethinking, too. Disturbingly, in an era of continual cyberthreats, only about one in five directors in our experience feels confident that the necessary controls, metrics, and reporting are in place to address hacker incursions. One board subcommittee conducted an intensive daylong session with the company's IT leadership to define an acceptable risk

appetite for the organization. Using survey data, it discovered that anything beyond two minutes of customer downtime each month would significantly erode customer confidence. The board charged IT with developing better resilience and response strategies to stay within the threshold.

Robust tech tools, meanwhile, can help some directors get a better read on how to confront mounting marketplace risks arising from digital players. At one global bank, the board uses a digital dashboard that provides ready access to ten key operational KPIs, showing, for example, the percentage of the bank's daily service transactions that are performed without human interaction. The dashboard provides important markers (beyond standard financial metrics) for directors to measure progress toward the digitized delivery of banking services often provided by emerging competitors.

### **FINE-TUNE THE ONBOARDING AND FIT OF DIGITAL DIRECTORS**

In their push to enrich their ranks with tech talent, boards inevitably find that many digital directors are younger, have grown up in quite different organizational cultures, and may not have had much or even any board experience prior to their appointment. To ensure a good fit, searches must go beyond background and skills to encompass candidates' temperament and ability to commit time. The latter is critical when board members are increasingly devoting two to three days a month of work, plus extra hours for conference calls, retreats, and other check-ins.


We have seen instances where companies choose as a board member a successful CEO from a digitally native company who thrives on chaos and plays the role of provocateur. However, in a board meeting with ten other senior leaders, a strong suit in edginess rarely pays off. New digital directors have to be able to influence change within the culture of the board and play well with others. There are alternatives, though. If a promising candidate can't commit to a directorship or doesn't meet all the board's requirements, an advisory role can still provide the board with valuable access to specialized expertise.

Induction and onboarding processes need to bridge the digital-traditional gap, as well. One board was thrilled to lock in the appointment of a rising tech star who held senior-leadership positions at a number of prominent digital companies. The board created a special onboarding program for her that was slightly longer than the typical onboarding process and delved into some topics in greater depth, such as the legal and fiduciary requirements that come with serving on a public board. Now that the induction period is over, she and the board chairman still meet monthly so she can share her

perspectives and knowledge as a voice of the customer, and he can offer his institutional insights. The welcoming, collaborative approach has made it possible for the new director to be an effective board participant from the start.

Organizations also need to think ahead about how the digital competencies of new and existing directors will fit emerging strategies. One company determined that amassing substantial big data assets would be critical to its strategy and acquired a Silicon Valley big data business. The company's directors now attend sessions with the acquired company's management team, allowing them to get a grounding in big data and analytics. These insights have proven valuable in board discussions on digital investments and acquisition targets.

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Board members need to increase their digital quotient if they hope to govern in a way that gets executives thinking beyond today's boundaries. Following the approaches we have outlined will no doubt put some new burdens on already stretched directors. However, the speed of digital progress confronting companies shows no sign of slowing, and the best boards will learn to engage executives more frequently, knowledgeably, and persuasively on the issues that matter most. 

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