

# Shaping the Future Board of Directors and Seizing New Opportunities for Development

*Deloitte*

## **Introduction**

The report of the 20th CPC National Congress proposed that China should build a high-level socialist market economy, improve the modern enterprise system with Chinese characteristics, promote entrepreneurship and accelerate the construction of world-class enterprises, so as to promote high-quality economic and social development. Under the guidance of these new goals, it has become an important task for Chinese enterprises to find ways to shape the future board of directors through corporate governance and grasp new development opportunities. The chair of the board of directors of a Chinese enterprise should have a deep understanding of the international status quo of corporate governance, learn from the insights of the chairs of overseas boards of directors and understand the future role of a chairperson of a board of directors more deeply under the unprecedented changes throughout the last century in order to better their execution of this central role in corporate governance, pave the way forward and improve governance efficiency for the company.

Under the modern enterprise system, the board of directors is the center of corporate governance and the chair of the board of directors is the leader of this board. The chair of the board plays a key role in the corporate governance system and has a significant impact on the effective operation of the board of directors. In recent years, tremendous social change, including unpredictable events such as COVID-19 and geopolitical turmoil, as well as challenges such as digital transformation, climate change, regulatory pressure and investor engagement, are redefining the role of the chair of the board.

In order to understand the change of the governance role of the chair of the board and the expectations of stakeholders for the future chair of the board, Deloitte's Global Boardroom Program conducted research on the theme "The Chair of the Future". The research posed a number of questions, including: what will the chair of the future look like? What skills, capabilities, and experiences will be required to be a successful chair? And how should chairs oversee management as their organizations face these manifold challenges? This research focused on 16 countries, namely: Australia, Belgium, Canada, China, Kenya, Uganda, Germany, India, Ireland, Italy, Japan, New Zealand, the Netherlands, South Africa, the United Kingdom and the United States. More than 300 chairs of boards from large listed companies and private enterprises (including some family enterprises) across the globe shared their understanding and insight on relevant topics.

The program's annual report *Five Changing Forces of Defining the Role of the Chair of the Modern Board of Directors* presented relevant results from the research. It defines five fundamental forces reshaping the future role of the chair of the board, specifically, organizational governance that asks the chair to play a greater role; a larger society that

place higher expectations on enterprises, a changing climate that forces enterprises to take action, external crises that encourage boards to operate differently; and increased need for the board to operate with digital efficiency and agility. The research report points out that under the influence of these five forces, the governance role of the chair is expanding to meet expectations of stakeholders, and for the chair to play a more active role in the forefront of corporate governance.

## **I. Understanding the Corporate Governance Role of the Chair of the Board of Directors**

As the center of corporate governance, the core role of the board of directors in corporate governance is oversight of strategic decision-making, in other words, to oversee the company's development goals and business strategies and to ensure the execution of business strategies and the realization of development goals through the implementation of incentives and supervision to senior management. As the leader of the board of directors, the chair plays a leading role in the effective operation of the board of directors, especially in the effectiveness of the strategic decision-making function of the board of directors.

On the one hand, as the "team leader" of the board of directors, the chair has the responsibility to ensure that "team members" with different identities, backgrounds and expertise can work together coherently, performing at their best, cooperating sincerely and contributing their own experience, wisdom and insight to the maximum extent in order to make the best collective decisions. On the other hand, the chair needs to master the superb art of balance and lead the board of directors to coordinate the interests of all parties. They do this via consensus and seeking balance between competing claims or potential conflicts, not only supporting enterprises to pursue economic interests, but also urging enterprises to fulfill their social responsibilities. Thus management receives support to pursue its full entrepreneurial and managerial abilities, as well as supervision to faithfully perform its duties and follow the appropriate code of conduct.

Deloitte's research reflects its respondents' new understanding of the role of the chair. Some interviewees define the role of the chair as "the Ultimate Chief Reputation Officer", indicating that the chair plays a key role in protecting and supervising the company's reputation, and the outstanding performance of the responsibility of "the Ultimate Chief Reputation Officer" is facing more and more serious challenges from both outside and inside the company. The interviewees also suggest up to three roles of the chair: supervisor, coordinator and decision-making consultant.

The report states that: "The current chair must sometimes maintain a delicate balance between competing choices. They should grasp the long-term strategic direction while not acting beyond their authority, effectively manage the board of directors while encouraging discussion and expressing different opinions, provide support for management whilst simultaneously daring to put forward different opinions on the decision-making assumptions of management, enhance the participation of stakeholders, yet not succumb to pressure from different parties."

Due to different laws and institutional systems related to corporate governance in different countries, the role of the chair has significant national differences. In Germany and in much of Continental Europe the board is organized into two-tiers, where the role of the chair in this report is generally undertaken by the chair of the Supervisory Board. In the UK, the United States, China and other unitary board countries, the role of the chair is quite different. For example, in the UK, the chair of the board of listed companies is almost always an independent non-executive director, and the roles of the chair and chief executive officer are strictly separated; in the United States, the positions of the chair and chief executive officer are often held by the same person – this is the case at nearly half of US listed companies. Since independent non-executive directors occupy the majority of the seats on the board of directors, the "chief independent director" is usually set up as the "leader" of independent directors; in China, the roles of the chair and the general manager are undertaken by different people, but the chair of most companies is the executive director, and the chair of state-owned enterprises in China also generally holds the position of secretary of the party committee.

## **II. Five Fundamental Changing Forces to Reshape the Role of the Chair**

Huge social changes are redefining the role of the chair, including unpredictable events such as COVID-19 and geopolitical turmoil, as well as difficult challenges such as digital transformation, climate change, regulatory pressure and investor engagement. Deloitte's research reveals five fundamental changing forces to reshape the role of the chair in a new era that is full of challenges and opportunities.

### **1. Organizational Governance Requires the Chair to Play a Greater Role**

Organizational governance requires the chair to change the depth and breadth of participation in governance, which increases the responsibilities of the chair. As one interviewee commented: "The chair of the board of directors is no longer a nominal leader far away. You need to know your company. You can't play any role if you only know how to hold the board of directors". The chair plays a greater role in corporate governance, and mainly needs to fulfill the following:

- ◆ Firstly, the chair should not only establish and maintain a highly trusted relationship with the chief executive officer based on frank, reliable and regular communication, but also be ready to question the ideas and assumptions of the chief executive officer and senior management at any time, rather than agree unconditionally. To this end, the chair needs to have a deep understanding of the enterprise and be willing to invest a lot of time and experience in the enterprise.
- ◆ Secondly, the chair should encourage and urge the management to accelerate the promotion of key strategic initiatives, especially in the areas of digital transformation and the future of work. At the same time, as part of the promotion of strategic measures, the chair should encourage the board of directors to provide strong oversight of risk and to pay more attention to network security and supply chain risks.

- ◆ Finally, the chair should play the role of enterprise caretaker and be committed to helping enterprises select personnel and cultivate company culture. The duties of the chair include providing oversight of corporate culture and, as part of this, assessing whether the corporate culture can support organizational strategy and promotion of responsible and ethical behavior. One way that the chair can influence the corporate culture is by providing oversight of personnel selection. In addition to leading succession planning for the CEO, the board of directors should also help management cultivate other senior managers besides the CEO.

## **2. Society Places Higher Expectations on Enterprises**

The changing relationship between enterprises and society is another key force that affects the role of the chair. The chairs interviewed recognize that they play a key role in promoting the formation of a good relationship between enterprises and society, encouraging positive change through consideration of the environment, society and governance (ESG), and promoting the participation of stakeholders. Deloitte believes this will become a more significant responsibility in the next few years.

- ◆ Firstly, in the context of rapid transformation from traditional shareholder-centered capitalism to a capitalism that creates value for all stakeholders, it will likely become necessary for the chair and the board to consider their stakeholders as a whole, including clients, employees, suppliers, investors, regulators and policy makers. As one respondent said, "strategy must be a dialogue with stakeholders, not just shareholders". Only by promoting the participation of stakeholders in corporate governance can we ensure the continued legitimacy of the enterprise – the so-called 'societal license to operate.'
- ◆ Secondly, chairs must focus on the integration of ESG into business strategy and promotion of an ESG performance framework. The chairs interviewed say that ESG is no longer separate from the company's business strategy. Commitments that only exist on paper and never come to practical fruition will always reflect poorly on the company's reputation. As one respondent said, "one can affect the whole value chain by integrating ESG into business strategy, and ensuring it becomes a part of our corporate DNA". At the same time, chairs should urge enterprises to redouble their efforts to develop a comprehensive performance measurement and incentive framework, so as to encourage management to better balance the relationship between profitability and sustainable development.
- ◆ Thirdly, chairs should encourage young managers and employees to participate in corporate governance. Some boards of directors are building "advisory boards" or "next generation boards", which are composed of younger managers and employees, or board committee members, and providing "walk-in clinics" for employees to share their concerns and encourage them to play an active role in the process of corporate governance.

## **3. Climate Change Forces Enterprises to Take Action**

In light of the operational, regulatory and reputational challenges and risks caused by climate change, more and more chairs put climate change at the top of the boardroom agenda. As one respondent said, "the board of directors has led on climate, including assessing the risks and opportunities brought by climate change, formulating short-term and long-term policies and setting specific goals". Deloitte believes that the chairs can play a greater role in promoting climate change in a number of ways”:

- ◆ Firstly, by helping the management of enterprises to realize that climate change presents not only risk, but also opportunity. As one respondent said, "If the government introduces a carbon pricing mechanism with a reasonable structure and sends a clear signal to the market, it may trigger a wave of innovation. The huge economic incentive will drive enterprises to go to the market and develop new technologies to reduce greenhouse gas emissions".
- ◆ Secondly, by encouraging management to strengthen communication with investors on climate change issues. An interviewee said, "On the one hand, investors told us that they expected to see us to take bold action when dealing with climate change, on the other hand, this would cause an instinctive reaction: solving the problem of climate change involves capital expenditure, which will lead to the decline of stock prices". To this end, the chair should emphasize the importance of communicating the company's current strategic actions on climate to shareholders, including communicating with major shareholders through both the annual shareholder meeting and a regular cadence of individual meetings with shareholders.
- ◆ Thirdly, by the introduction of a climate expert or the establishment of a specialized board committee. On this issue, there are certain differences in the views of the interviewees. Some respondents say that inviting climate experts to join the board of directors would help improve the board's understanding of climate issues. On the other hand, other respondents believe that it is sufficient to carry out climate change related training for the board of directors. Some respondents suggest that the board of directors should establish an ESG special committee of the board, but other respondents suggest that the board of directors should jointly discuss climate issues.

#### **4. Crisis Leadership has Become the Norm**

The series of crises witnessed in recent years has highlighted the need for greater corporate resilience and faster decision-making, as well as a stronger ability to communicate to stakeholders. Challenges may arise at any time, resulting in the board of directors having little time to digest fully and understand each issue before taking action, and sometimes being forced to make decisions based on their own beliefs and with insufficient information. For many companies, crisis management is not a temporary matter, but a continuous state of operation. In this case, the crisis leadership capability of the chair is of great value for enterprises to cope with uncertainty and provide guidance for the board of directors. At the same time, the chair is also responsible for helping management improve its crisis response.

- ◆ Firstly, delegating decision-making power. Crisis management requires the chair and the senior leadership to be more hands-on, but it is also necessary to allow local

decision-making, which is particularly important for companies operating in multiple geographical regions. In order to improve the effectiveness of crisis management, it is sometimes necessary to give local management the power to deal with emergencies on its own. However, the chair and the Chief Executive Officer should carefully consider the manner and timing of delegating decision-making power, and strike an appropriate balance between central management and local flexibility.

- ◆ Secondly, improving empathy. No matter the industry or size of the enterprise, the pandemic has forced the chair to think more seriously about workplace safety, mental health and corporate culture. The experience of responding to the pandemic has made many chairs realize the importance of maintaining empathy towards employee health and well-being.
- ◆ Finally, enhancing resilience. A core role of the chair is to help the company prepare for emergencies and empower the company to persevere in times of difficulty. The chair should encourage management to carry out stress tests more regularly and consider more scenarios and response plans to assess and improve the company's cash flow, management capability, resilience and responsiveness to changing challenges of the enterprise.

## **5. The Operation of the Board of Directors Needs Digital Efficiency and Agility**

COVID-19 has changed many things about the way boards of directors operate, including where and when they meet. The pandemic made remote online meetings the new default. The adoption of online meeting tools has improved the flexibility of board meetings, which often makes meetings shorter, more frequent and more targeted. Of course, online meetings also have their limitations. For example, it is difficult to understand the atmosphere of the meeting and to capture nonverbal information. The chair must also make greater efforts to ensure that directors concentrate and remain focused.

With the easing of the pandemic, offline meetings have resumed, but online meetings continue to be used because of their practicality and flexibility. In the future, the board of directors will likely adopt a combination of online and offline meetings in order to achieve maximum efficiency. The chair can discuss the ongoing affairs of the Board of Directors through online meetings to monitor the progress of work, financial reports and risks. At the same time, in-person meetings can be dedicated to discussing issues related to the development or direction of the organization, such as strategy, climate change and technology, important personnel issues related to diversity, fairness, inclusiveness and executive compensation.

Other practices that can improve the efficiency and agility of the board of directors include: requiring board members read meeting materials in advance, and limiting the length of meeting materials to ensure that they convey key information concisely. At the same time, by properly setting up a certain number of special committees of the board of directors to solve specific technical or professional problems, it can also save the board of directors

from the trouble of dealing with details and improve the operational efficiency and agility of the board.

### **III. Eight Suggestions for the Future Chairs**

In this era of great change, it is not easy to become an effective chair of the board of directors. The chair needs to show unprecedented leadership. Through this research, Deloitte summarizes eight leading practices of being a good chair:

- 1) Establishing a relationship of trust. While maintaining independent thinking, one should build and maintain trust with the board of directors, management and all stakeholders, especially the CEO.
- 2) Prioritising long-term development. A chair should understand and focus on items that really matter, and never waste energy on trivial work.
- 3) Understanding the enterprise. The chair should understand the operation, talents, competitive advantages and disadvantages and culture of the enterprise.
- 4) Leading the construction of corporate goals and values. The chair must make difficult and sometimes unpopular decisions on the premise of safeguarding the reputation and long-term interests of the organization.
- 5) Becoming a learning leader. In the face of many unknowns, the chair should ask for help with an open mind, keep learning and take the lead in building a "learning board" – a board that is always learning new things.
- 6) Cultivating a wide range of skills. In addition to technical ability, emotional intelligence and the ability to inspire others to reach their maximum potential are equally important.
- 7) Advocating diversity. Diversity of background and skills among board members improves the quality of discussion and prevents herd thinking.
- 8) Being a good listener. To create value for the organization, a chair should listen to a variety of opinions, especially when everyone has different opinions, then discuss fully these various opinions before reaching a consensus.

### **Epilogue**

In the post-pandemic era, China's economy is recovering rapidly along the right path of "building a new development pattern and promoting high-quality development". Enterprises are the lifeblood of China's economy, and the board of directors of enterprises bears the historic responsibility of continuously promoting organizational culture and governance, improving resilience, spanning the economic operation cycle and achieving green and sustainable development. In the face of today's challenges and future opportunities, the chairs of Chinese enterprises should be highly sensitive to changes in the external environment, constantly strive to gather the consensus of the board of directors and lead the enterprise to respond proactively to changes within the management team. They should lead and guide the enterprise's reformation and transformation from multiple dimensions of strategy formulation and adjustment, technology empowerment, personnel training and succession, corporate governance, as well as internal collaboration of the board of directors. (The end)