

AN FTI CONSULTING WHITE PAPER IN PARTNERSHIP WITH CGLYTICS



Boards & Technology: A Gap in Expertise

Executive Summary

The Board of Directors, and a company's corporate governance framework, are under ever more scrutiny by investors. As outlined by Federated Hermes in their April 2020 paper on 'Guiding Principles for an Effective Board': *"Investors care deeply about how well a company Board is functioning"* adding that a well-functioning Board *"makes it more likely that material risks and opportunities will be well managed."*

The Board is charged with managing and overseeing the principal risks to a business – an issue which is clearly set out in Principle O of the 2018 UK Corporate Governance Code. However, beyond outlining that the Board should oversee and review the effectiveness of risk management systems, and facilitate an annual evaluation of the Board, there is limited guidance on the approach the Board should take.

The 2018 'Guidance on Board Effectiveness', also issued by the UK FRC, highlights that *"diversity of skills, background and personal strengths is an important driver of a Board's effectiveness, creating different perspectives among directors, and breaking down a tendency towards 'group think'"*. They add that *"non-executive directors should possess a range of critical skills of value to the Board and relevant to the challenges and opportunities facing the company."*

Company Boards will have spent much of 2020 focused on addressing the hugely challenging impact of COVID-19. While pandemic risk was unlikely to have been a feature of

many companies 'Principal Risks & Uncertainties', one that is listed, or very much should be, is cyber and technology risk. Technology is now a central part of many business models including those in major sectors such as banking, transport and retail. Most businesses hold some form of personal data and every business has hardware and software which ensures the business can function on a day-to-day basis.

Given the importance of technology to businesses today - and the fact that a technology failure or crisis can substantially impact business integrity and damage corporate reputation - it is surprising that it does not appear to be considered as a priority skillset for Board members.

As business models have evolved, Boards have not fully reflected that evolution in their skillsets. Principle K of the 2018 UK Code states that the Board and its committees should have a combination of skills, experience and knowledge. This research indicates that Boards – specifically those at FTSE350 and ISEQ20 companies – need to re-consider their composition and assess whether they have the combination of relevant skills for the true risks that face the business.

Adopting a more rigorous approach to assessing the Board's skills – through the creation of a Board skills matrix – is one means to ensure than any gaps in expertise, be it technology or otherwise, are more apparent and can be addressed through Board refreshment and renewal.

Table of Contents

Gaps in Board Expertise	2
Board Technology Expertise	5
Considerations	7
References	8

Gaps in Board Expertise

In August 2020, during the midst of the COVID-19 pandemic, our research team engaged with institutional investors on a range of issues including ESG considerations; and, to assess their perspectives on, and concerns about, the companies in which they invest. This followed similar research conducted in February 2020, just as the pandemic was flaring up in Asia-Pacific and shortly before its arrival in Europe.

In responding to a question as to the likely factors that could most harm the companies in which they are invested over the next year, the single greatest concern among the 267 institutional investors surveyed was 'cyber-attacks stealing or compromising company assets'. Not COVID-19, not climate change, not regulation or policy change; not a litany of other factors. The stand-out issue was cyber/technology threat.

This is not entirely surprising. We have, for some time, considered technology and cyber threat as perhaps the single greatest reputational risk facing companies today. It prompted us to consider the lack of focus on 'S' factors within ESG – data, cyber and technology risk are considered to be within the S – and we published a paper on that earlier this year.

This finding is consistent with feedback from recent research from the *Diligent Institute*, a sister organisation to *CGLytics*.

In a survey of over 400 Directors and corporate leaders in mid-2020, cyber risk was cited as the third most common issue that the Board had changed its guidance to management on during the course of 2020 (Employee Health & Welfare; and Crisis Preparedness being first and second respectively).



<https://fticonsultations.com/en/time-to-rethink-the-s-in-esg/>

Our crisis team also published the third paper in our '*Anatomy of a Crisis*' series this past summer, focused on the learnings from the high-profile cyber breaches of the past 10 years and what they can teach us about how to prepare for them in future. Apart from the various learnings about constantly reviewing and revising policies and practices – and consistently testing response protocols – the principle learning is: Data breaches and cyber-attacks will happen. The questions are: have you taken as many steps as possible to mitigate that risk; and; how prepared you are to respond? It is incumbent on Boards to ensure they have the requisite skills central to doing both. A November 2020 report issued by the Irish Computer Society, a representative body for the IT industry in Ireland, highlighted that of the 169 Directors surveyed, 21% said they are not discussing Cyber Resilience at all, 44% are not being brief on ongoing developments while 80% had not participated in any testing of cyber incident response plans in the last year.



<https://fticonsultations.com/en/the-anatomy-of-a-crisis-3-cyber-breaches/>



FTI Consulting's FORTIFY Crisis Preparedness & Simulation product offers companies a bespoke process to assess crisis preparedness across 18 distinct crisis situations including cybersecurity and data breaches.

<https://fticonsultations.com/en/fti-fortify-crisis-and-critical-event-preparedness>

A company's Board of Directors is charged with setting corporate strategy; overseeing its implementation; and, managing and addressing the principal risks to the business. If technology has become the greatest threat to business (or at least one of them), we need to ask the question as to how prepared Boards are to effectively manage that risk. More importantly, are they equipped to respond in the aftermath of a crisis?

This links to the broader question as to the assessment of the required skills and expertise at Board level. It is standard for companies to affirm financial expertise among Board members in addition to specific sector expertise. However, as businesses and business models evolve, so does the expertise required at Board level. UK companies are acutely aware of needing to point directly to the financial literacy of a Board member to assure stakeholders of the ability of the Board to oversee management; and, it may be the case that other areas follow suit.

In 2019, UK regulations were updated to include a requirement for UK and Irish companies to put in place more robust channels of engagement between the Board and a company's workforce. The COVID-19 crisis has simply magnified that expectation, creating an environment where there is heightened focus on how companies – and in turn their Boards – are managing the needs of their workforce. Human Resources (HR) is perhaps another skillset that needs to be more carefully considered at Board level. At a time when diversity is (and should be) on the corporate agenda, the debate on diversity at Board level needs to extend to skills and expertise as well as gender, age and ethnicity. One of the aims of increasing diversity is the enrichment of perspectives and discussions. Adding skillsets can surely serve a similar purpose.

We set out on the following pages our findings in reviewing the technology capability on Boards of FTSE350 and ISEQ20 companies. This provides an insight into potential gaps in expertise and an example of perhaps a Board blind spot in terms of matching Director experiences with the risks facing the business.

What is required from an issuer perspective is a candid evaluation of the expertise at Board level and the creation of a skills matrix. This skills matrix should then be mapped across the Group's risk register to identify potential gaps in what the UK Corporate Governance Code identifies as "skills, experience and knowledge". In turn, this should foster a debate at the Nomination Committee – and among all Board members – as to the extent to which gaps need to be filled. In its 2020 report on 'Guiding Principles for an Effective Board', Federated Hermes also points to the role that external evaluations plays in identifying skills gaps. A combination of a skills matrix and a Board evaluation – one which is "*conducted with genuine commitment from Directors rather than a compliance exercise*" – offers the best basis to continually test the Board's expertise and its ability to assess, calibrate and manage risk.

Lessons from 'Down Under'

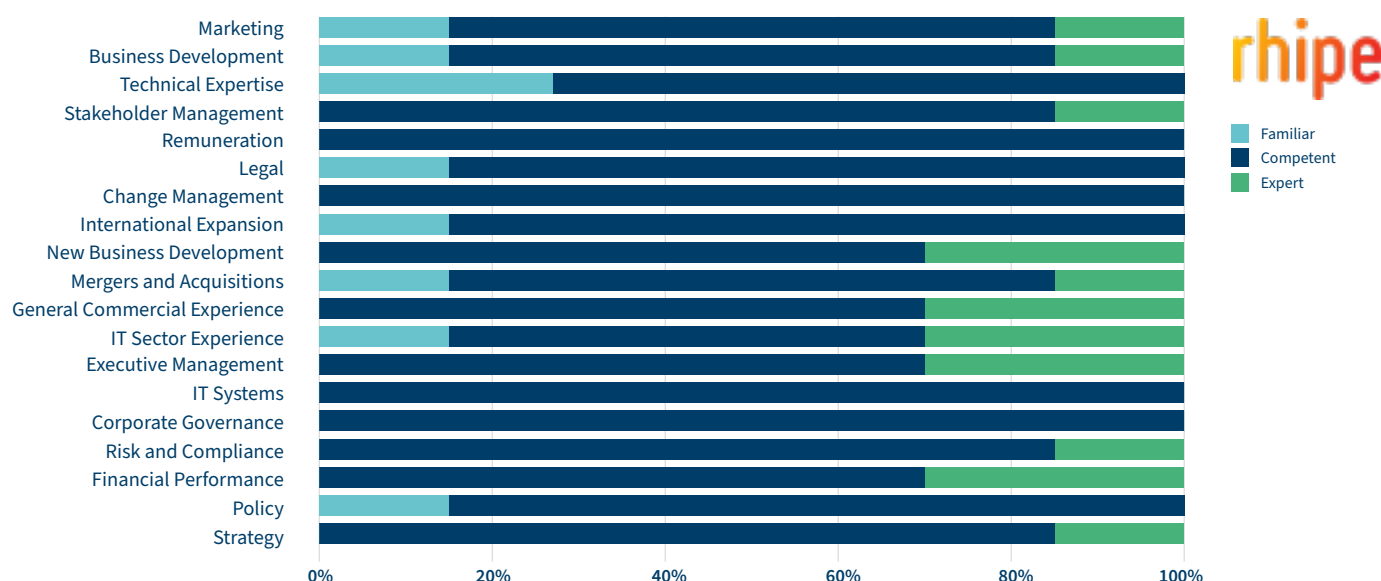
Since 2010, Australian companies have been required to detail the skillsets of their Boards. Currently, Recommendation 2.2 of Australia's Corporate Governance Principles and Recommendations states:

"A listed entity should have and disclose a board skills matrix setting out the mix of skills that the board currently has or is looking to achieve in its membership."

In detailing the rationale for the recommendation, the document goes on to state:

"Disclosing the board skills matrix gives useful information to investors and helps to increase the accountability of the board in ensuring it has the skills to discharge its obligations effectively and to add value."

As a consequence, every listed company in Australia discloses a skills matrix, to varying levels of detail. The following is an example from Rhipe, a cloud services company:



The company also sets out details of how it assesses the existence of skills:

DESIRED SKILL	DESCRIPTION
Strategy	Ability to think strategically and identify and critically assess strategic opportunities and threats and develop effective strategies in the context of the strategic objectives of the Company's relevant policies and priorities.
Policy	Ability to identify key issues and opportunities for the Company within the technology industry and develop appropriate policies to define the parameters within which the organisation should operate.
Financial Performance	Qualifications and experience in accounting and/or finance and the ability to: <ul style="list-style-type: none"> analyse key financial statements; critically assess financial viability and performance; contribute to strategic financial planning; oversee budgets and the efficient use of resources; and oversee funding arrangements and accountability.
Risk & Compliance	Ability to identify key risks to the organisation in a wide range of areas including legal compliance, regulatory compliance and monitor risk and compliance management frameworks and systems.
Corporate Governance	Experience in best practice corporate governance structures and policies and processes ensuring compliance with laws and regulations and delivering quality improvement and business performance.
IT Systems	Knowledge and experience in the strategic use and governance of information management and information technology within the organisation.
Executive Management	Experience at an executive level, including ability to: <ul style="list-style-type: none"> appoint and evaluate the performance of the CEO and senior executive managers; oversee strategic human resource management including succession planning, workforce planning, and employee and industrial relations; and oversee large scale organisational change
IT Sector Experience	<ul style="list-style-type: none"> Software/IP development Software and hardware distribution Security Support Services
Commercial Experience	Broad range of: <ul style="list-style-type: none"> commercial/entrepreneurial/business experience - particularly in industries that have been subject to intense competition and/or potential innovative disruption; commercial/business experience, preferably in the small to medium enterprise context, in areas including communications, marketing, branding and business systems, practices and improvement.
Mergers & Acquisitions	Experience in the identification, assessment, valuation, negotiation and integration of mergers, acquisitions, joint ventures and divestments.
New Business Development	Experience in assessing, prioritising and executing new business opportunities (e.g. business diversification, new products/services, commercialisation of intellectual property, etc).
International Expansion	Experience in assessing, prioritising and executing business expansion into new countries (e.g. organic, strategic partnerships, M&A, etc).
Change Management	Experience in overseeing transformational change agendas and associated engagement of key internal and external stakeholders (e.g. rapid growth, process re-engineering, ownership transition, etc).
Legal	Experience in corporate and commercial law, including major contracts.
Remuneration	Experience in remuneration structures in IT and/or other commercial industries.
Stakeholder Management	Experience in dealing with and presenting to strategic clients, strategic partners, key financiers/suppliers and industry/regulatory bodies.
Technical Expertise	Experience in software development, architecture, agile methodologies or other relevant technical discipline.

While there is no current expectation that UK and Irish companies meet this level of detail, the preparation of an in-depth skills matrix – for internal review, at least – will allow Directors to identify gaps and evolve Board composition with the evolving needs of the business. Based on our research, we consider it likely that the skill they are missing might well be technology related; the same skill their investors may consider the single biggest risk to their business.

Board Technology Expertise

There are 3,103 Directors at the 367 companies that comprise the FTSE350 and ISEQ20 indices - a number of Irish companies are in both indices so are removed to avoid double counting. Of these Directors, only 263 - representing less than 10% of all Directors - are deemed to be technology experts or specialists. This represents a low level of expertise in an area deemed as presenting significant risk.

With 367 companies and an average Board size of just over eight Directors, could 263 'experts' mean that the vast majority of companies have technology expertise? Unfortunately not. 205 companies or 56% have no Director deemed to be a technology expert or specialist; 104 companies have one Director; while the remaining 58 have two or more.

53 companies - or 14% - also have a technology committee or a Director with experience of a technology committee at previous company or other Directorship. Looking at the indices in more detail, FTSE100 companies are best placed with 56% of companies having technology expertise at Board level, 41% within the FTSE250 and just 20% in the ISEQ20.

Which of the following do you consider are likely over the next 12 months and concern you about harming companies you invest in?

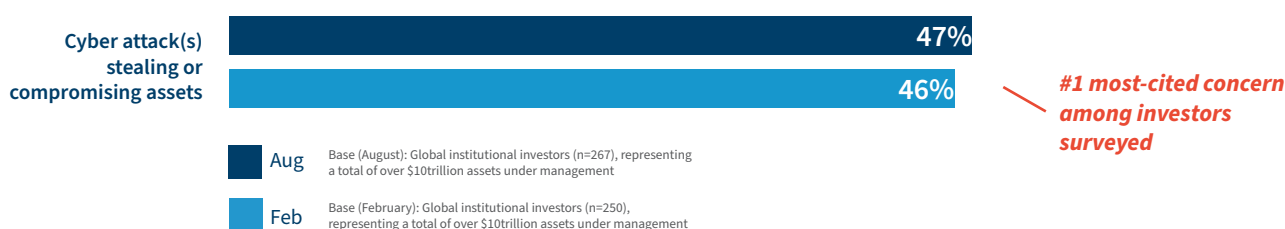


Figure 1: Investor Concerns - Global Institutional Investors Research: FTI Consulting, Aug 2020.

High-profile Cyber Incidents, 2009-2019.

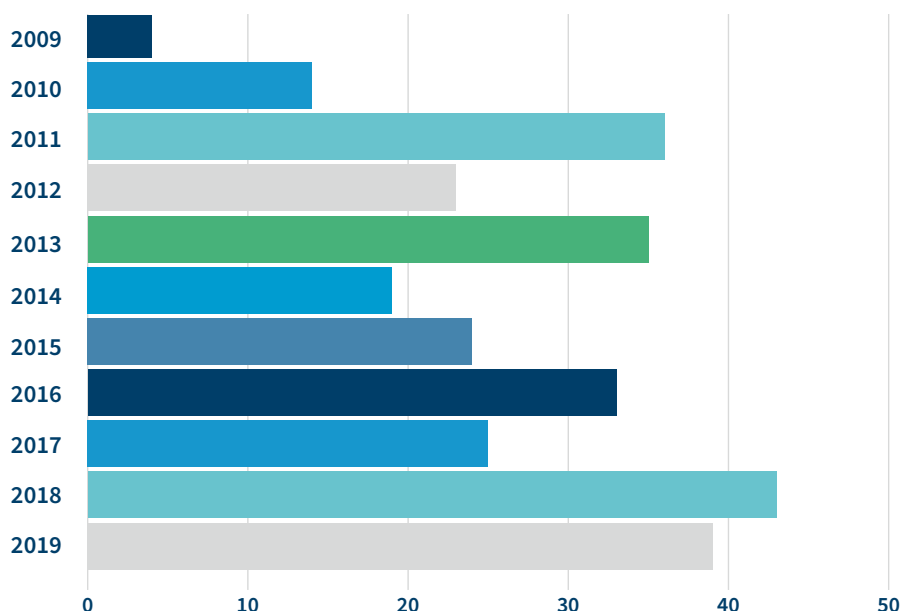
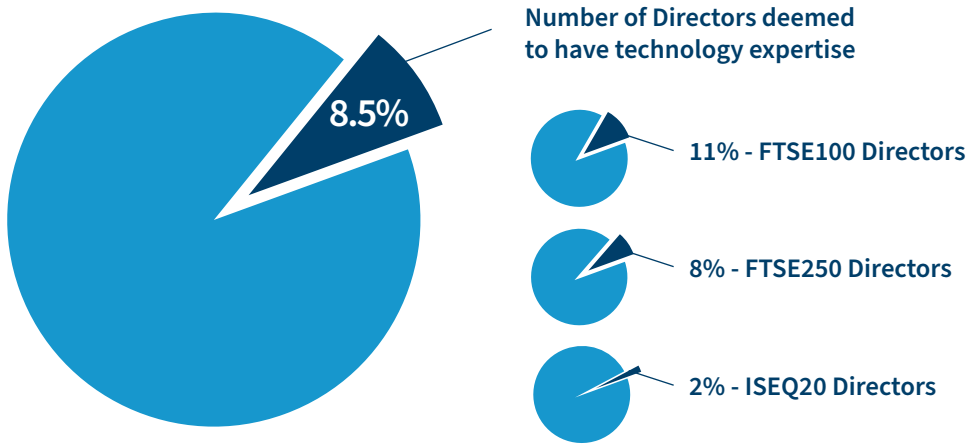
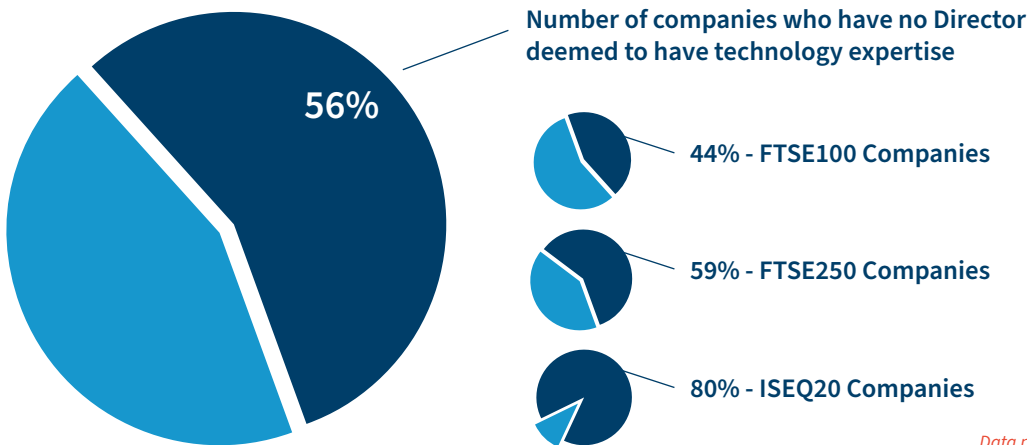


Figure 2: Growth in Data Breaches, Anatomy of a Crisis 3, FTI Consulting, June 2020.



Data provided by CGLytics

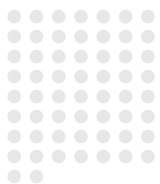


Data provided by CGLytics



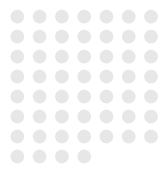
8.5

Average number of Directors on Board of FTSE350 or ISEQ20 company



58

Number of companies with 2 or more Directors with technology expertise



53

Number of companies with a technology committee or Directors with expertise of such a committee

Data provided by CGLytics

This analysis is based on CGLytics data. Based on that data, we consider a Director who meets their technology benchmark to be either ‘expert’ or ‘specialist’ as an expert for the purposes of this analysis. Details of what constitutes an ‘expert’ or ‘specialist’ is set out on page 7.

Considerations

Businesses have increasing amounts of data which are exposed to breaches or hacking; or systems which are at risk of hardware failure or software crashes. It is surprising, therefore, that there appears to be such a dearth of technology expertise on company Boards.

Is there a requirement for Boards to have multiple Directors with technology expertise? No. But the absence of an 'IT expert' at so many companies begs the question as to whether Boards are truly equipped for the opportunities and threats facing the business.

Challenges to this view will be that Boards do not require deep technology expertise and that such expertise can reside within the executive team or, as required, be provided by external advisors. However, given the extent to which IT is now a core part of almost every business, technology expertise provides an added layer of protection, challenge and insight in decision-making.

There are many examples of data breaches and hacking at companies and organisations. These can be prepared for but not always prevented as they are subject to the influence or intent of third parties. But they can be managed and planned for. There are also other examples of IT failures which are (significantly more so) within the control of the company and the Board. One such example is TSB Bank ('TSB').

In April 2018, TSB commenced a major IT migration including the accounts of over 5 million customers from its former owner, Lloyds Banking Group, to a new system to align with its current owner, the Spanish bank Sabadell. TSB expected services for customers to be offline for a period over a weekend but following a failure of the migration, some customers were still unable to access accounts or process payments almost a month later.

In November 2019, TSB published a report by law firm Slaughter and May following an investigation into the incident. In a detailed statement, TSB indicated that in relation to the migration *"the evidence presented to the Board at the time signalled readiness and followed a period of extensive testing and as well as continuous technical, third party advisory and regulatory engagement throughout."* Factual as this may be, one has to question if there was sufficient Board insight and expertise to challenge the evidence presented to them.

TSB's technology failure may have been unavoidable regardless of the extent of expertise at Board level. However, greater scrutiny may have been placed on certain decisions had more technology expertise been present on the Board. While this may not have eliminated the mistakes, it may have mitigated their impact and allowed the company to respond more effectively, the essence of risk management.

CGLytics Definitions

Technology expertise is assigned to individuals, who have had extensive experience in technology roles during their career. This would include responsibilities for information technology, software development, digital, cyber security and another IT related departments. Individuals with a PhD in Technology, Information Technology or Computer Science will be automatically assigned with Technology expertise.

Specialist expertise: A specific areas of expertise derived from a broad range of professional areas of specialisation, based on the entire career of an individual e.g. a Director of M&A will have as a field of specialisation M&A. There are 44 specialisation fields used of which technology is one.

References

<https://fticonsulting.com/en/time-to-rethink-the-s-in-esg/>

<https://www.ics.ie/cyberresilience/report.pdf>

<https://fticonsulting.com/en/the-anatomy-of-a-crisis-3-cyber-breaches/>

<https://www.asx.com.au/documents/asx-compliance/cgc-principles-and-recommendations-fourth-edn.pdf>

<https://www.rhipe.com/wp-content/uploads/2019/12/Board-Skills-Matrix-FINAL-AND-APPROVED.pdf>

<https://www.diligentinstitute.com/stakeholder-capitalism-translating-corporate-purpose-into-board-practice/>

<https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code>

<https://www.frc.org.uk/getattachment/61232f60-a338-471b-ba5a-bfed25219147/2018-Guidance-on-Board-Effectiveness-FINAL.PDF>

<https://www.hermes-investment.com/au/eos-insight/eos/guiding-principles-for-an-effective-board/>

<https://www.theguardian.com/business/2018/jun/06/timeline-of-trouble-how-the-tsb-it-meltdown-unfolded>

<https://www.tsb.co.uk/news-releases/slaughter-and-may/>

<https://www.tsb.co.uk/investors/results-reports/tsb-banking-group-annual-report-2017.pdf>

For Further Information



JONATHAN NEILAN

jonathan.neilan@fticonsulting.com

PETER REILLY

peter.reilly@fticonsulting.com

KATE BRADER

kate.brader@fticonsulting.com

DAN HEALY - Head of Research

dan.healy@fticonsulting.com



NATHAN BIRTLE

nbirtle@cglytics.com

ANDREW NEWBERY

anewbery@cglytics.com

FTI Consulting is an independent global business advisory firm dedicated to helping organisations manage change, mitigate risk and resolve disputes: financial, legal, operational, political & regulatory, reputational and transactional. FTI Consulting professionals, located in all major business centres throughout the world, work closely with clients to anticipate, illuminate and overcome complex business challenges and opportunities.

For more information, visit www.fticonsulting.com and connect with us on Twitter (@FTIConsulting), Facebook and LinkedIn.

The views expressed in this article are those of the author(s) and not necessarily the views of FTI Consulting, its management, its subsidiaries, its affiliates, or its other professionals.

©2020 FTI Consulting, Inc. All rights reserved. www.fticonsulting.com