



*Mr. Martin Reeves

The Role of Boards in Digital Transformation

Technology is increasingly important for developing & renewing competitive advantage. Tech companies consistently make up 50% of the Fortune Future 50, an annual list that predicts propensity for future growth. And most of the companies not formally belonging to technology sectors that make it onto the list have prioritized building digital capabilities.

Fully embracing digital technology is therefore an imperative for pre-digital companies not only for growth and advantage but even for survival. Of the top ten global companies by market capitalization 10 years ago, only two have maintained their positions today [See Exhibit 1]; many of the rest were replaced by digital natives. Digital platforms players now account for seven of the top ten companies by global market capitalization, compared to two just 10 years ago. And we expect the list ten years hence to be at least as different from today's: we know that only one-third of companies faced with industry disruption thrive, while the remaining two-thirds languish or fail.

TOP GLOBAL COMPANIES BY MARKET CAPITALIZATION ¹



(Exhibit 1: BCG Henderson Institute)

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While the imperative to transform for digital is clear – the path to get there remains elusive for many companies”

It is not surprising, then, that incumbents in many sectors are engaged in extensive digital transformation efforts to inoculate themselves against the threat of disruption.

Three-quarters of large-scale change efforts fail to meet their objectives - with digital transformation efforts being among the riskiest because of the depth and breadth of change involved, the capability disadvantage of many incumbents, the pace at which digital disruption can unfold, and the fact that customers' expectations are more likely to be set by a digital native like Amazon or Netflix than by a direct competitor. Given the high stakes, it's imperative to consider how digital transformation can be set up for success by creating competitive advantage rather than functional efficiency.

Transforming for Competitive Advantage

Instead of merely executing today's processes more efficiently, technology can reshape a company's information gathering (sensing), its collaborations with others (sociality), its extraction of insights (cognition) and its ability to evolve to thrive in changing circumstances (adaptability). Companies undergoing digital transformation therefore need to focus on these aspects by:

- **Extending the senses of the organization.** Technology can expand reach beyond the traditional boundaries of the organization. For example, many leading tech companies have built massive digital ecosystems that give them access to data from a wide range of suppliers and customers. Sensors and Internet of Things technologies can also increase sensing ability by capturing new sources of data.
- **Creating connected digital learning loops.** Traditionally, organizational learning was gated by the rate at which human decision-makers could process and act on information. But with the advancement of artificial intelligence, companies can now learn and act with algorithmic speed. To achieve this, data systems must be connected to AI algorithms, which drive decision making without human intervention — and those actions create new data, creating an integrated learning loop. For example, Netflix' recommendation platform captures granular consumer behavior, analyzes it at scale and produces automated, personalized recommendations for each user that evolve over time.
- **Facilitating cooperation and adaptation.** Digital technology can catalyze collaboration within and across individual firm boundaries. This can enhance information capture, collaborative development, customization, the reduction of innovation risk, and adaptability by deploying dynamic digital marketplaces to replace linear decision-making processes.

- **Focusing humans and algorithms on respective areas of strength.** The history of technological innovation shows that most impact materializes when this is accompanied by organizational innovation. This is also true of cognitive technologies like AI too. Algorithms can identify patterns in data much more quickly and powerfully than humans can. By delegating more such tasks to machines, humans can focus on leveraging their own unique cognitive abilities, such as imagining new possibilities that don't yet exist, or activities requiring ethical reasoning or empathy. For example, Amazon has autonomized routine decisions such as inventory management and pricing under a philosophy known as “Hands Off the Wheel”, refocusing human talent on coming up with new ideas such as the company's Amazon Go stores. New human-algorithm interfaces will also be required to make these very different styles of cognition work together synergistically in what can be called the “bionic organization”.
- **Facilitate communication between brains.** For new ideas to reach their potential, they must spread from one person to many, allowing them to evolve and be acted upon. The complex structures of large organizations can often impede this flow. Technology can be used to help understand and accelerate the spread of ideas throughout an organization. For example, metadata on people's interactions can be used to create a network map, allowing the identification of “brokers” who bridge different functions or groups acting as a conduit for new ideas.
- **Addressing broader systems health and overcoming planetary and social limits.** Businesses do not operate in a vacuum; environmental & social challenges are increasingly pressing problems for businesses in all sectors. Such challenges are complex collective action problems, which cannot be solved by optimizing the activities of each company individually. Businesses must deal with these new contextual problems as part of business strategy and digital ecosystem technologies have great potential to address the complex tracking, coordination and collective innovation challenges entailed.

There is one area where technology will not help however, which is in setting the purpose of a business. Only humans can decide the human ends to which the corporation and the technologies it uses are applied. Each company must determine why it exists by understanding the intersection of capabilities, aspirations, and social needs — and this must guide transformation efforts for coherence, societal relevance, and appeal to a generation of more ethically attuned employees. Today's norms are shifting rapidly away from the idea that a corporation's only or main goal should be to maximize shareholder value.

Leverage your board to define Purpose and guide Strategy and Change

At first glance, it sounds like a trivial observation that boards should be highly involved in corporate strategy and bold shifts such as a digital transformation. Directors themselves recognize the need: collectively, they rate long-term strategic planning as the top issue demanding attention by the board [See: NYSE “What Directors Think” (2016)].

In practice however, many boards are ill-equipped to deal with strategy in the modern environment. They may not have the appropriate expertise: many directors built their careers in a “classical” business environment rather than today's increasingly dynamic and uncertain environment and may not have the right capabilities to master the variety of strategic approaches that are now required.

Furthermore, directors typically have many different roles and competing commitments, limiting their available time and energy. Their legal mandates cover topics like audit, compensation, and governance. Regulatory changes, such as the Sarbanes-Oxley Act, have increased their focus on compliance. And new risks, including cybersecurity, data privacy, and harassment are drawing more attention from boards. These demands can collectively crowd out directors' attention to strategy and transformation.

As a result, there is very wide variation in board engagement on strategy and proficiency with digital technology. On one end of the spectrum, some may lean toward a less active role: For example, more than half of directors said that management, rather than directors, is responsible for identifying potential strategic disruptions at their company in a recent survey [See: NYSE “What Directors Think” (2017)]. At the other end of the spectrum, some boards have a very hands-on approach: In the same survey, a small minority said they have a separate board committee that focuses on disruption risk.

Boards can add significant value by focusing more on challenging and shaping strategy:

- **Focusing on the long term to complement management.** Management tends to focus on the short-term operating picture. This is understandable — and necessary — given that running the business presents constant challenges. CEOs themselves recognize this tendency: 86% say they focus more on short term than the long term [See: CECF Board of Boards, Executive Report (2016)]. But for the firm to remain vital over time, it must also pay enough attention to the future. By sitting outside the day-to-day operations, directors are in an ideal position to counter-balance management's tendencies and focus on the long run.

This is especially valuable when setting strategy for digital transformation – management will likely bias towards solving short-term problems. Boards can offer a valuable perspective of the long run, helping future-proof transformation strategy.

- **Leveraging breadth of vision. The impact of external forces on business is increasing.** As the rate of technological disruption increases, so does the external risk to business as usual. Board members can uniquely use their external affiliations to understand the broader picture and use it to help build a successful digital transformation. By leveraging their different backgrounds, as well as their connections to other stakeholders through concurrent involvement in different businesses or industries, directors may be able to detect emerging threats or opportunities more quickly and ensure that the firm adapts accordingly.
- **Contributing cross-domain insights.** As industry boundaries are blurred by new technologies and business models, sector-specific knowledge is no longer sufficient. As firms experience and respond to digital disruption, leadership must be informed about emerging technologies and new competitors beyond traditional industry boundaries. When selected thoughtfully, directors can fill gaps in management's skills or knowledge in key areas.
- **Governing transformation strategy and execution.** Given the increased stakes and complexity of strategy, strategic governance is increasingly more important. Boards are in a unique position to pressure-test management's decision-making, ensuring that the transformation strategy is tailored appropriately to the firm's situation and continually probing key assumptions to make sure they remain valid. Furthermore, directors can use their role to monitor execution of the transformation, and ensure it is being carried out properly.

A key shift here is to minimize “being presented to” and instead to focus valuable board time on pressure testing assumptions or progress against goals.

- **Support the courage needed to transform.** Lastly, boards can serve as supporters for transformation, encouraging teams and leaders, and providing cover as teams adapt to new ways of operating.

Digital transformations are crucial and sometimes daunting efforts. By adopting these actions, we can shift the board's engagement model for strategy and transformation well beyond being a “rubber stamp.” Instead, boards can take an “activist” approach and think about how to challenge and disrupt the firm's strategy — before an actual activist investor (or competitor) does so.

Additional Reading:

- **Competitive disruption:** <https://www.bcg.com/publications/2017/value-creation-strategy-transformation-creating-value-disruption-others-disappear>
- **Transformation for success:** <https://sloanreview.mit.edu/article/the-truth-about-corporate-transformation/>
- **Board role in strategy:** <https://bcghendersoninstitute.com/the-boards-role-in-strategy-in-a-changing-environment-ec143e7ec558>
- **Digital strategy:** <https://www.bcg.com/en-us/publications/2020/the-power-of-digital-transformation>

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