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The following article originally appeared in Deloitte's 2020 Global Directors' Alert

Look before leaping (into the future)

Reassessing culture, conduct, and reputation in the digital age

It's funny. A digital decision here, an automation initiative there, and before you know it, the organization you are charged with overseeing has been transformed into something different and maybe unfamiliar. Your entire industry may be transforming. But as a board member with a view from the bridge, you must look ahead to the storms and rogue waves in the virtual ecosphere while confirming that the course stays true.

On the one hand, this calls for looking toward the horizon. On the other, it requires close scrutiny of the course management has chosen. Both entail overseeing risks and clarifying opportunities that may escape management's attention, including those

related to culture, conduct, and reputation. Each of these factors can be profoundly influenced by digital transformation or even a single intelligent automation initiative.

Digital transformation means different things to different people, but here we define it as modifying, updating, or entirely changing processes, business models, and organizations by means of digital technology. Increasingly, this includes the use of cognitive technologies. Organizations are projected to spend nearly $2 trillion on digital transformation in 2022, spurred by a proliferation of new technologies and a fear of disruption by tech-enabled competitors.[1] ❯
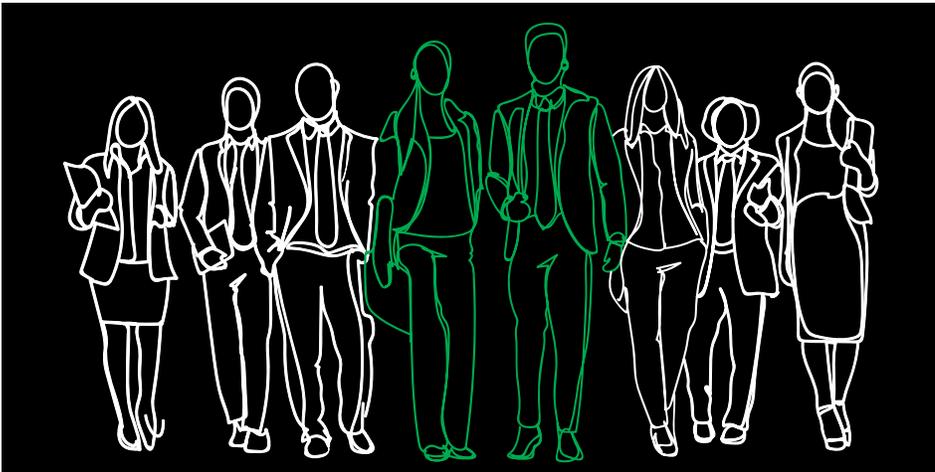
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At this point, many of the barriers to achieving true digital transformation are related less to technology and more to culture, talent, strategic execution and risk management. These attributes need to be considered to develop a business case for adoption—something many organizations are still coming to terms with. The most common barriers to scaling intelligent automation are not regulatory issues or lack of senior-level support or board approval, but challenges related to the business case, talent, capabilities, governance, and culture. These are the findings from a recent Deloitte survey of 166 individuals in digital, change management, technology, risk, and internal audit functions of organizations across EMEA, the Americas, and Asia Pacific.[2]

Additional Deloitte research indicates that organizations whose boards actively engage with technology issues typically perform better financially.[3] Boards can help catapult businesses to higher levels by overseeing management's efforts to use technology in ways that benefit the organization.

The impact on the larger enterprise can be significant, and the prospect of overseeing culture, conduct, and reputation risks can drive many board members out of their comfort zone, even to the point of minimizing the issue or leaving it to others. That's understandable. After all, relatively few of today's leading organizations began as digital businesses, yet most are becoming so. In digital transformation, those organizations are experiencing disorienting rates of change

amid an explosion of data, technologies, opportunities, and risks. Even boards of organizations founded as digital businesses have difficulty keeping up with the pace of change.

During digital transformation, an organization may move away from analog processes, for example, by changing the delivery method of physical goods from humans to drones or moving from one computerized process to another, such as offering payment by smartphone at point-of-purchase locations.

Although the movement from analog to digital may seem more radical than movement from a manual process to an automated process, both can be transformative for organizations. For example, payment by smartphone can eliminate the need for a credit card, confer security benefits, and open doors to new intermediaries. Mobile capabilities can also enable payments to come from new sources, such as cryptocurrency, as well as from traditional bank accounts. That's transformative for customers, retailers, credit card issuers, banks, and cryptocurrency providers. It's also disruptive, because it influences business models, processes, and human behavior.

Rapid, significant impact leads to disruption and change—abrupt, sharp, unpredictable breaks with existing patterns and practices. Digital technologies, including the Internet, social media, scanning and imaging

capabilities, and voice generation and recognition have already altered industries, as well as our cultural and political landscape. Cognitive technologies such as artificial intelligence have only begun to transform business and society.

In an environment of ongoing disruption, senior executives face seemingly discrete but related decisions:

- Which features of our business model and processes can be digitalized and to what extent?

- Which digital technologies should we consider? Which ones have proven most useful and reliable?

- What is the best use of our funds? Which model for building, buying, or accessing the needed technologies and skills is best for our organization?

- What is the potential impact of digital transformation on our employees, customers, investors, and other stakeholders? Where are the best opportunities for our organization? What are the risks, and how can we monitor, mitigate, and manage them?

- What does an executive team need from the board to manage digital transformation? How can board members provide the guidance and oversight stakeholders need?

These decisions seem discrete because digital transformation often arrives through individual initiatives that apply technology to the business. They are related because digital technologies foster connectivity and interaction. That means the initiatives must be aligned strategically for them to work together for the benefit of stakeholders. It also means that risks will arise from unexpected areas and may generate equally unexpected ripple effects.

To provide proper governance and oversight, the board must focus not only on discrete initiatives but also on the strategic intent and collective impact of those initiatives. Each initiative will pose its own benefits and risks; together, they can have a far greater cumulative effect.

When dealing with something truly transformative, it's often best to assess the big picture: the impact of digital transformation on organizational culture, conduct, and reputation. Culture centers on how the organization uses digital technologies and its values, ethics, goals, and incentives for that use. Conduct relates to how stakeholders behave when influenced by digital technologies. Reputation involves the impact on brand and the evolving views of stakeholders in an organization undergoing digital transformation.

Organizational culture, conduct, and reputation are critical risks requiring strong board oversight. If management fails to manage culture, conduct, and reputation risks well, other risks may become secondary, because these elements can undermine the organization's ability to pursue and implement its strategy.

Gauging the stakes and the risks

Organizational leaders benefit by thinking in terms of the potential upside and downside impacts of digital transformation on the organization's strategy, culture, conduct, and reputation. Achieving powerful results requires organizations to coordinate their cultures, people, structure, and tasks and to keep them in alignment as technology evolves. A Deloitte/MIT Sloan Management Review survey found that 80 percent of respondents who identified their organizations as "digitally maturing" credited a clear and coherent organization-wide strategy.[4] Among organizations characterized as "least mature," only 15 percent had adopted an articulate strategy.

The strategic stakes

The strategic questions largely boil down to this: Do we want our organization to be a disruptor or the disrupted? The choice may not seem that stark, but it often is because competitors who have adopted digital business models have already proven highly disruptive to incumbents in many industries. Does management have a history of embracing powerful trends? Digital technologies level the playing field in ways that favor organizations with relatively few resources and those unencumbered by legacy business models.

Given the disruptor-or-disrupted question, management must identify where to apply cognitive technologies to best advance the organization toward its strategic goals. They must also locate threats from innovative or digitally enabled competitors—those who usually aim to exploit underserved markets or to improve inefficient customer-facing or supply-chain processes.

In a world of such rapid technological change, it can be easy to focus on the technology. But the business need for transformation should be the primary driver. Once real requirements have been identified, efforts should turn to creating well-researched, compelling business cases and locating employees with the skills to fulfill those needs. Effective leaders will formulate a clear vision of the transformation and communicate it throughout the organization on an ongoing basis. Conversations about strategy present a natural opportunity for the board and management to discuss the culture needed for implementation.

A look at the leading edge

A Deloitte survey of more than 500 executives across a range of industries found that 58 percent of organizations had started to use robotic process automation (RPA) and artificial intelligence at some level by the spring of 2019.[5] Among those using intelligent automation, 38 percent are in the piloting stage (1 to 10 automations), 12 percent are in the implementation stage (11 to 50 automations), and eight percent are automating at scale (51 or more automations). That eight percent is double the four percent that were scaling in 2018.

Our survey found that organizations that scale their efforts successfully tend to exhibit six characteristics:

- **An enterprise-wide strategy** for intelligent automation that leads to higher returns in workforce capacity, cost reduction, and revenues.

- **Combined RPA and AI initiatives**, leading to an average increase in revenue of 9 percent, as opposed to 3 percent in organizations that do not combine the technologies.

- **Supportive IT functions** with the required technology, infrastructure, and cybersecurity resources in place, enabling a 21 percent reduction in costs as compared with 13 percent in organizations that lack this characteristic.

- **Mature processes with clear definitions and standards**, which produce an average increase in back-office workforce capacity of 19 percent compared with 12 percent in organizations that do not have these processes.

- **A clear understanding of how to capture value**, leading to an average cost reduction of 21 percent versus 15 percent in organizations with less understanding.

- **Radical simplification of processes** driven by a need for cost reduction, which is reported by 73 percent of scaling organizations versus 61 percent of those in the pilot stage.

The board should provide guidance in many of these areas, particularly strategy, support functions, process maturity, and understanding of value capture, and ask questions that challenge management's assumptions. Successful digital transformation also depends on management's ability to maintain a positive, productive culture and to manage the conduct and reputation risks that accompany these initiatives. This implies a need for continuous oversight at the board level, with ongoing reporting from management to the board on the goals, expected outcomes and progress of the digital transformation and any modifications to the strategy.

Boards and CEOs can differ on reputation risk

A 2018 Deloitte survey of 200 CEOs and 200 board members[6] found that boards tend to be more concerned about reputation risk than CEOs are. Results included the following:

- Boards and CEOs are closely aligned on their perception of security risks, crisis response capabilities, and extended enterprise risks as potential sources of reputation risk.

- Boards have more concerns than CEOs about product quality and safety, ethics and integrity, and employee and executive misconduct as potential sources of reputation risk.

- In the past year, only half of the board members and CEOs surveyed had discussed the organization's reputation or how to address reputation risks, or how to enhance reputation.

- About half of the organizations surveyed lacked programs, such as formal risk sensing, to identify reputation risk events; more than 50 percent did not have plans to develop or acquire tools to monitor and manage these risks.

Boards are in a strong position to intensify management's focus on reputation risk as part of the broader conversation about culture and conduct. The board should also learn about, and advise management on, formal risk sensing programs that monitor and manage reputation in social media and across the digital ecosystem.

The cultural stakes

Most boards understand that an organization needs an optimal culture to achieve certain goals. Yet most are less informed about how to define that culture, identify what needs to improve, and oversee management's efforts to bring about change. Many also underestimate the impact digitalization can have on the culture. For example, intelligent automation can undermine morale as employees fear loss of autonomy or their jobs. It can leave an organization short of the skills needed to sustain success. It can raise new ethical questions, which management may not be prepared to answer.

Culture can also advance or inhibit digital transformation. The consequences of failing to align the initiative's goals with organizational values can range from slow adoption of digital technologies to loss of market competitiveness, productivity, and revenue. To pave the way for an effective digital transformation and cultural alignment, efforts should span human resources, risk, finance, accounting, and other functions, not only the areas that are already strong users of technology. Cultural alignment should extend to the extended enterprise partners and temporary workers who may have limited understanding of the organization's strategy.

If management can build a culture that is more adaptable to change, implementation of new technology and business processes can proceed more smoothly. Those are among the conclusions of a study by Deloitte/MIT Sloan Management Review based on responses from more than 16,000 people in 157 countries and 28 industries.[7] Nearly 60 percent of respondents from digitally maturing organizations noted that their organizations drive digital adoption and engagement by cultivating values such as risk-taking, collaboration, agility, and continuous learning.

Digital transformation calls for a new mindset, typically one that is more innovative, flexible, collaborative, and tolerant of failure than the current one. It will also be less amenable to command-and-control management. It will favor experimental, agile methods of development over highly planned, linear, inflexible waterfall approaches. The required mindset will drive teamwork across multiple functions and enable rapid response to changing conditions.

In an environment undergoing digital transformation, leadership entails asking powerful questions and fostering continuous learning. The executive team will need to lead cultural change by communicating openly and consistently, modeling the desired behavior, and using formal change management methods. Failure to develop the right culture poses its own significant risk. Management must appreciate how critical the right culture is to success and clearly define its goals. Management must also appreciate how transformative cognitive technology is for most organizations. It's not about the technology or even the process; it's about new ways of working, new skills, and new ways of thinking.

The board must understand how management should approach these tasks and track how the executive team manages the cultural transition. For example, rather than attempt to bring about enterprise-wide digital transformation all at once, it's usually best to start with small projects, iterate rapidly, learn from each iteration, build the culture's agility muscle as individuals accommodate and absorb each change and then launch broader initiatives.

During those early efforts and throughout the transformation, pulse checks on the culture can provide a window to management and the board on how technology affects people, what accelerates change, and which skills are needed.

The conduct stakes

Conduct risk generally refers to unethical business practices and behaviors that harm stakeholders or the community, society, or financial system. It encompasses the risk of fraud, collusion, insider trading, misrepresentations to stakeholders, and inaccurate or dishonest financial reporting. Conduct risk can emanate from a subculture within the organization or from factors such as bad hiring decisions or poorly designed incentives.

Although heightened conduct risk does not arise directly from digital technologies, it poses new opportunities for bad actors. For example, employees could design a bot to bypass controls for their own enrichment or to exhibit sexism, racism, or other biases. Intelligent automation initiatives must be well understood and well controlled, and the models must be monitored properly. The board needs to receive adequate assurance that this oversight is, in fact, occurring.

Use of cognitive technologies to monitor conduct also poses risks. Some financial institutions now monitor employee emails, texts, and social media accounts, then use analytics to identify patterns that indicate potential conduct risks with respect to people, products, exposures, and locations. One organization linked conduct risk with increased use of sports and war metaphors in emails and texts. This kind of monitoring must be conducted with care. The board should be concerned with fairness; it should confirm that appropriate disclosures are made to those being monitored, and it should take guidance from ethics and legal professionals. Overreliance on data in monitoring conduct can also encourage people to "work to the numbers" rather than align with organizational values.

In addition to obtaining information on conduct risk, the board needs to maintain an ongoing conversation with management about culture. Management and the board should foster the desired culture by discussing values, telling stories, and celebrating ethical wins as well as marketplace gains. Leaders reinforce values by modeling behavior such as sharing information, collaborating, experimenting, tolerating failure, providing appropriate rewards, and putting employees and customers first.

The reputational stakes
New technologies have a significant potential to augment, disrupt, or replace business models. The risks brought by new technologies are likely to have a broad impact across the enterprise, and it is critical that businesses reflect on whether their governance models are fit for the future and flexible enough to navigate the rapid pace of change. This includes having a firm grasp on where new risk areas are, who is responsible, and how are they are managed, monitored, and mitigated.

Reputation risks arise from operational, financial, technological, cyber, data privacy, regulatory, legal, sustainability, third-party, and other risk events that become public knowledge, particularly when management's response is perceived to be inadequate. Reputation risk can harm the organization's brand, market value, license to operate, employee morale, and recruitment efforts.

Given intense news coverage of business, distrust of large institutions, and the realities of social media, management must be proactive in addressing reputation risks. Even with cognitive technologies still in the early stages of adoption, several organizations have seen their brands harmed by events related to chatbots, biased algorithms used in hiring, and digital employee scheduling.

If AI models can use biased data to "learn" the wrong things or are programmed to do so, they can create reputational risks as serious as those posed by rogue employees. Worse, they have the potential to do more damage in less time. That risk stands apart from reputation risks arising from poor communication about intelligent automation and any negative effects on employee morale.

Given the broad impact of digital technology in all areas of business, management and boards need a clear view of where responsibility and accountability for digital risk reside. In most organizations, it is in the IT, strategy, or marketing functions, or it is not well defined: 33 percent of participants in Deloitte's global survey indicated that digital risk is the responsibility of the chief information officer. It was the most frequent response. Twelve percent suggested that responsibility is not clearly defined. Approximately eight percent of respondents indicated that digital issues are handled by the chief technology officer, the chief executive officer, or the chief risk officer.[8]

The broad impact of digital transformation creates links and dependencies between risk owners across the business that can inhibit risk remediation. Management and risk teams need to make sure that governance models put the right people at the table with the right information at the right time, supported by a culture of transparency and collaboration.

Significant culture, conduct, and reputation risks arise from employing intelligent automation at scale. But even limited use of cognitive technologies can create issues resulting from the poor choice of use cases, insufficient controls, lack of communication, or other mismanaged aspects of model development or deployment. The board must be prepared to understand and oversee these risks.

Steps for directors to take
The following are suggestions to help boards oversee the culture, conduct, and reputation risks of digital transformation and intelligent automation:

- **Discuss the strategic goals and rationale of the transformation.** Given the board's role in overseeing and approving strategy, directors should understand how management intends to use cognitive technologies, as well as their anticipated impact and risks. The board should review management's intelligent automation plans for alignment with the strategy. These plans may focus on reducing costs, improving processes, increasing market share, entering new markets, developing new products or services, meeting competitive threats, or other strategic goals. The board should also ascertain the scope and timing of management's intelligent automation plans. If management does not intend to use cognitive technologies to advance the strategy, the board should understand why.

- **Assist in aligning digital initiatives with the organization's principles.** Senior executives, under board oversight, are responsible for the ethical and fair use of cognitive technologies, particularly in AI decision-making processes. To set the context, the executive team and board

should define principles for the use of cognitive technologies. This does not require a deep understanding of how the models work; it does require knowledge of which processes they will be applied to, who is affected by those processes, and the potential outcomes. The clearer the principles and policies, the better. For example, if an ethics committee has no visibility and developers have no mandate to make in-the-moment design choices based on fairness, it is difficult for organizations to confirm that ethics are being operationalized.

- **Gauge the cultural impacts and how they will be addressed.** The board should understand the cultural changes that cognitive intelligence brings to, and demands from, the organization. Learn how others have been affected, including peers and organizations in other industries. The board should assist the executive team in defining the culture needed to deliver on the scope and timing management envisions. This means defining cultural attributes and developing a plan to realize them. It is also important to gauge management's ability to lead cultural change and ascertain what resources may be needed to support it. Be wary of executives who minimize the importance of culture in digital transformation or who believe that technology can solve strategic or organizational problems.

- **Review and monitor the change management plan.** Central to culture change is a plan to coordinate management's verbal and behavioral messaging and to make any required adjustments to KPIs and compensation plans. Before-and-after cultural assessments can be extremely useful. Culture and culture change are nebulous concepts, so the more objective and concrete plans and metrics are, the more information the board will have to evaluate management's performance. As noted in "The rise of the smart machine: Rethinking risk governance around intelligent automation" in this issue of *Directors' Alert*, consider establishing a center of excellence to provide resources and coordinate digital transformation.

- **Evaluate applications that monitor conduct.** Using cognitive technologies to monitor conduct presents ethical issues. For example, it is now possible to develop an "ethical score" for an employee or customer based on data from internal systems, surveys, credit reports, and other sources. This score could be used to gauge a person's inclination toward misconduct and signal a need to intervene with guidance, training, or risk limits for that person. But these scores can be inaccurate, unfair, or invasive of privacy. The situation may be different if the technology monitors a group, with notification and consent, rather than an individual, but the issue remains cloudy. Recent data privacy and misuse scandals have drawn attention to how organizations store, manage, and use employee and customer data. With input from legal or ethics personnel, management must decide what to monitor and how to respect privacy and individual rights, and the board must oversee those efforts.

- **Understand and monitor reputational impact.** Because boards tend to be more sensitive to reputational impact than management,[9] they are in a strong position to lead discussions of how to improve an organization's oversight of reputation risk. Executives should be proactive in developing strategies for managing and enhancing reputation. The ability to scan for risks and design dynamic safeguards will be essential in a world where risks continually evolve. Efforts should include launching positive social media programs, cultivating individuals in primary stakeholder groups, simulated exercises and scenario planning with interdisciplinary experts, developing networks of supporters who believe in the organization's mission and purpose, and monitoring trends in sentiment among employees, customers, and other stakeholders. A formal risk sensing program can also provide early warning of positive and negative trends.

- **Obtain adequate assurance on these risks.** Risks related to culture, conduct, and reputation can escape the attention of second-line risk management functions and internal auditors. As management

develops, launches, and maintains technologies such as RPA and AI, it is essential that the risk committee, audit committee, and full board receive adequate assurance that all risks are identified and monitored and that controls are in place and operating effectively. Each of these risks should, at a minimum, be on the internal auditors' rotational plan, with more frequent reviews as automation scales. When an organization undergoes digital transformation, its board should confirm that the risks associated with change management have been identified and addressed and that proper resources and accountabilities are in place. These risks should be considered explicitly in assessments of the organization's risk appetite, profile, and tolerance. By designing mechanisms to remediate risks swiftly, organizations can preserve trust and build resilience in responding to unexpected points of failure.

- **Prepare the board for the digital age.** Unless they have an IT background, most directors lack expertise and experience with cognitive technology. This can put the board at a disadvantage in overseeing digital transformation. The board should be able to provide credible challenges to recommendations from management, which obligates members to stay informed. Boards should be diligent in identifying and addressing gaps in their knowledge of technology. Chief information and technology officers and other internal or external experts can help educate the board. Those that lack cognitive technology skills should tap into the expertise needed to illuminate the challenges and opportunities that cognitive technologies and digital transformation present. They should also cultivate new members who can bring that understanding to the board, including former CTOs or CIOs with exposure to cognitive technologies and executives from successful digital businesses.

As the ultimate overseers of the organization, the board must be aware of the potential for cognitive technologies to disrupt culture, shape conduct, and affect reputation. Those technologies can either accelerate and enhance or distort and derail an organization's strategy.

The board should insist on clarity when discussing culture, conduct, and reputation risks with management. Ascertain that management is clear about these risks and intentional in identifying and addressing them. The board also needs to confirm that management is doing what is needed to realize the upside potential of developing a supportive culture, ethical conduct, and a sound reputation as the organization embarks on intelligent automation.

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Questions for directors to ask

- What digital disruptions in the marketplace could influence the organization's business? How does management view the role of digital technologies in its strategy? How has management evaluated the use of these technologies in the context of our strategic goals?

- Where is the organization with regard to cognitive technologies? How many automations have we developed? How many have we launched? What have we learned so far, and how are we applying those lessons? How will the organization measure success?

- What kind of culture do we need to succeed in the digital age? How can we foster technology-enabled innovation? Which cultural characteristics do we have or lack, and in which parts of the organization? What is management's plan for establishing the type of culture needed for digital transformation?

- How has management identified the conduct risks presented by cognitive technologies? How does the organization monitor and manage those risks?

- Do we use technology to monitor or measure conduct risks in our organization or among customers and extended enterprise partners? How comfortable are we that our methods are ethical, legal, and appropriate?

- How does our organization's reputation compare with those of our peers? Do we monitor our reputation through a formal risk sensing program, particularly among key stakeholders and in social media? Is management proactive in managing reputation, and if so, how and with what results?

- How is the board informed about culture, conduct, and reputation risks related to digital technologies? Have we defined these risks? Do we have policies and procedures for reporting these risks and related events to the board?

- Do we have sufficient technology expertise? What characteristics and experience should we seek as we fill openings on our board? How can we improve our knowledge of digital technologies and their impact?
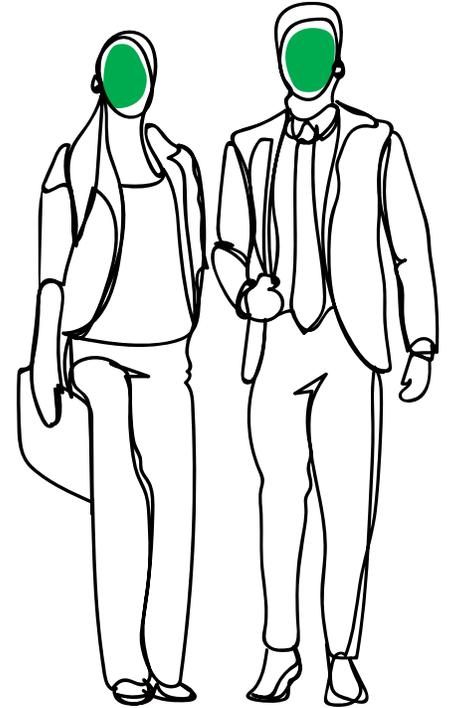
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