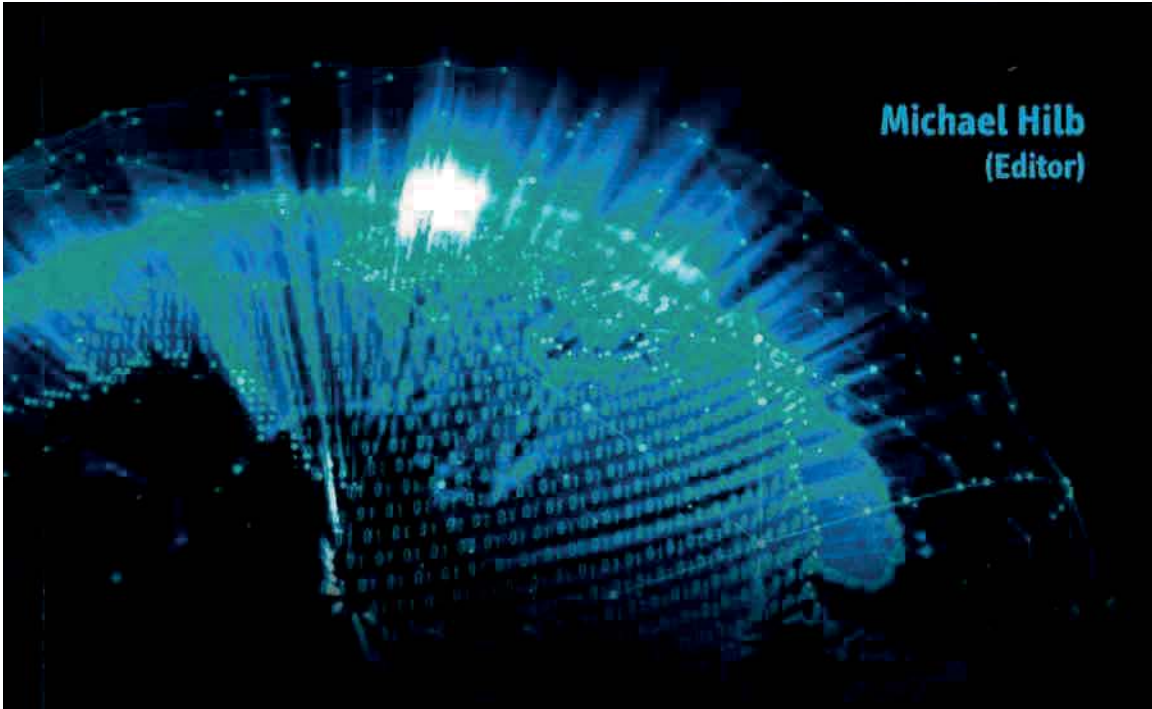




Michael Hilb
(Editor)

Governance of Digitalization

**The Role of Boards of Directors and
Top Management Teams in Digital Value Creation**

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Haupt Verlag

1st edition: 2017

Bibliographic information published by the *Deutsche Nationalbibliothek*:

The Deutsche Nationalbibliothek lists this publication in the Deutsche Nationalbibliografie;
detailed bibliographic data are available at: <http://dnb.dnb.de>

ISBN 978-3-258-08038-3

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Cover design: Daniela Vacas, Berne

Cover illustration: spainter_vfx/Shutterstock.com

Typesetting: Die Werkstatt Medien-Produktion GmbH, Göttingen

Printed in Germany

www.haupt.ch

B.2 Digitalization Decisions at the Board Level

Author



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Abstract

In the digital era, the board of directors has an additional task: information governance. While storing data is no longer the problem, handling the data is. At the strategic management level, decisions have to be made as to the processes, organizational measures, and technologies required to actively manage the data throughout its life cycle in compliance with external and internal regulations. Therefore, efficient risk management systems, internal control systems, and compliance management systems must be implemented by the board of directors to guarantee the successful transformation of the enterprise in the digital world.

1 Issue Overview

1.1 Board of Directors Confronted with Digitalization

The catalog of non-transferable and inalienable duties of the board of directors (BoD), in accordance with article 716a of the Swiss Code of Obligations (SCO), has received intensive attention in research and legislation. It is, therefore, not surprising that the number of liability claims lodged against BoD every year is increasing. Two additional factors influence the board's work: overregulation and digitalization. While the flood of regulations is being met with effective compliance–assurance measures, BoD still tend to lack awareness of the opportunities and risks of the digitalization of information stored worldwide. The large-scale collection, storage, and transfer of digital data pose a considerable challenge for the strategic management of a company in various ways. The options that are currently available for the monitoring of people, machines, and processes can be used to streamline and accelerate business activities. At the same time, however, the danger of compromising employees' rights to privacy, as well as the threat of competitive or damaging third-party interventions are rising exponentially.

Years ago, members of the BoD often complained about receiving too little information from management; the opposite holds true today. There are too many tools that generate countless data evaluations at the touch of a button. Storing data is no longer a problem. Instead, selecting relevant data and destroying unnecessary data have become issues. In many companies, the secretary to the BoD no longer provides hard copies, but instead uploads electronic versions or provides updates on the BoD's intranet. BoD meeting participants now have relatively few printed documents, which have largely been replaced by laptops or iPads. The constant accessibility of data and the duty to be available at all times certainly increase the pressure on members of the board.

1.2 The Need for Strategic Decision-making on Digitalization

The BoD is obliged to make decisions in order to deal successfully with the opportunities and risks that digitalization presents. These decisions primarily include IT organization and investment decisions on the following topics:

- Should the prerequisite IT knowledge be acquired within the company or should external providers be used?
- What exact hardware and software have to be procured?
- Where should data be stored and backed up?
- How can the available IT tools be used within the company?
- Who should be granted access to different forms of data?
- How can data security and safety be guaranteed?
- How can data archives be best used?

BoD often lack the technical background knowledge to deal with these IT issues. Therefore, it is essential that the members of the board consult with thorough and experienced IT consultants so that they can weigh all the options before making the necessary decisions. All decisions about IT should consistently follow a uniform strategy. In concrete terms, the BoD should strive to meet the following strategic IT targets:

- support business processes;
- promote economic feasibility/reducing costs;
- increase efficiency through standardization; and
- improve IT service delivery.

2 The Impact of Digitalization on the Board of Director's Tasks

2.1 The Impact on the Duty to Exercise Overall Management

In accordance with article 716a paragraph 1 of the SCO, the BoD has a duty to exercise the overall management of the company and to issue all necessary directives. The main strategic task can be divided into the following IT-related subtasks:

- define the strategy with tangible IT goals;
- analyze the strengths, weaknesses, opportunities, and threats in IT;
- select the means and resources for the implementation of the IT strategy;
- direct the executive board about the implementation of the IT strategy;

- ensure that all instances of IT use comply with the legal, statutory, and regulatory requirements at all times (IT compliance);
- define IT personnel policy;
- issue a risk management policy that incorporates IT risks;
- ensure the provision of the prerequisite IT user licenses;
- define IT contract-management principles;
- decide on the conclusion of important IT contracts (e.g., outsourcing);
- hold BoD meetings to deal with the required IT agenda items;
- discuss and question the updated master risk list, including IT risks, at least once a year; and
- check the insurance status quo based on an updated insurance overview, including IT infrastructure insurance, at least once a year.

The BoD may not rely entirely on assistance from the executive board to perform these tasks; thus, it must also employ targeted BoD committees. Since actual IT committees are very rare in practice, IT tasks are often referred to the audit committee. However, it is important to bear in mind that the BoD cannot circumvent its IT responsibilities by delegating in this way. In accordance with article 716a in connection with article 717 of the SCO, the BoD assumes responsibility for the careful execution of non-transferable duties, and can be prosecuted even for a minor breach of its obligations with reference to article 754 of the SCO.

Risk management is particularly important for the BoD in connection with the duty to exercise overall management. Irrespective of size and industry, all companies face IT risks. For this reason, the BoD must ensure that these risks are recorded, analyzed, and mitigated in line with corporate priorities.

2.2 The Impact on the Duty to Determine the Company's Organization

In order to exercise the overall management of the group, the company has to be sufficiently organized. This means that tasks, rights, and responsibilities must be allocated. The same applies to IT. In the interests of avoiding redundancies and ambiguities within each individual's area of responsibility, it is necessary to develop specific job profiles for the employees involved and to define the corporate hierarchy. In large companies, a chief information officer (CIO) may be appointed to deal with this task. While the importance of the IT department continues to increase, that of the CIO is decreasing. The focal point today is to increase IT efficiency.

As part of the organization, it is extremely important for the BoD to define access rights. In order to prevent the theft of data, which frequently occurs, employees should only have access to data that they require to fulfill their role. Employees' rights to independently install software must also be limited. This is the only way to avoid the infiltration of malware.

2.3 The Impact on the Appointment and Supervision of the Executive Board

The appointment and supervision of the executive board has also changed significantly as a result of digitalization. For example, when vacant posts on the board are advertised, not only are advertisements placed in print media, but also on major social media platforms. In this way, more potential candidates can be reached.

Once applications have been received on paper or electronically, the backgrounds of the most promising candidates are often checked online. Racist utterances or sexually suggestive images of a member of the executive board could have extremely detrimental consequences. Therefore, the BoD should ensure that the online profiles of current and future members of the executive board can withstand critical checks.

The BoD can fulfill the responsibility of appointing members to the executive board by proceeding in the following way:

- carefully selecting members of the executive board (*cura in eligendo*),
- carefully instructing members of the executive board (*cura in instruendo*), and
- carefully monitoring members of the executive board (*cura in custodiendo*).

These three component tasks are an ongoing process. The BoD should not be content with the evaluation made at the time of employment. Instead, it should periodically check whether members of the executive board are still able to perform their tasks. Corresponding appraisals can be conducted to achieve defined annual targets. There is also software designed for this purpose.

2.4 The Impact on the Duty to Hold a General Meeting

In accordance with article 716a paragraph 1 (6) of the SCO, the BoD is obligated to compile annual reports, prepare for general meetings, and implement

resolutions. The ordinance against excessive compensation (Verordnung gegen übermäßige Vergütungen, VegüV) dated January 20, 2013 imposes additional duties on listed companies in connection with the general meeting. These new tasks would be impossible to perform without digital aids. In accordance with Article 9 of the VegüV ordinance, the BoD must ensure that shareholders have the option to provide instructions to their independent proxies concerning each motion to agenda items provided in the invitation to the general meeting, as well as to provide general instructions concerning new motions not disclosed in the invitation and new agenda items pursuant to article 700 paragraph 3 of the SCO, and to grant proxies and instructions electronically.

The BoD is also responsible for preparing the annual report, which is comprised of financial statements, status reports, and consolidated financial statements if applicable. Depending on their importance for the company, details of the IT infrastructure may be included in the status report. When drafting the financial statements, the BoD must ensure that capitalized work is not excessive, particularly with respect to the IT department (e.g., software creation), and that hardware and software is included according to operational requirements.

Article 700 paragraph 1 of the SCO stipulates that shareholders must be invited to the general meeting at least 20 days in advance. This raises the question about whether shareholders can be invited electronically. Since the form of the invitation is expressly left at the discretion of statutory regulations, in principle, invitations may be sent via email.

In the event of shareholder objections, the BoD must ensure that participants are entitled to participate in the meeting, and that unauthorized third parties are excluded from the proceedings. These types of checks can only be executed in large public limited companies using electronic aids that are based on electronic share registers.

Finally, the BoD is responsible for accurately counting votes, which includes confirming voting eligibility and providing reference documents for secret ballots. In large companies, software can be very helpful for performing these duties.

2.5 The Impact on the Duty to Notify the Court in the Event of Overindebtedness

In accordance with article 716a paragraph 1 (7) of the SCO, the final non-transferable and inalienable duty of the BoD is to notify the court in the event of overindebtedness. Many liability claims are founded on this duty. Article 725 of the SCO provides the legal differentiation between capital loss and overindebtedness.

Under company law, capital losses are recorded when cumulative losses account for at least half, but not all, of the nominal share capital and statutory reserves. The law stipulates that losing half of the capital is a critical threshold. In the event that this threshold is exceeded, shareholders must be informed without delay of the company's tense financial situation so that they can decide on remedial measures.

A company is overindebted, per article 725 paragraph 2 of the SCO, if balance sheet losses have entirely consumed the equity capital. At this point, the available assets, as calculated in accordance with the corresponding regulations, only partially cover the debt capital (liabilities and reserves). A distinction can be made between real and artificial overindebtedness. In the event of real overindebtedness, debt capital is no longer covered by asset capital when all hidden reserves have been dissolved, which means that the equity capital is actually lost. In the event of artificial overindebtedness, the dissolution of all hidden reserves would mean that third-party liabilities are covered by the current and fixed assets, and that the equity capital is only lost on paper.

The evaluation of the IT infrastructure and capitalized work in connection with the creation or implementation of software often has a significant impact on the final categorization of the overindebtedness situation. The BoD should not rely solely on input from the internal IT department for this purpose. Instead, external evaluations should be conducted and submitted to the external auditor.

The digital era has also significantly changed procedural aspects. According to article 130 of the Swiss Civil Procedure Code, it is not necessary to inform the court on paper; this can be done electronically. The document containing the application for the commencement of insolvency proceedings due to overindebtedness and the impossibility of a return to viability must be certified with the recognized electronic signature of the sender. However, if documents are submitted electronically, the court is at liberty to request that the submission and the attachments be also submitted on paper.

3 Summary and Recommendations

In the digital era, the BoD has the additional task of information governance. The handling of data is a significant problem. Decisions about the processes, organizational measures, and technologies that are required to actively manage data at all stages must be made that comply with the external and internal regulations. In this sense, information governance also comprises the sub-areas of management information systems (MIS) and risk management.

New technologies, such as online shopping platforms and the social media, are forcing BoD to deal with the digital revolution. Data are the currency of the information era. By gathering, storing, and evaluating large amounts of data (so-called big data), the foundations can be laid for data-based decision-making, which can help improve the efficiency of a company. The driving forces of digitalization include new technologies, changes in consumer behavior, new data protection regulations, and increased cost awareness.

Continually monitoring and adapting corporate strategies have become important because of digitalization. New, spontaneous business developments and the resulting competition, such as Uber as an example of sharing investment goods, are just as much of a challenge for BoD as the potential for an “economy on demand.” Some companies are employing as few personnel as possible and outsourcing their services abroad, including IT.

The digital era harbors many strategic advantages, but BoD must remain vigilant of the risks and dangers that it entails. Physical security is no longer the issue—companies require virtual protection from attacks from outside and within. This requires considerable changes in IT organization. The head of IT is no longer responsible for the protection of data, but rather the corresponding division head.

With this in mind, the BoD has to master the following information governance tasks:

- the strategic definition of IT targets and IT resources;
- the future organization of the IT department and corresponding team development;
- comprehensive internal and external communications on IT topics; and the continual monitoring of IT compliance and IT security.