WHAT DIRECTORS THINK
A CORPORATE BOARD MEMBER/SPENCER STUART SURVEY
Let’s face it—sitting on a public company board is not the job it once was. In the years since Sarbanes-Oxley was enacted in 2002, directors have exchanged expense-paid club memberships, retreats to exotic locales, and a seemingly untouchable status for longer hours, pervasive liability, and increasingly intense scrutiny from shareholders, regulators, and the public. So why do they continue to serve?

Foremost, directors tell us the job can be very rewarding—even profitable, though the latter, they note, is not always commensurate with the workload. To better understand directors’ motivations, fears, and desires, each year Corporate Board Member conducts its flagship What Directors Think study. In the last 11 years, we’ve gathered data and opinions on a wide range of issues encompassing risk and liability, strategy and performance, and much more.

In order to share the data we’ve compiled along with post-survey interviews where we dug deeper into directors’ insights, we’ve organized our survey responses into four key areas this year: risk oversight, strategy and performance, shareholder engagement, and board structure. Though risk is not a new focus area, it is certainly one that is expanding and ever changing; likewise, strategic issues are consistently a top-drawer concern for directors. As Charles Rossotti, nonexecutive chairman at AES Corp. noted, “At the board level, risks are a focus of every meeting and, in fact, every committee. In the last few years, focus on risk has been elevated to adopt a more strategic focus that looks across the whole portfolio for themes and correlations.”

Shareholder engagement, meanwhile, is a more recent focus area—and one that some directors may either need coaching on or boards may need to bring on directors who have such experience, our survey results show.

With those subject areas in mind, read on to see how the directors we surveyed handle the critical and often complex issues that arise in the boardroom. Armed with this information, we hope these results will help you assess whether your own board is prepared for the challenges of 2015 and beyond.

Risk Oversight

Perhaps the single biggest challenge directors face is understanding the multiple forms of risk their companies are encountering today. In fact, 55% of the directors we surveyed don’t believe it’s reasonable to expect that a public company board can ever fully get its arms around all the different aspects of risk in the current corporate environment (Figure 1), particularly the newer forms of technology risk like cyber risk and social media risk. This begs the question: Are boards today equipped to tackle all that is thrown at them, especially in these emerging, and largely unknown, risk areas?

“The expectations placed on boards in terms of what they are asked to oversee is much greater today due to many factors, including an increasingly dynamic global economy, political uncertainty, disruption caused by new technologies, and an active M&A environment,” says Kevin M. Connelly, CEO, Spencer Stuart. “As a result, directors find themselves needing to be knowledgeable in areas they may or may not have had much past exposure to or experience in, such as cybersecurity.”

With a relatively low amount of director turnover, boards today often look to add directors who tick several boxes for the board, for example, relevant industry and global expertise as well as financial acumen, Connelly notes. In some cases, he says, boards have elected to enhance their board composition by adding a director with digital expertise; however, in most cases, this is to augment the business strategy as opposed to a direct focus on cybersecurity. “As the expectations of boards continue to grow, we predict more boards will look to outside experts to help them address, and bring an increased focus to, areas of expanded oversight such as IT risks and cybersecurity,” he says.

In terms of their confidence in managing risk oversight, survey respondents are most confident in their ability to monitor operational risk and internal fraud (72% very confident; only 1% or less not confident), followed closely by FCPA/anticorruption risk and legal risks related to labor and employment (64% and 62%, respectively, very confident). Cyber risk and social media risk gathered the highest percentages of “not confident” ratings, at 23% and 19%, respectively.

In an effort to better understand these risks, directors realize they have to face them head on—in the boardroom. In terms of risk issues the board has covered as an agenda item in the last 12 months, more than 90% of the directors we surveyed cited operational risk, followed by cyber risk at 80%, and sudden loss of leadership at 79%. It’s telling that, while it appears directors are discussing cyber risk, a large percentage still aren’t fully confident in their ability to manage it. Also of interest, only 35% of respondents...
In light of heightened risk concerns today, we examined directors’ opinions about the formation of a separate risk committee, which was mandated for financial companies and certain others in the wake of Dodd-Frank legislation.

While some experts maintain that cordoning off certain aspects of risk for deeper examination at the board level is a good idea, others believe the entire board needs to stay fully immersed in risk oversight, and in fact, more than half (54%) of board members surveyed agree, and do not see the need for a separate committee. Twenty-four percent concede that while a separate risk committee is a good idea, their board has no plans to create one. Meanwhile, 18% serve on boards that already have a risk committee, and an additional 4% are on boards that are in the process of creating a separate risk committee.

Strategy and performance, which go hand in hand in terms of helping to drive the business forward, are perennially of concern to the directors we survey each year. This year, we asked directors to identify board actions that are critical to company performance (Figure 3). Regular evaluation of the CEO was rated “very important” by 96%, with review of short- and long-term strategic plans a close second at 91%.

Bruce Claflin, who has been a director for 15 years and currently serves on the boards of Ciena Corp. and as chairman of Advanced Micro Devices (AMD), believes the most important thing a board can do is to make sure it has a strong leadership team in place. “If the senior team is lacking, they will either not be able to think strategically or [not] be able to execute the strategy they devise, and there will be no compensating for this by anything the board can do.”

Indeed developing a strong emphasis on having the right talent at the senior team level, as well as evaluating the strength of the entire workforce, can often make the difference between a leading and a lagging company.

Clearly, directors believe human capital and talent are just about the most critical factor tied to the success of the business. But are directors doing enough
to plug into the gaps and talent driving the human side of their businesses, and what tangible impact can that have in their ability to help drive business forward?

“In a world where the rapid pace of change and growing complexity calls for stronger, more visionary leaders, the ability of boards to make astute judgments about internal leaders is critical,” says Thomas J. Neff, chairman of Spencer Stuart U.S. “While boards find themselves with increasing accountability for CEO succession planning, they often lack the insights to thoroughly assess their company’s rising executives, make judgments to understand whether a candidate will be ready when the time comes or know when to seek outside talent.”

He says one reason directors sometimes miss this important piece is because their exposure to likely candidates (for both CEO and senior management roles) may be limited, and therefore they may not have the insights or the information needed to make the most informed decisions. “In order to help boards feel more confident in their knowledge of internal talent and that they have the right candidates to move the company forward, it’s important that the board engage with HR and the CEO to ensure that the company’s assessment and development process is active, robust, and well managed,” Neff says.

Claflin agrees, noting that once a strong C-suite team is in place, “the board must make sure it allocates sufficient time at every board meeting to discuss strategy in order to keep it top of mind with the management team,” whom he says will inevitably have more immediate pressures dominating their time.

Other crucial issues directors identified include regular evaluation of the use of capital as well as frequently reviewing management’s assessment of organizational bench strength (both were rated “very important” by 83% of respondents), regular analysis of potential acquisitions (73% very important), periodically meeting with managers onsite (62% very important), and bringing innovative ideas to the boardroom (58% very important). In a follow-up question, the survey sought to evaluate how effective boards
are at these activities. Again, regular evaluation of CEO performance was highly rated, along with regular evaluation of the use of capital.

Turning the lens inward, we asked directors to rate the effectiveness of their board in monitoring corporate performance. Nearly 70% said understanding and agreeing on the company’s key performance objectives and strategy is what their board does best (69% very effectively; 28% somewhat effectively). Furthermore, 63% said their board is very effective at developing and confirming that key performance objectives are monitored and achieved, while 32% said their board is somewhat effective at doing so.

But when we asked directors if they feel comfortable in their understanding of management’s rationale when there are fluctuations in the financial numbers, there was a more mixed response. While 50% said yes, always, 46% said yes, usually. Though notable in comparison to the other figures, this latter finding likely reflects the wide range of expertise among board members—some of whom qualify as financial experts and others who rarely deal with in-depth financial reporting.

In addition, for senior management, knowing what to include in the board’s financial review can be a challenge—too much financial detail can be overwhelming, while too little financial detail could create gaps in areas where board members must make key strategic decisions. Thus, striking the right balance to ensure directors are comfortable and responsibly informed is key to helping them perform their fiduciary duties.

Finally, we asked directors a question we’ve asked in some form every year since our survey began. Does your board spend enough time on strategic planning? Interestingly, although nearly three-fourths (74%) said yes (Figure 4), the response “more time for strategic planning” still topped their list of aspects they wished for to improve their board experience (Figure 5).

WHO DO WE SURVEY?

This year we received nearly 500 responses from directors who didn’t mind sharing their opinions and comments on these issues. More than 70% came from those who identified themselves as outside directors, and another 20% said they serve as board chair or lead director. Forty-four percent have served on a board for more than 10 years, and another 33% have served five to 10 years. Just over 30% are at companies whose annual revenues are in the $1.1 billion to $5 billion range; another 20% serve companies in the $500 million to $1 billion range. The remainder are fairly evenly split between companies with less than $500 million in revenues and those with revenues $5.1 billion and above.
the board’s time in recent years, spurred by issues related to increased disclosure, majority voting in director elections, and say on pay, among others. And there’s little doubt the current uptick in shareholder activism has increased awareness of the need for transparency and external communication.

John Ballbach, who has served on several boards in the last 10 years, including his current directorship at Valspar, explains, “Today’s public companies need at least one or two board members with experience in private equity and/or with activism. It is important to understand the mindset of activist investors, their (determined) approach, and levers they are likely to engage.”

To get a feel for how well boards know their investors, the survey asked directors to rate their board’s understanding of its investor base. Nearly 60% rated their board’s understanding as good, while 29% rated it as excellent. Only 12% said fair and 1% poor.

Next we ascertained the level and type of communication boards have with their shareholders. One such form of communication involves shareholder proposals. Though data from Georgeson indicates the number of shareholder proposals submitted annually has remained at an active and steady level since 2012, only 20% of the directors we surveyed indicated shareholders had introduced proposals on their proxy ballots in the last 12 months. Of those that saw proposals introduced, 68% said the process went smoothly and amicably, while 23% said that despite some dissension, shareholders, the board, and management were ultimately able to come to an agreeable outcome.

Although they may not have had shareholder proposals to contend with, many of the directors we surveyed did indicate they engaged with shareholders outside of the annual meeting in the last year, with the most common topics being executive compensation (41%), financial underperformance (33%), change of leadership (27%), and board nominations (27%).

Communications and activism related to the composition of the board has certainly ramped up in recent years and was especially acute in 2014, when ISS’s new focus on director tenure shined a bright light on the issue of director independence.

“We are observing that shareholders desire more transparency into board composition—specifically, who is in the boardroom and whether they have the skills and perspective to bring independent oversight in making smart, strategic decisions for the company in critical areas including CEO succession, risk oversight, and corporate strategy,” notes Julie Daum, leader of Spencer Stuart’s North American Board Practice.

“Most boards (93%) have annual elections, a practice that is viewed favorably by large investors, Daum says. “Investors are also starting to become more vocal on director tenure when independence may become blurred based on the length of time a director has been on a board.” As a result, she explains, “We’ve seen proactive boards more commonly preparing skills matrixes to provide deeper understanding of the skills and demographics of directors, as well as communicating on topics such as say on pay, CEO compensation, director slate, and chairman independence.”

With these conversations in mind, we asked directors if their board has clear protocols designed to explain how to engage with investors. While almost two-thirds (62%) said yes, nearly 30% said no.

And though that 30% figure might raise some eyebrows, John Ballbach, the Valspar director, says he would be surprised if a standard set of protocols could easily be developed to deal with each and every situation. In fact, he says the bigger concern is whether board leadership understands the importance of having a member with direct experience who can help the board and its advisers when preparing for and reacting to an activist environment. “I believe too many boards rely primarily on outside advisers to educate themselves on the potential for activism and how to deal with an activist,” he explains.

So while developing a standard set of protocols might sound tricky to implement, the recently introduced Shareholder-Director Exchange (SDX)
whether board diversity should be mandated in the United States. More than 70% strongly disagree with that premise, though a nearly equal number believe boards ought to voluntarily set diversity goals and agree that a more diverse board stimulates better decision making. Nearly half of those surveyed believe there is still an inadequate supply of diverse board candidates. So what should be done, that isn’t currently being done, to continue the momentum toward greater boardroom diversity?

"Progress toward more diverse boardrooms in the US is slower than in other countries, particularly in comparison to those countries that have opted to mandate changes in board composition,” says Daum of Spencer Stuart. “In the US, one of the primary reasons we see a lack of increase in diversity is the lack of turnover in the boardroom.” Daum notes that US boards have traditionally steered away from term limits and have relied instead on retirement ages to encourage turnover. Indeed when we asked directors whether it is a good idea to have a policy on director tenure that specifically outlines how long a director should remain in place before the board needs refreshment, nearly two-thirds (65%) said no.

Moreover, retirement ages have been steadily moving up, and most boards now have a retirement age of 72 or older, which has had the unintended effect of stifling refreshment, she says. “The result has been an increase in board tenure, an increase in average age, and a decrease in board turnover. The result is a lack of opportunity for new directors, including women,” explains Daum.

Many directors we spoke to are quite certain, however, that the tide needs to change to encourage refreshment and diversity. Charles Yamarone, a board member for more than 20 years who currently serves as a director for United Continental Holdings and El Paso Electric, says that having a diverse board is especially critical with regard to creating a culture of "continuous improvement.” Yamarone also notes that directors from "varied backgrounds are more likely to help management gain a wider range of insights into areas for improvement.”
Claffin, the Ciena Corp. and AMD director, agrees, saying management and boards should "expose themselves to others who may have insights into the company’s industry, customers, and competitors in order to ensure they are not too inwardly focused.”

This matter is particularly poignant at present, as companies strive to find a balance that seems appropriate for their board as well as to address the concerns of investors and ISS, which has elevated the issue to a top priority.

“Boards are not good at refreshing themselves,” said Michael Garland, assistant comptroller in the New York City Comptroller’s Office, during a recent appearance on “Governance Minutes,” produced by the Society of Corporate Secretaries. “I don’t think directors are comfortable telling their fellow directors to go, and when you have a board with a large number of tenured directors, it raises concerns about director independence, first and foremost. But also, investors are looking for diverse boards, with diverse, fresh perspectives,” Garland said.

IS YOUR BOARD READY?

Considering the rapid pace of change in today’s corporate environment, your board will likely face numerous challenges in the coming months, and on multiple fronts. Topping that list, many directors say, is risk. Boards must be ready to oversee a myriad of risks, especially those related to cybersecurity—and the social media realm—which is unfamiliar territory for some current directors (Figure 6).

As a result, forward-thinking boards looking to refresh their ranks will want to add members who have technological and social media experience to guide the board in an arena where it is all too easy to make innocent but often damaging corporate blunders. Boards also value directors who have industry, financial, and regulatory experience, our results show. Filling these roles may provide the added bonus of attracting directors who will bring diversity to the boardroom—in terms of thought, age, gender, and ethnicity.

In addition to refreshment in the boardroom, directors also need to make sure they have the right management team in place to drive the business forward.

Our survey results have consistently indicated that strong leadership in both the boardroom and C-suite, with leaders who share a common vision, is the key to long-term performance. Thus directors must continue to devote meeting time to reviewing the strategic plan—and making sure management sticks to that plan.

Finally, directors will want to continue to improve their dialogue with shareholders, who ultimately will hold the board accountable for the company’s overall success. In doing so, these important stakeholders—along with regulators, employees, and the public—will continue to demand transparency and due diligence from board members.

Now is a good time to take stock and ask your fellow directors: Is our board ready to meet the challenges 2015 and beyond will bring?

Corporate Board Member would like to thank its research partner, Spencer Stuart, and all the directors who took time to participate in our survey.