WHAT DIRECTORS THINK

SUCCESSFULLY NAVIGATING TODAY’S CHALLENGES WHILE MAXIMIZING SHAREHOLDER VALUE

A CORPORATE BOARD MEMBER/SPENCER STUART SURVEY
DUE TO AN EVER-CHANGING MARKETPLACE, public boards are constantly realigning their priorities to ensure they can fulfill their fiduciary duties while enhancing shareholder value. To that end, NYSE Governance Services issues an annual survey, What Directors Think, to better gauge board practices and understand what’s on the minds of US public company directors, thus bringing fresh insight to the corporate governance community and better understanding about best practices for boards to follow.

In the fall of 2015, NYSE Governance Services joined forces with Spencer Stuart to poll nearly 400 US public directors for the 13th edition of our flagship survey. This report shares the key findings of this research.

KEY TAKEAWAYS

• Half (48%) of the directors surveyed agree that economic uncertainty is one of the biggest challenges facing corporate boards in 2016, ahead of market risk (37%) and cyber risk (35%).

• More than a third of those responding (38%) believe that although they are doing all they can to protect the company’s data, most cybersecurity risk is really out of their hands.

• Over half (57%) of those surveyed say they have not thoroughly vetted a crisis communications plan within the past 12 months. Yet, 52% are confident their current plan would run successfully.

• Two-thirds (65%) of respondents agree that direct engagement with shareholders can serve to open dialogue in a meaningful way before critical issues come to a head.

• Nearly two-thirds (62%) of board members surveyed believe the recent wave of hedge-fund activism has reinforced and rewarded short-termism.

• Close to half (42%) of directors surveyed believe their board needs to focus more on long-term strategic planning.

• Industry (83%) and financial (78%) expertise/experience are the two most important attributes sought during the selection of a new board member.

• Almost half (45%) of our respondents lack confidence in the idea that their employees are thoroughly trained, understand, and assume appropriate responsibility for compliance related to the use of corporate social media, followed by data security (33%) and third-party risk (28%).

• Most respondents showed great confidence in their employees’ training, understanding, and compliance with insider trading (92%), internal controls (92%), and antibribery rules (87%).
RISK OVERSIGHT

One of the fundamental responsibilities of the board is to oversee the universe of risks that can damage reputation or impede shareholder value. Looking ahead to 2016, directors revealed that a waviering economy and a bumpy global market currently top their list of challenges (Figure 1).

Following the first uptick in interest rates in nearly a decade, there’s speculation as to how quickly rates will continue to escalate. Add in typical election year jitters, the impact of trade policies, tax issues, and a tumbling US stock market, and it’s no wonder directors are on edge.

As veteran director Mark Sheffert, chairman and CEO of Minneapolis-based Manchester Companies, a business management consultancy, points out, “In essence, the directors and executives will need to fire the arrows while the government is out there running around with the target, [which makes it] pretty hard to get a bull’s-eye!”

Given the plethora of recent high-profile breaches, it is no surprise that cybersecurity rounds out the list of the three biggest challenges directors expect to face in 2016. Considered a leading concern from a regulatory, reputational, and contingency standpoint, cybersecurity is also one of the top three issues directors believe their board is not addressing adequately (Figure 2).

In fact, more than a third of our respondents believe that while they are doing all they can to protect the company’s data, most cyber risk is really out of their hands (Figure 3).

The fact is, for many companies, it’s difficult to know where to start. Many board members do not have the cyber expertise necessary to deal with today’s high-tech breaches. A quarter of the directors we surveyed believe an outside adviser would help the board improve its oversight of cyber risk and 83% say it is at least somewhat important to consider IT/cyber expertise when selecting new board members.
Beyond the optimization of their cybersecurity oversight, boards also need to make sure their company has a comprehensive crisis communications plan in place in the event a breach occurs. The recently released *Navigating the Digital Age: The Definitive Cybersecurity Guide for Directors and Officers*, a collaboration of the New York Stock Exchange and Palo Alto Networks, reports that a delayed, bumbling response to a security breach often leads to increased data loss, exposure to regulatory action, and reputational damage.

“When a breach occurs, there will be pressure to move quickly. You will have to make a series of decisions in a matter of hours. Therefore, it is vital to have policies and procedures in place,” according to Spencer Stuart CEO Kevin Connelly. Yet, while more than half of the directors surveyed (57%) say they have not vetted such a plan in the past 12 months, 52% are confident it would nonetheless run successfully (Figure 4).

Cybersecurity and all of the risks that keep directors up at night are also of concern to regulators, who in turn react with new rules aimed at increasing oversight and providing transparency for shareholders. The need to set the tone at the top around a commitment to compliance and ethics is therefore imperative, both for internal and external constituencies. Boards must ensure that senior management is fully committed to integrating the compliance culture throughout the organization and that it has developed, implemented, and communicated clear, enterprisewide compliance policies.

Most board members (95%) say they are confident in having instilled a culture of compliance and ethics throughout their organization, with some noting that it is an ongoing process that requires constant feedback and monitoring.

Where do directors believe their companies are most and least successful with regard to risk oversight? Directors are most confident in employees’ understanding, training, and compliance with regard to insider trading (92%), internal controls (92%), and antibribery rules (87%). In contrast, nearly half of them (45%) say they lack confidence that employees are complying with corporate social media policies (Figure 5).

To address these and other concerns, boards must continually evaluate their skill sets to ensure they have the right mix of experience and perspectives. In doing so, directors say their boards are looking for members with strong industry (83%) and financial (78%) expertise, along with gender diversity (59%) and CEO leadership experience (55%) (Figure 6).

**BOARD/C-SUITE COMMUNICATION**

To fulfill their responsibilities, boards must maintain a strong working relationship with the CEO and executive team. According to survey respondents, the board/C-suite pipeline is in good order. The majority of directors say they are satisfied with the level of information and in-person reporting they receive from their CFO (94%), CEO (93%), GC (90%), internal audit (88%), CCO (84%), and CIO/CISO (65%) (Figure 7).
However, at least a third of respondents think information flow between their board and management could be improved, either through a higher frequency of updates (36%), more concise reporting (31%), or in the time allotted to review materials prior to a meeting (34%). Other communication components directors believe could be of benefit include additional onsite visits with managers (44%) and more time allotted to discussing critical agenda items (47%).

Bearing out these mostly positive numbers, our survey reveals that major conflicts between the board and the CEO seldom arise. Most of our respondents agree good communication is the key to successfully working with management toward the common goal of maximizing shareholder value. Of course, boards do need to stand up to management on certain issues, but as one director noted, “Our board sticks to the role of strategic oversight and leaves management to manage...The relationship is one of respect for each other’s roles, and [we aim to find] a way to resolve differences in a positive way.”

Indeed, most directors seem to agree that opposing views are welcome in the boardroom. “Many conflicts are relative; it isn’t a matter of ‘giving in’ or ‘standing up’ but often entails discussion to understand both viewpoints,” commented one director.

In looking specifically at their relationship with the CEO, nine out of 10 survey respondents say they are pleased with their CEO’s ability to listen to issues raised by board members, think strategically...
about the future of the company, work as part of a complementary team with the board, communicate frequently with board members, and offer strategic analysis for initiatives and proposals (Figure 8).

With regard to succession, it appears that most CEOs are involved in planning their own succession, at least in the early stages of the process. More than 70% of directors indicated their CEO is involved in a periodic plan review, development of internal talent, and a determination of the desired skill set. As the search continues, just over half (53%) take part in the identification of finalists, though only 17% are involved in the management of external searches, which is primarily a board responsibility.

SHAREHOLDER ENGAGEMENT
In last year’s survey, directors revealed that shareholder engagement was becoming a more exigent issue for boards, which also aligns with the wave of proxy access proposals expected this year, as well as the uptick in many proxy contests. Two-thirds (65%) of the directors surveyed say they view direct engagement with shareholders as a way to open meaningful dialogue before critical issues come to a head.

Many directors, however, still prefer to refrain from engaging with investors outside the boardroom, regardless of the topic. Although some governance experts suggest boards should have more accountability toward shareholders, nearly a third (31%) of our respondents insist direct shareholder engagement carries undue risk of board and individual director liability. Moreover, 28% say it elevates the risk of violating Reg FD, 21% think it creates a wedge between the CEO and the board, and 14% feel direct engagement creates undue influence on the board.

Yet, more governance advisers are giving the green light to board and investor communications, provided there’s a well-defined policy guiding the circumstances and nature of the communications. Two-thirds of board members (63%) we surveyed say they have such a protocol in place.

On the investors side, in a June 2015 article published on the Harvard Law School Forum on Corporate Governance and Financial Regulation website, F. William McNabb III, chairman and CEO of investment management behemoth Vanguard, refers to
engagement as the be-all strategy to transparency, placing an emphasis on quality over quantity, including knowing your shareholder base, a criteria about which, as our survey indicates, the great majority of directors (86%) believe their board has a good to excellent understanding.

When it comes to shareholder activism, however, directors—even those who support engagement—have a markedly different viewpoint. Specifically, our study found that while half of the directors surveyed believe the recent wave of hedge fund activism has created more awareness for the need for good governance, 62% believe it has reinforced and rewarded short-termism, which can short-circuit decisions that directors believe will provide more sustainable, long-term growth (Figure 9).

And yet, the activists aren’t going away, so boards must think strategically about this challenge. As NYSE Governance Services President Adam Sodowick remarks, “Rather than putting their heads in the sand, boards could benefit from employing ‘think like an activist’ scenarios, examining vulnerabilities that may put them in the crosshairs. As is so often the case, the best defense is a good offense.”

**CONCLUSION**

To maneuver through all these headwinds, public corporations can either set their strategy and stay the course, hoping it is the right one, or prepare for various scenarios and be ready to deploy the best strategy at a moment’s notice.

Regardless of the approach taken, and considering the increasing complexity of issues on directors’ plates, boards need to evaluate their current communications, reporting, and information flow with management and be more attuned to their shareholders’ barometer as they address future agenda topics. And on those agendas, given what we’ve gleaned from respondents this year, risk oversight will stay front and center as the overarching challenge.
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