WHAT DIRECTORS THINK

GUARDED OPTIMISM AMID A SHIFTING POLITICAL LANDSCAPE

A CORPORATE BOARD MEMBER/SPENCER STUART SURVEY
EVERY YEAR, NYSE Governance Services and Spencer Stuart collaborate to survey directors of publicly traded companies to check their pulse on the challenges and best practices of corporate directorship in the United States. This year, in our 14th annual What Directors Think survey, more than 600 board members shared their thoughts about the unpredictability that characterized 2016 and the skill sets needed to navigate the uncertainty ahead. This report presents our key findings.

KEY TAKEAWAYS

• While a full third of board members agreed Dodd-Frank should be completely repealed, the majority (58%) argued in favor of tweaking only certain provisions.

• Half of the respondents believe a one-time deemed repatriation of 10% on offshore profits would support their company’s domestic growth.

• Six out of 10 directors anticipate the new administration will bear no effect whatsoever on SEC enforcement efforts, and 41% predicted a chilling effect.

• Two-thirds of directors said it is unlikely they’ll adjust their global strategy over the near term, though 46% speculated about the likeliness of doing so domestically.

• Thirty-nine percent of directors said they discuss cybersecurity at every meeting, a slight uptick from the 35% reported six months earlier.

• Four out of 10 respondents reported their board has at least one director with cyber expertise, with an additional 7% who are in the process of recruiting one.

• Strategy, regulatory compliance, and capital allocation remain the most discussed topics at board meetings.

• Three-quarters of directors said they would like to see more agenda time allotted to strategic planning.

• Nearly half of board members believe length of tenure does not affect board autonomy.

• Only 8% of directors reported being in favor of federal regulations for overboarding.
ECONOMIC POLICIES

There is no doubt 2016 will go down in history as a year of schismatic divide and turbulence across global markets. Yet, despite the divergence of opinions, our survey shows that the great majority of public directors share one uniform sentiment: a strong preference for the abatement of what many perceive as onerous regulations said to be stifling corporate growth and profitability. Dodd-Frank is often made out to be the bête noire of this ordeal and, while directors agreed that the 2008 financial crisis evidenced the need for rigorous oversight, a full third believe the act should be completely repealed for having done more harm than good. The majority (58%), however, admitted it had helped create stability in financial markets and therefore shouldn’t be fully dismantled (Figure 1).

With the change in administration, many directors are also hoping for a reduced regulatory burden, pointing to the growth potential that could arise from freeing corporations from certain rules in sectors such as energy, environment, and health care.

The data collected in the survey makes it clear that directors across all sectors and market capitalizations are divided on several issues, including the benefit of the one-time deemed repatriation of 10% on offshore profits, which about half (52%) believe would support their company’s domestic growth. When it comes to oversight of the securities markets and SEC enforcement, we find another mixed bag, with 57% believing the new administration will bear no effect whatsoever on those efforts and 41% predicting a chilling effect (Figure 2).

One director rationalized the opinion divide by noting that at this time, arrows appear to be pointing in different directions, making it difficult to predict which way the wind will blow. This befuddlement may explain why two-thirds (65%) of directors say it is unlikely they’ll adjust their global strategy over the near term, though nearly half (46%) speculated about the likeness of doing so domestically (Figure 3).

A large majority of directors who commented on the issue said they are hoping for a redress of the monetary policy along with corporate tax reform, which one director qualified as “the key to keeping companies domiciled in the US.”

FIGURE 1
SHOULD DODD-FRANK BE ROLLED BACK?

FIGURE 2
HOW WILL THE NEW ADMINISTRATION AFFECT SEC ENFORCEMENT EFFORTS?

FIGURE 3
HOW LIKELY IS YOUR ORGANIZATION TO ADJUST ITS STRATEGY OVER THE NEAR TERM?

DOMESTICALLY  |  GLOBALLY
---|---
46% Likely | 28% Likely
50% Not likely | 65% Not likely
4% Don’t know | 7% Don’t know
RISK OVERSIGHT

For public company board members, the long list of strategic and risk issues that perennially exists often makes setting the agenda a challenge in and of itself. According to our survey, around two-thirds of directors say they discuss strategic risk at every regular meeting, along with regulatory compliance. Nearly half say capital allocation is on every meeting agenda (Figure 4).

While these traditional topics come as no surprise, there has been a newcomer of late that has risen in the ranks of risk priorities: cybersecurity. Increasingly, breaches are occurring on larger scales, in more insidious ways and with greater repercussions, and boards are responding in kind. Thirty-nine percent of respondents said they discuss cybersecurity at every meeting (slightly higher than the 35% reported six months earlier in a separate NYSE Governance Services survey with Veracode), and nearly half report they do so “as needed” throughout the year. Moreover, 61% of directors surveyed indicated that their CISO regularly meets with the board to discuss the issue at length, 53% said they regularly bring in outside consultants to advise and educate them on the matter, and 41% reported that their board has at least one director with cyber expertise, with an additional 7% who are in the process of recruiting one. According to our survey, 20% of respondents reported having a committee dedicated to providing oversight of cyber/IoT risk, and nearly half (45%) said they rely on their risk or audit committee’s expertise in this matter. The remaining 35% choose to discuss and analyze cyber risk at the full-board level.

“It’s encouraging to see boards increasingly coming to the realization that cybersecurity is an organization risk issue, not just something that falls under IT’s domain.”

WHAT DIRECTORS THINK
Another area of risk that has been gaining attention involves business disruptions. Despite being a relatively nascent area of measurement in our survey, a surprising 61% of directors said their company already has a contingency plan in place in the event of a disruptive innovation, and an additional 35% remarked that although they haven’t laid out a strategy, they evaluate such risks regularly. A little over half of directors said management is responsible for identifying strategic disruptors; 40% say the full board does so as part of its overall risk oversight responsibility, and 3% say a separate committee has been tasked with that purpose. Only 5% of respondents reported not having a plan or not discussing the risk of disruptive innovations at the board level.

**BOARD COMPOSITION, COMPENSATION, AND PROCESSES**

In recent years, board refreshment has become the watchword of boards and governance observers, and director tenure is currently in the crosshairs of investors and proxy advisers. Interestingly, the directors we surveyed were fairly split on the issue, with nearly half (46%) believing tenure isn’t in any way correlated with their ability to fulfill their fiduciary duties and 54% believing there is a cutoff where objectivity and autonomy are affected (Figure 5). Many observers hold that long-tenured directors tend to challenge management more effectively than newer directors and that changing directors for the sake of refreshing a board on a specific time schedule is counterproductive to board effectiveness. Consensus from our respondents who agree that longer terms can become problematic suggests that directors whose tenures surpass 10 years should be carefully evaluated.

While the issue of refreshment is often framed in the context of objectivity, the larger concept relates to the idea that a board’s overall skill sets and perspectives must shadow the changes occurring within the technological, scientific, social, economic, and political realms. In that regard, 97% of directors responded they are either very confident (61%) or somewhat confident (36%) that their board has the right mix of experience, skill sets, and talent to conduct thorough and diligent oversight and take the company to the next level, while an average of just more than half of respondents (52%) reported being confident in their board’s gender and ethnic diversity.
Nearly 80% said diversity of viewpoints is the most important element to keeping a board fresh and effective and that matters of board composition should not be imposed by regulation but left to the particular context and circumstances of individual enterprises.

The issue of overboarding holds similar sentiment for most public board members, where, despite an elevated outcry from investors and proxy advisers, 76% of directors believe boards or their companies should have the discretion to impose limits on the number of boards on which a director can serve. An additional 16% say there shouldn’t be limits at all. Only 8% are in favor of federal regulation in this regard (Figure 6).

And while executive compensation has been under intense scrutiny for years, the more recent focus on director compensation is another topic that board members say has been blown out of proportion because of misconduct on the part of a very few individuals. Less than a third (29%) of respondents have discussed the idea of implementing director pay limits, despite more reports in the press claiming a growing number of companies are capping director compensation, particularly with respect to stock awards. Furthermore, although the liability risk and workload of directors are both growing exponentially, almost three-quarters of respondents (70%) report being satisfied with their remuneration.

SHAREHOLDER ENGAGEMENT

Directors have a duty to generate long-term value for shareholders and many are evolving their engagement practices and policies to meet and communicate with shareholders outside of the annual meeting. In fact, eight out of 10 agree that meeting with shareholders is a governance best practice that helps gain shareholder support and alleviate concerns before they escalate.

A majority (59%) of survey participants argued that while the IR or management team should be present during talks with shareholders, they shouldn’t single-handedly lead shareholder discussions. Some directors have opined that regular, ongoing engagement with shareholders can help mitigate the threat of activism, and two-thirds (66%) said their board regularly—at every meeting or throughout the year—discusses and assesses potential weaknesses that may make their company vulnerable to activism.
Long-term strategic planning and short-term growth and financial performance tied as the topics most often discussed with shareholders (Figure 7).

**KEEPING A FIRM GRIP ON THE WHEEL**

Corporate directorship in the US has never posed so many challenges, and boards have doubled up their efforts to stay on top of regulatory compliance requirements and oversee a growing myriad of risks, both new and traditional, all while keeping an eye toward the future.

General consensus calls for speculation and unpredictability to continue to muddy the waters for a little while longer. Risks remain high and abundant, with technology leading the pack, in terms of both information security vulnerabilities and the threat of disruptive innovations. There is no doubt that activism will remain rampant in 2017, while on the economic front, experts suggest it is best to keep a close watch on developments before changing course. In all, directors appear calm and steady at the wheel, with a strong grip on diligent governance practices.
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