What matters in the boardroom?
Director and investor views on trends shaping governance and the board of the future

2014

pwc

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Our Center for Board Governance helps directors effectively meet the challenges of their critical roles. We do this by sharing governance leading practices, publishing thought leadership materials, and offering forums on current issues. We also meet with boards of directors, audit committees, and executives to share our insights into significant corporate governance challenges and developments.

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PwC's Investor Resource Institute seeks to add value to investors' decision-making processes by sharing PwC's insights and educational materials regarding markets, industries, and corporate governance.

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Please note: Charts may not all add to 100 percent due to rounding

Executive summary

In the summer of 2014, PwC conducted two separate surveys to gain insights from both public company directors and institutional investors. Both surveys were structured to focus on certain trends which we believe are shaping corporate governance and will impact the board of the future. 863 directors responded to PwC's *2014 Annual Corporate Directors Survey*—of whom 70% serve on the boards of companies with more than $1 billion in annual revenue. At the same time, institutional investors with over $11 trillion in aggregate assets under management responded to PwC's *2014 Investor Survey*.

This research compares the responses of these two groups in order to identify areas where viewpoints are shared or different perspectives may exist. We hope directors, investors and management teams will use this information to help close the expectations gap. Highlights of what we learned include:

- **Both directors and investors say that financial expertise is the most important director attribute (93% of directors and 82% of investors say it's "very important").** Consistent with last year, both parties also place industry and operational expertise toward the top of their respective lists. However, investors prioritize risk management expertise more than directors (79% describe it as "very important" compared to 65% of directors). This may be a reflection of investors' concern about downside risk to their investment portfolios.
- **Investors and directors express greater concern about low levels of negative shareholder support than a year ago.** This year, 48% of investors say the board should become concerned with re-nomination if a director receives 20% negative shareholder support or less, versus 36% last year. Directors were also more conservative (31% say there should be concern at this threshold, compared to 28% last year).
- **Thirty-six percent of directors now say someone on their board should be replaced—a jump from 31% only two years ago.** Directors continue to cite diminished performance due to aging, lack of expertise and unpreparedness for meetings as the top reasons for their dissatisfaction with peers' performance. Perceived director independence, level of expertise, and over-boarding are the three most important factors investors consider in their director voting decisions—94% say they consider a director's independence and 85% a director's expertise and over-boarding.

- **Ninety-four percent of investors say there are obstacles to replacing underperforming directors, compared to only 53% of directors.** Investors perceive a close relationship between the CEO and the underperforming director as the greatest challenge. Directors who say there are impediments most frequently cite their board leadership's discomfort addressing the issue.

- **Investors are more skeptical about overcoming board diversity challenges.** Eighty-five percent of investors believe there are impediments to increasing gender diversity compared to just 14% of directors. Investors and directors also disagree about what the greatest challenges are; investors say the top impediment is that directors don't want to change their current board composition to create a position for a diverse candidate, while directors say it is a lack of awareness of qualified candidates.

- **All investors responding to the survey believe boards should be considering and discussing board diversity.** Nearly seven-in-ten directors say their board is already doing so. The responding investors also believe boards should be discussing majority voting, but only 19% of directors (from boards that have not adopted majority voting in director elections) have had, or are considering, doing so. A similar disparity exists regarding a combined Chair/CEO, as 94% of investors believe companies with a combined role should be discussing a split, but only 23% of directors of such companies have had, or are considering, such discussions.

- **Directors and investors both identify strategic planning, risk management and succession planning as top areas for board focus in the coming year.** Notably, 74% of investors say strategic planning should be a "high priority" for directors, and more than six-in-ten directors say they want to spend more time on this topic. But investors rank the appropriateness of performance metrics much higher on their priority list than directors do. A gap also exists regarding each party's prioritization of IT issues.

- **Ninety-five percent of directors say they understand their company's risk appetite at least "moderately well", compared to only 61% of investors who believe this is true.** More than nine-in-ten directors say their board understands the company's ability to prioritize the most important risks at least "moderately well", compared to 58% of investors who believe this is the case.

- **Two-thirds of directors now say their board participates in dialogue with investors and a similar number of investors say they are communicating with directors.** And, 48% of investors and 25% of directors say their communications with one another increased during the last 12 months. About one-quarter of investors and one-fifth of directors say they each increased communications with proxy advisory firms and regulators over the same period.

- **Directors and investors have some different perspectives about which topics are appropriate for direct communications.** That said, there are also some areas of general agreement. Eighty-five percent of investors say executive compensation is at least a "somewhat" important topic for dialogue with directors and 73% of directors say it's an appropriate topic. There is less agreement around communications surrounding board composition and risk oversight. Eighty-five percent of investors view communications on risk oversight as at least "somewhat" important, but only 62% of directors say it's an appropriate discussion topic.
- **Directors and investors both rate compensation consultants as the group that has the most influence on board decisions about executive compensation.** However, investors are 64 percentage points more likely than directors to believe that CEO pressure has a "very influential" effect on the board's decisions about pay.
- **When it comes to assessing the cumulative impact of "say on pay", at least two-thirds of each group agrees that say on pay has not resulted in a "right-sizing" of CEO pay despite the significant attention afforded compensation issues.** More than three-quarters of directors and investors at least "somewhat agree" that it has prompted directors to change the way they communicate about compensation, encouraged boards to look at compensation disclosure in a different way, and increased the influence of the proxy advisory firms. Moreover, 97% of investors at least "somewhat agree" that "say on pay" has allowed boards to hear from a broader group of shareholders—compared to only 70% of directors who feel the same.
- **There are considerable gaps between how engaged directors are with certain aspects of IT and how engaged investors believe they should be.** Eighty-one percent of investors believe directors should be at least "moderately" focused on new business models enabled by IT, but only 49% of directors say they are so engaged. At the same time, 90% of investors believe directors should be at least "moderately" focused on privacy risk but only 64% of directors say they are engaged at that level.
- **Nearly three-quarters of investors believe it's important for directors to be discussing their company's crisis response plan in the event of a major security breach, yet only half of directors have had those discussions.** Similarly, 63% of investors believe it's important for directors to discuss engaging an outside cybersecurity expert and only 42% of directors say they have done so.

Board composition and structure

One of the most significant trends impacting governance and the board of the future is the focus on board composition and structure. Shareholders are increasingly concerned about whether boards are effective in carrying out their oversight responsibilities. Consequently, board composition, voting support for re-nominated directors, and individual director performance have become key issues.

Which director attributes are most important?

Both directors and investors agree that financial expertise is a top director attribute; 93% of directors and 82% of investors say it's "very important". Consistent with last year, both parties also place industry and operational expertise high on their respective lists. However, investors prioritize risk management expertise more than directors—79% describe it as "very important" compared to 65% of directors. This may be a reflection of their concern about downside risk to their investment portfolios. Investors also say that gender diversity is more important than directors do, reflecting their views about the desired composition of boards of the future. Directors assign higher priority to technology expertise. Consistent with 2013, both groups rank marketing, human resources and legal expertise toward the bottom of their lists.

Preferred director attributes

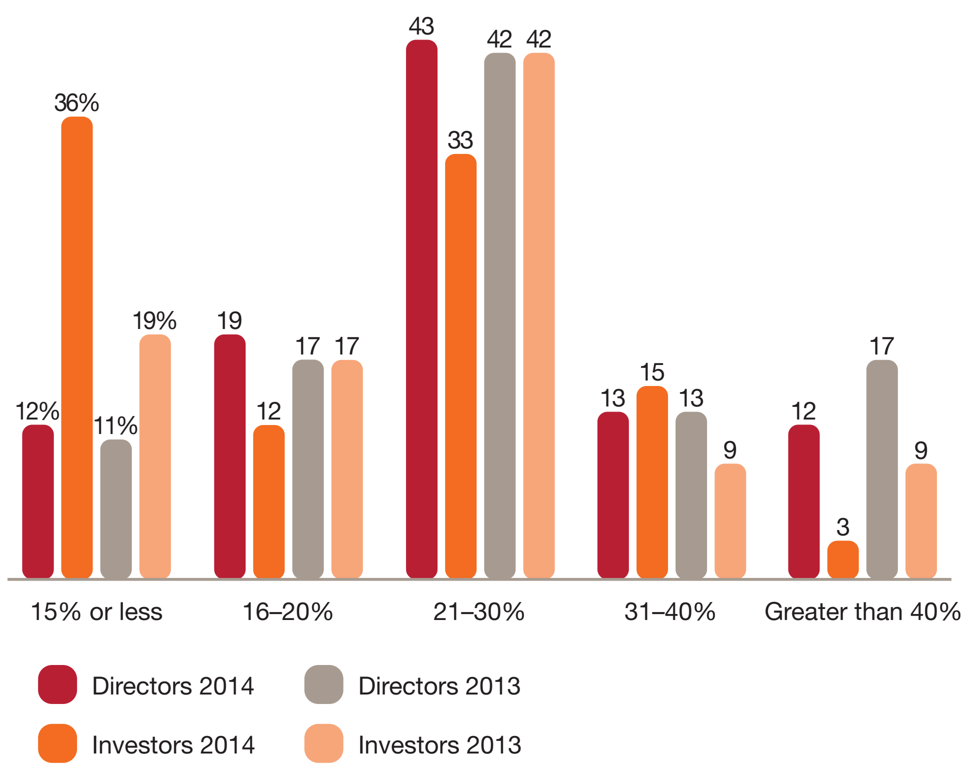
Directors		Investors
Financial expertise	1	Financial expertise
Industry expertise	2	Risk management expertise
Operational expertise	3	Operational expertise
Risk management expertise	4	Industry expertise
International expertise	5	Gender diversity
Technology/digital media expertise	6	International expertise
Gender diversity	7	Technology/digital media expertise
Marketing expertise	8	Legal expertise
Human resources expertise	9	Marketing expertise
Legal expertise	10	Human resources expertise

Survey Questions:
Directors: How would you describe the importance of having the following attributes on your board:* (Select all that apply)
Investors: How would you describe the importance of having the following attributes represented on US corporate boards:* (Select all that apply)
** Ranked by those responding "very important"*

Sensitivities about low support for board nominees

During the 2014 proxy season, directors received average shareholder support of 96%. But 5% failed to receive at least 70% support and 2% did not receive majority support[1]. Despite this relatively high overall level of support, investors and directors expressed greater concern about low levels of negative shareholder support than a year ago. This year, 48% of investors say the board should become concerned with re-nomination if a director receives 20% negative shareholder support or less—versus 36% last year. Directors were also more conservative (31% say there should be concern at this threshold compared to 28% last year). One-quarter of directors say that negative voting would need to exceed 30% before they should be concerned about re-nomination, compared to 18% of investors.

Concerns about director re-nomination support



Survey questions:
Directors: At what level of negative shareholder voting for individual director nominations should the board be concerned about re-nominating a director:
Investors: At what level of negative shareholder voting for individual director candidates should US corporate boards be concerned about re-nomination:

[1] *PwC+Broadridge ProxyPulse, October 2014*

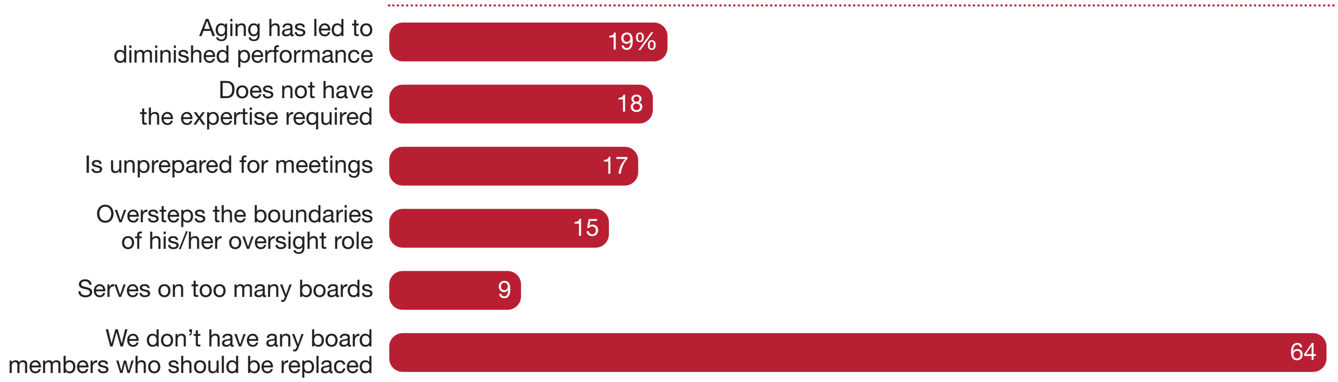
Perspectives on underperforming directors

The level of dissatisfaction directors express with their fellow directors continues to increase. Thirty-six percent of directors say someone on their board should be replaced—a jump from 31% only two years ago. Directors continue to cite diminished performance due to aging, lack of expertise and unpreparedness for meetings as the top reasons for their dissatisfaction with peers' performance.

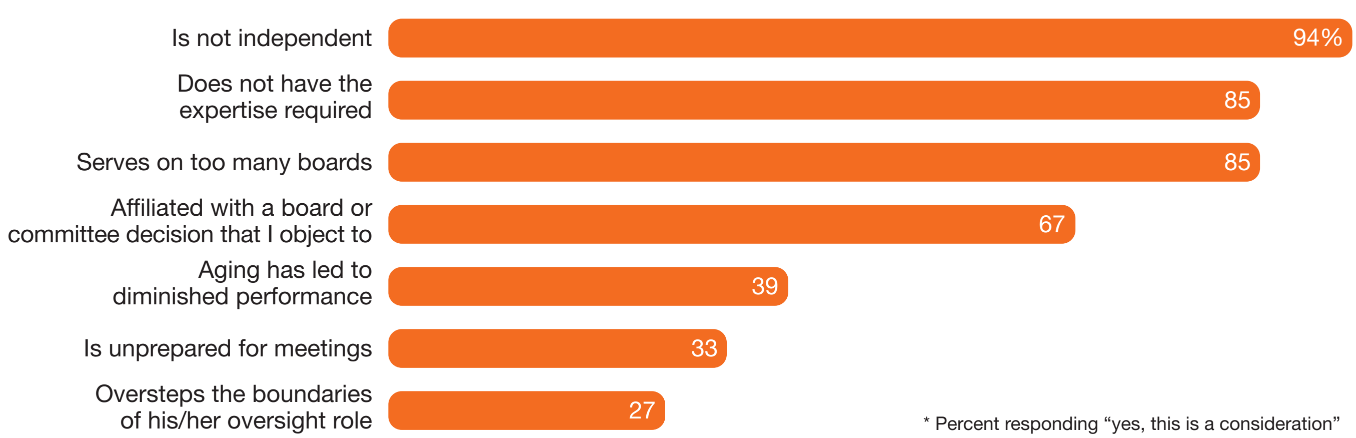
When investors decide whether to vote for individual directors, independence, perceived expertise, and over-boarding have the most impact. While 85% of investors say that a director serving on too many boards impacts their voting decisions, only 9% of directors cite over-boarding as a reason to replace a fellow director. Investors also say that diminished performance due to aging is less of a concern (only 39% say they consider it) whereas it's the top factor behind director dissatisfaction with their peers. This gap may reflect the perceptions of investors as compared to the actual experience shared by directors in the boardroom.

Director performance under the spotlight

Directors: Do you believe that any of your board members should be replaced for the following reasons: (Select all that apply)



Investors*: Do the following factors influence your decision to vote for/against (or withhold your vote for) a director: (Select all that apply)



* Percent responding "yes, this is a consideration"

Board renewal

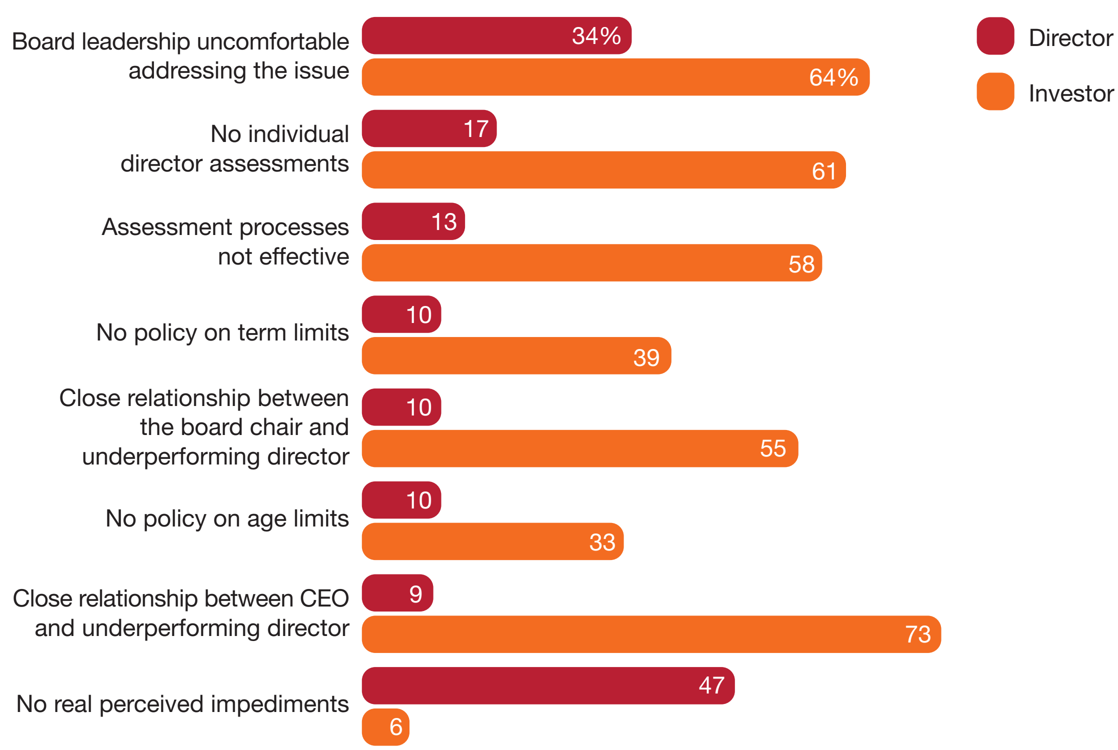
Many investors and other stakeholders are expressing a keen interest in board turnover and diversity. A number of individual shareholder groups have even undertaken initiatives designed to increase diverse representation on their investee companies' boards. Not surprisingly, directors are increasingly looking at director turnover and are focused on ensuring their boards have diverse backgrounds and experience. We expect this trend will continue to impact the board of the future.

Impediments to board renewal

There are significant differences between director and investor views on the impediments to replacing underperforming directors. Investors are much more skeptical in this regard. Ninety-four percent say there are obstacles to replacing those individuals, compared to only 53% of directors. Investors most frequently cite a close relationship between the CEO and the underperforming director, but only a small number of directors say this is a factor. Directors who believe there are impediments most frequently cite board leadership's discomfort addressing the issue as the greatest challenge.

The concern expressed by investors is consistent with an overall theme regarding their perception of the importance of director objectivity and independence. More than half of investors believe a lack of individual director assessments or ineffective assessment processes are specific challenges to replacing underperforming directors (compared to only 17% and 13% of directors, respectively).

Impediments to board renewal



Survey questions:
Directors: What are the impediments to replacing an underperforming director: (Select the most relevant considerations)
Investors: What impedes US corporate boards from replacing an underperforming director: (Select all that you believe are relevant)

Impediments to gender diversity

The number of women serving on US public company boards has increased only marginally over the past several years. And, investors are more apt than directors to believe there are impediments to increasing gender diversity: 85% believe there are obstacles compared to just 14% of directors. Investors and directors also disagree about the top challenges: investors feel that directors' unwillingness to change their current board composition to create a position for a diverse candidate is the number one reason; directors say a lack of awareness of qualified candidates is the greatest impediment. Only a very small percentage of investors believe finding qualified female candidates is a problem. A little over half of both groups say board leadership is not invested in recruiting diverse candidates.

Perceived obstacles to boardroom diversity*

	Directors		Investors
1)	Directors are unaware of many qualified diverse candidates	1)	Directors don't want to change the current board composition to create a position for a diverse candidate
2)	Directors don't want to change the current board composition to create a position for a diverse candidate	2)**	Board leadership is not invested in recruiting diverse directors
3)	There are insufficient numbers of qualified diverse candidates	2)**	Directors are unaware of many qualified diverse candidates
4)	Directors don't view adding diversity as important	2)**	Directors don't view adding diversity as important
5)	Board leadership is not invested in recruiting diverse directors	5)	There are insufficient numbers of qualified diverse candidates

** Results shown from top impediment to least impediment.*
*** Selections with same ranking had an equal number of responses.*

Survey Questions:
Directors: In general, what impedes a board's ability to increase gender diversity: (Select the most relevant considerations)
Investors: What impedes increasing gender diversity on US corporate boards: (Select all those statements that you think accurately describe the current state)

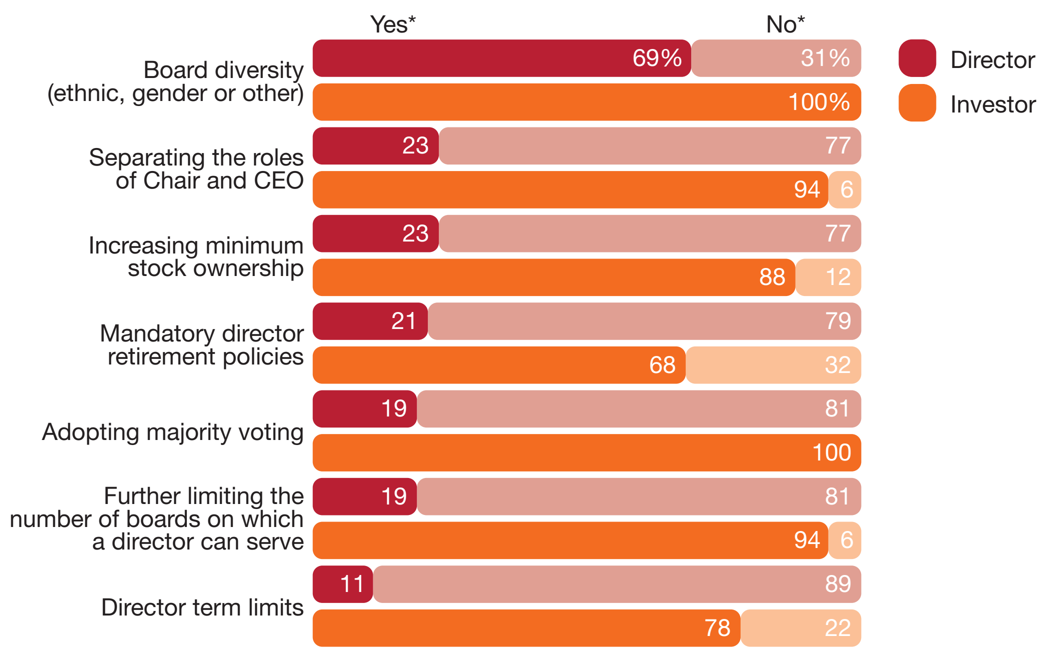
Board performance, priorities and practices

Directors continue to face scrutiny from investors and other stakeholders regarding their performance, priorities and practices. Today, boards are reassessing their discussions, agendas, and behaviors in order to evaluate and enhance their effectiveness. This includes continuing to emphasize a prime concern of investors—risk oversight.

Top governance issues for boardroom discussion

Directors and investors sometimes have different perspectives about the need to discuss or consider certain board practices. Regarding board diversity, all investors responding to the survey believe boards should be considering and discussing board diversity; nearly seven-in-ten directors saying their board is already doing so. However, there is less alignment in other areas. All investors responding to the survey believe boards should be discussing majority voting, but only 19% of directors (from boards that have not adopted majority voting in director elections) have, or are considering, doing so. Similarly, 94% of investors believe companies with a combined Chair/CEO should be discussing a split, but only 23% of directors of such companies have had, or are considering having, these discussions.

Governance issues for boardroom discussion



** Percentages noted have been calculated based on the exclusion of directors and investors that responded 'already adopted' or 'no opinion.'*

Survey questions:
Directors: Is your board considering/discussing any of the following:
Investors: Do you believe US corporate boards should be considering/discussing their policies on the following items in the upcoming year:

Where should directors spend more time?

Boards and their committees have to prioritize how they allocate their time. What are director and investor views on the most important areas?

Directors and investors both identify strategic planning, risk management and succession planning as top areas for focus in the coming year. Notably, 74% of investors say strategic planning should be a "high priority" for director focus, and more than six-in-ten directors say they want to spend more time on this topic. Investors rank the appropriateness of performance metrics as the top priority and executive compensation third. This fact mirrors an overarching theme related to investor concern about compensation.

Prioritizing the boardroom agenda

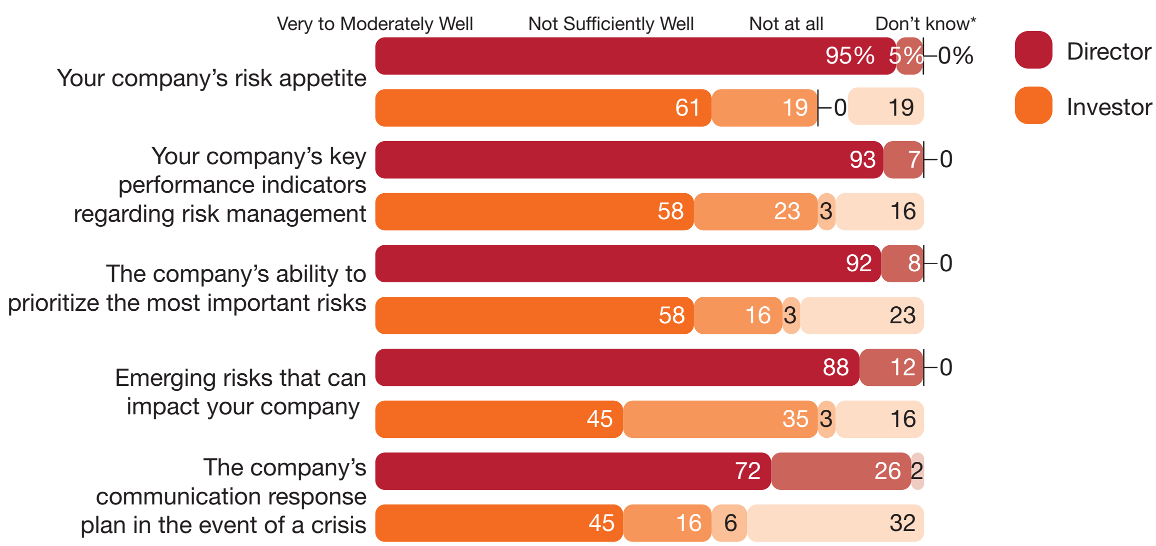
Directors		*Investors*
Strategic planning	1	Appropriateness of performance metrics
IT risks (including cybersecurity)	2	Strategic planning
Succession planning	3	Executive compensation
IT strategy	4	Risk management
Risk management	5	Succession planning
Talent management	6	IT risks (including cybersecurity)
Industry competitors	7	Talent management
Business intelligence/analytics (big data)	8	Crisis management/planning
Appropriateness of performance metrics	9	Regulatory compliance
Crisis management/planning	10	Industry competitors
Regulatory compliance	11	IT strategy
Executive compensation	12	Business intelligence/analytics (big data)

Survey Questions:
Directors: Please indicate if you believe your board should change the amount of time it spends on the the following:
Investors: In your opinion, which areas should US corporate boards prioritize their time in the upcoming year:
**Ranked by those responding "very important/high priority"*

Depth of director understanding about risks

Risk oversight is a critical board responsibility but directors express more confidence in their understanding of their company's risk issues than investors do. For example, 95% of directors say they understand their company's risk appetite at least "moderately well" compared to just 61% of investors who believe this about boards. And more than nine-in-ten directors say their board understands their company's ability to prioritize the most important risks at least "moderately well" compared to only 58% of investors who agree. Additionally, 88% of directors say they understand emerging risks that can impact their company at least "moderately well", but only 45% of investors have the same degree of confidence in the board's knowledge.

Depth of director understanding about risks



* The answer choice "Don't know" was not an option in the Directors Survey.

Survey questions:
Directors: In your opinion, how well does your board understand:
Investors: In your opinion, how well do US corporate boards generally understand:

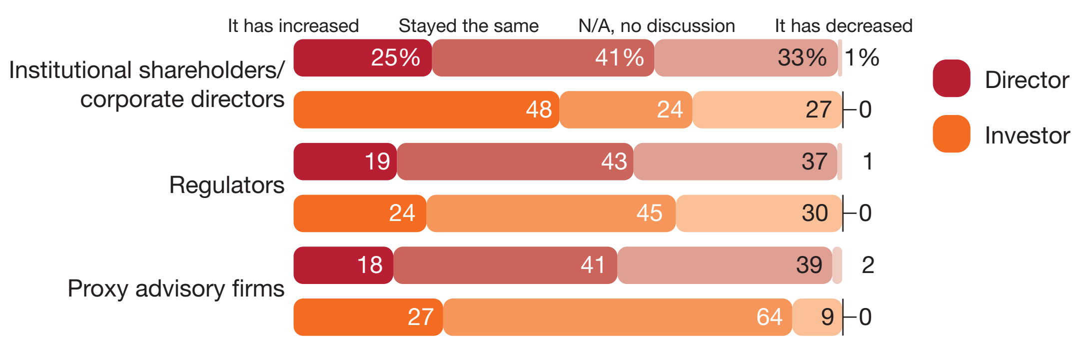
Director communications

Increasing expectations about director communications is another trend shaping governance and the board of the future. Boards need to evaluate their involvement in stakeholder communications and the nature of those communications. We asked directors and investors about their current behaviors and views about this important area.

External communications on the rise

Direct communications between directors and investors is a much more common practice than it was—even five years ago: two-thirds of directors now say their board participates in such dialogue. And, 48% of investors and 25% of directors say their communications with one another have increased during the last 12 months. About one-quarter of investors and one-fifth of directors say they each have increased communications with proxy advisory firms and regulators.

Director and investor external communications



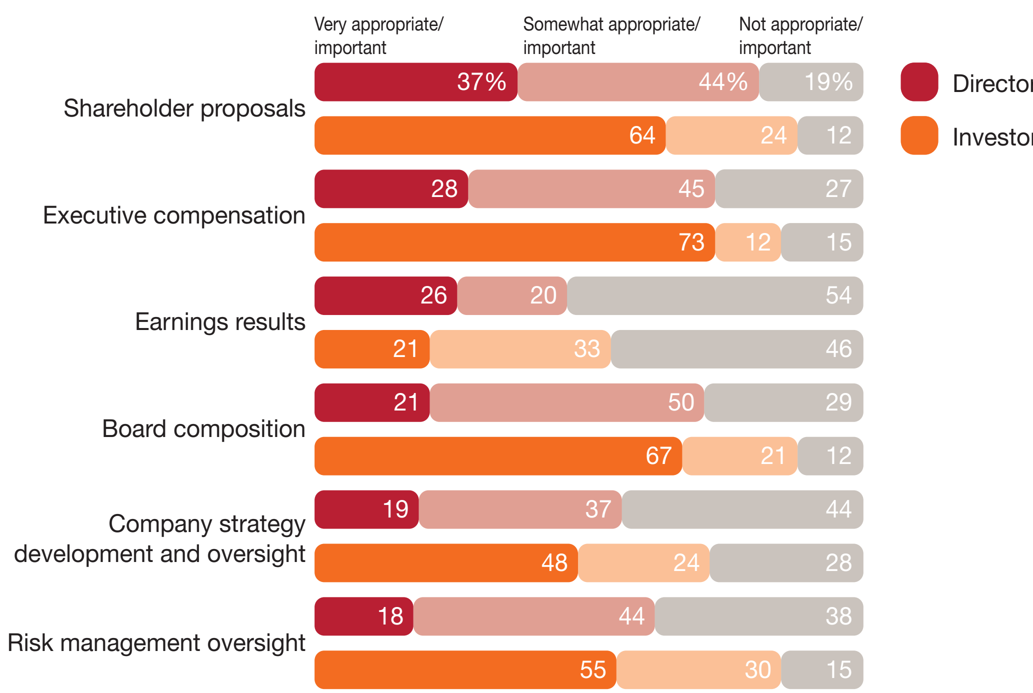
Survey questions:
Directors: During the last 12 months, how would you describe the level of your board's direct communication with:
Investors: During the last 12 months, how would you describe the level of your direct communication with the following parties:

Important topics for director/shareholder discussions

Investors and directors hold differing views about the appropriateness of topics to cover in direct interactions.

Executive compensation is one key area for both investors and directors. Eighty-five percent of investors say executive compensation is at least a "somewhat important" topic for them to have direct communications with directors, while 73% of directors say the same. However, there is less agreement around communications about board composition and risk oversight. Eighty-five percent of investors view this topic as at least "somewhat important" for direct dialogue, but only 62% of directors say it's appropriate. Similarly, 72% of investors would like to communicate with directors about company strategy development and oversight, but only 56% of directors believe this is an appropriate discussion. Directors may believe that direct dialogue in some areas should be done only by the management team due to the role of a director being focused on oversight rather than operations.

Focusing director-investor communications



Survey questions:
Directors: Regarding the following topics, how appropriate is it for boards to engage in direct communication with shareholders:
Investors: How important is it for corporate directors to engage with you in direct communications about the following topics:

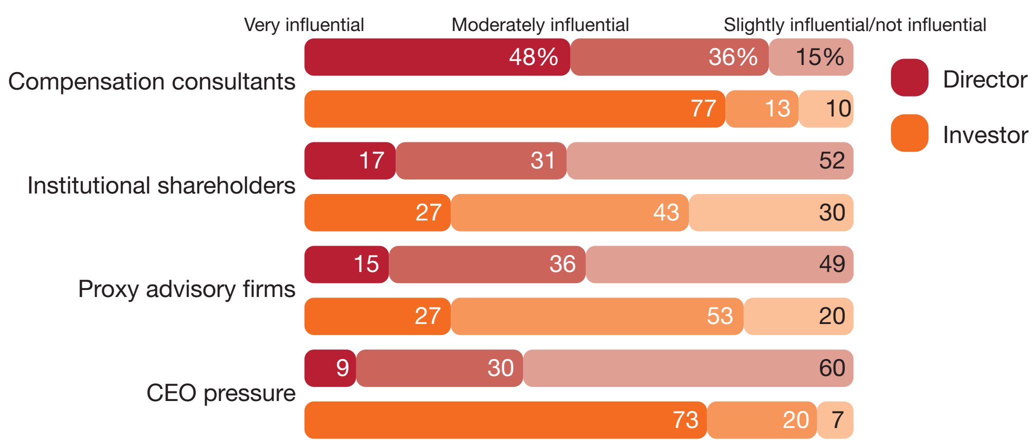
Executive compensation

The attention given to executive pay continues to be a trend impacting boards. Not surprisingly, boards are devoting considerable time to the critical issue of appropriate compensation. With four years of "say on pay" behind us and equity markets rising to high levels, we asked directors and investors to give their current perspectives on who influences compensation and the cumulative impact of the advisory vote.

Who influences CEO pay?

Directors and investors both rate compensation consultants as the group that has the most influence on board decisions about executive compensation. But they do not agree on the influence of institutional shareholders—70% of investors believe they are at least "moderately" influential compared to 48% of directors. Investors are 64 percentage points more likely than directors to believe that CEO pressure has a "very influential" effect on the board's decisions about pay. A significant majority of both groups agree that public opinion, the media, and retail shareholders have little influence on on executive compensation decisions.

Compensation drivers



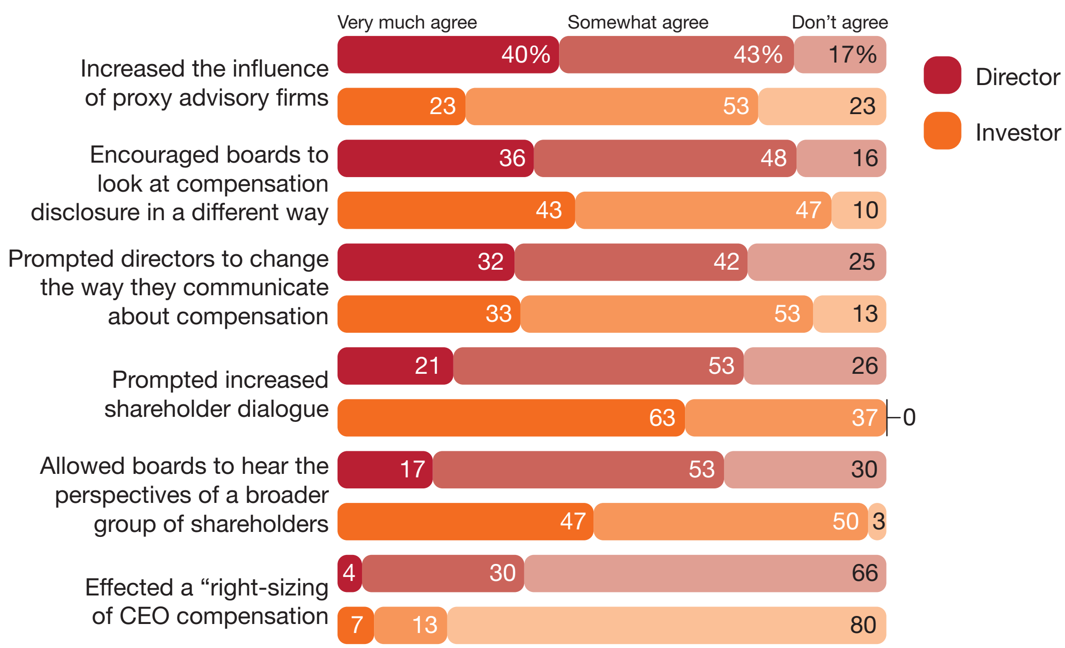
Survey questions:
Directors: Rate the level of influence that the following have over your board's decisions on executive compensation:
Investors: Rate the level of influence that you believe the following factors have over US corporate board decisions on executive compensation:

What's the real impact of "say on pay"?

Shareholders continued to support "say on pay" proposals at high levels during the 2014 proxy season (89% affirmative voting on average)[2]. In light of this, how do directors and investors assess the cumulative impact of "say on pay" voting?

When it comes to assessing the cumulative impact of "say on pay", at least two-thirds of each group agree that "say on pay" has not resulted in a "right-sizing" of CEO pay, despite the significant attention afforded compensation issues. More than three-quarters of directors and investors also at least "somewhat agree" that "say on pay" has prompted directors to change the way they communicate about compensation, encouraged boards to look at compensation disclosure in a different way and increased the influence of the proxy advisory firms. However, 97% of investors at least "somewhat agree" that "say on pay" allowed boards to hear from a broader group of shareholders—compared to only 70% of directors who feel the same.

Has "say on pay" made a difference?



Survey questions:
Directors: What is your assessment of the cumulative impact of "say-on-pay" voting:
Investors: Please indicate your level of agreement with the following statements regarding the cumulative impact of "say on pay" advisory votes thus far:

[2]*PwC+Broadridge ProxyPulse, October 2014*

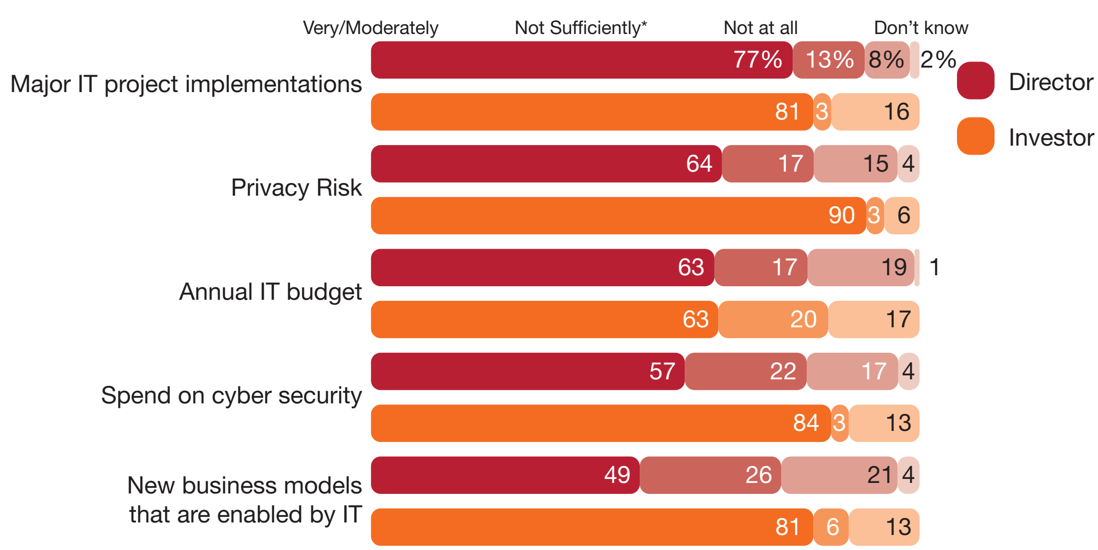
Digital concerns

The influence of emerging technologies and increased cybersecurity concerns are two additional trends impacting governance and the board of the future. Directors and investors now see IT as inextricably wed to corporate strategy and the company's business—IT is now a business issue, and not just a technology issue. Cybersecurity breaches are regularly and prominently in the news. Directors are increasingly focused on effective oversight of their companys' technology initiatives, how management leverages emerging technologies, and cybersecurity issues.

Engagement in specific IT areas

There are some considerable gaps between the level of director engagement with certain aspects of IT and investors' priorities. Directors say they are most engaged in overseeing the status of major IT project implementations. Investors are more concerned with two particular areas: privacy risk and the ability of IT to enable new business models. Eighty-one percent of investors believe directors should be at least "moderately" focused on new business models enabled by IT, but only 49% of directors say they are engaged at that level. And, 90% of investors believe the board should be at least "moderately" focused on privacy risk, but only 64% of directors say they are engaged to that extent.

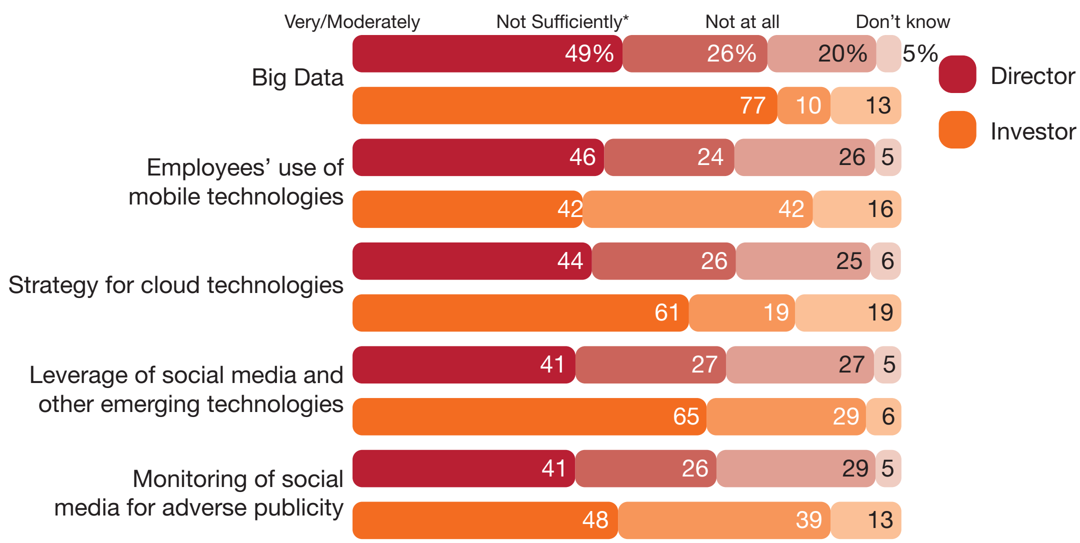
Attention to technology initiatives



* The answer choice "Not Sufficiently" was not an option in the Investor Survey.

Survey questions:
Directors: How engaged is your board or its committees with overseeing/understanding the following:
Investors: To what extent should US corporate boards be engaged in overseeing/understanding the following:

Attention to technology initiatives



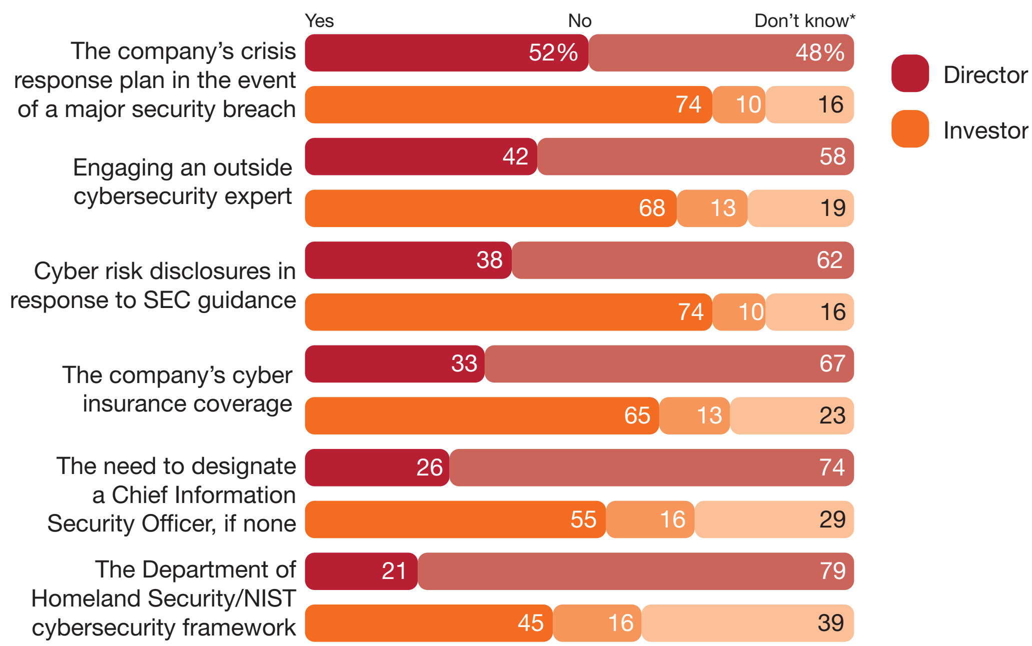
* The answer choice "Not Sufficiently" was not an option in the Investor Survey.

Survey questions:
Directors: How engaged is your board or its committees with overseeing/understanding the following:
Investors: To what extent should US corporate boards be engaged in overseeing/understanding the following:

Involvement with cybersecurity issues

Considering the significant focus on cybersecurity, it's not surprising that nearly three-quarters of investors believe it's important for directors to discuss their company's crisis response plan in the event of a major security breach. However, only about half of directors have had those discussions. Similarly, 63% of investors believe it's important for directors to discuss engaging an outside cybersecurity expert but only 42% of directors have done so. And the gap is even wider when it comes to new security frameworks. Forty-five percent of investors believe it's important for directors to discuss the NIST/ Department of Homeland Security cybersecurity framework, but only 21% of directors have done so. The low level of perceived importance could suggest a lack of full awareness about these new standards.

Preparing for the inevitable



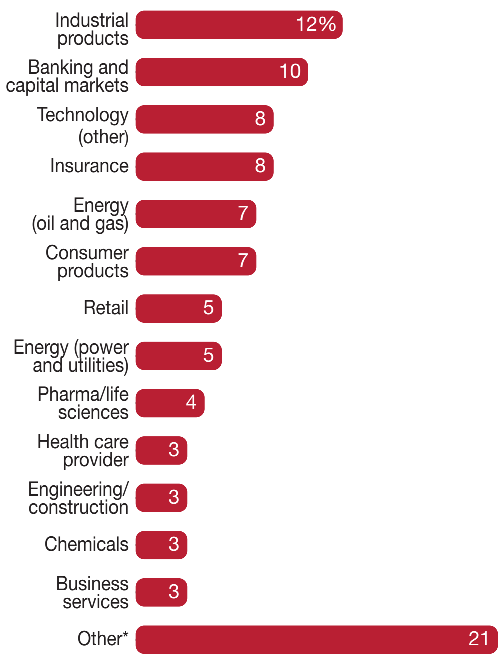
* The answer choice "Don't know" was not an option in the Directors Survey.

Survey questions:
Directors: With regard to cybersecurity issues, has your board or its committees discussed:
Investors: Focusing on cybersecurity issues, is it important for US corporate boards to discuss the following:

Demographics of survey respondents

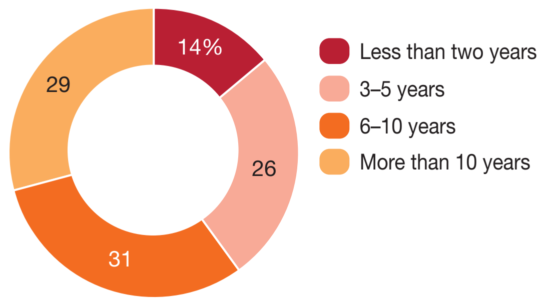
Directors:

Which of the following best describes the company?

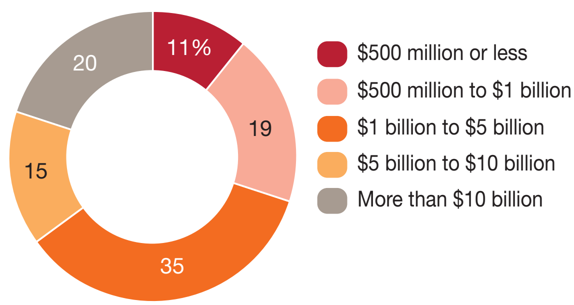


* Other includes the sum of the following industries, with no individual category receiving over 2% of responses: transportation/logistics; software/internet solutions; semiconductor; hospitality/leisure; government contracting; communications; automotive; asset management; mining; healthcare payer; forest, paper, and packaging; entertainment/media; and agribusiness.

How long have you served on this board?



What are the annual revenues of the company?



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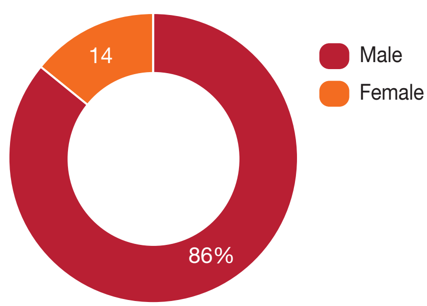
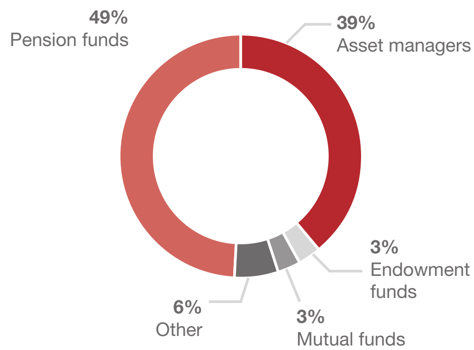


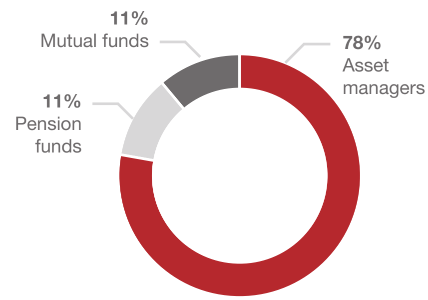
Base: 863 respondents

Investors:

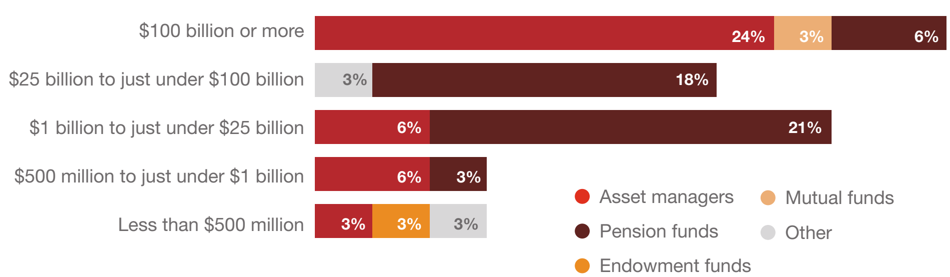
Numerical



By AUM (assets under management)



AUM by investor type



Base: 33 respondents

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To have a deeper conversation about how this subject may affect your business, please contact:

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