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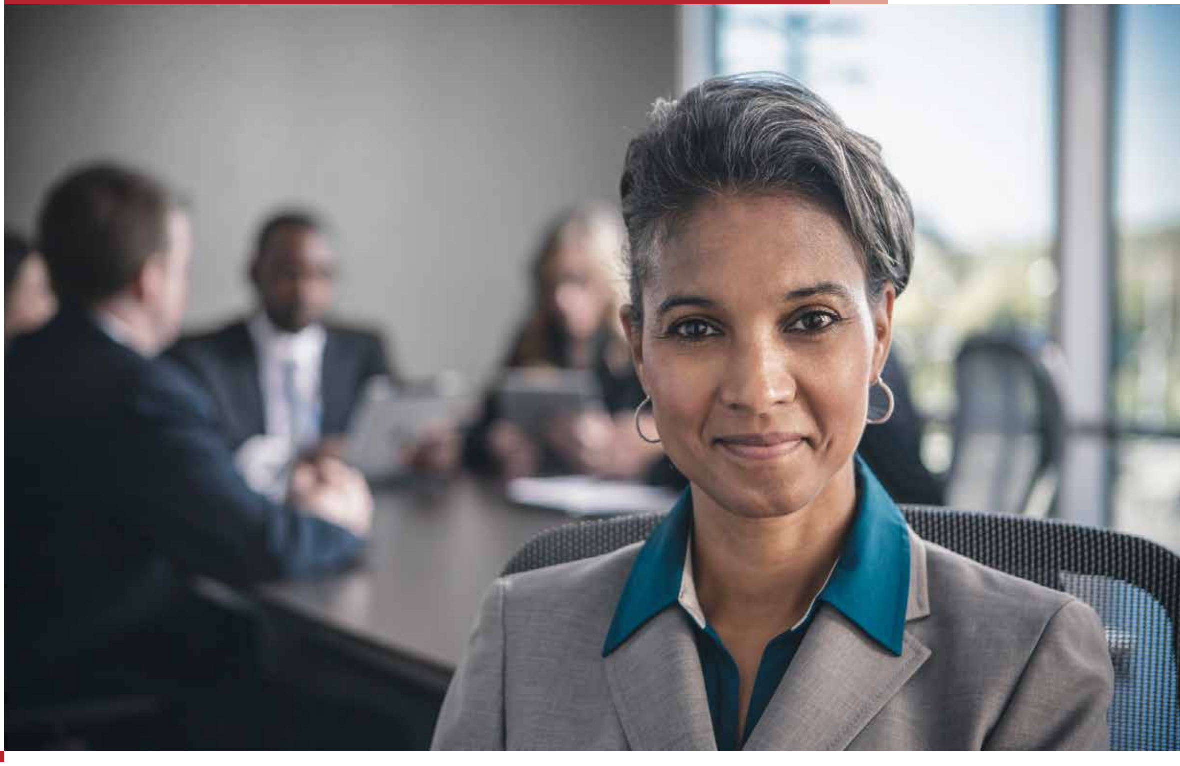
Governing for the long-term: Board Composition and Diversity

PwC's 2015 Annual Corporate Directors Survey

Looking down the road with an eye on the rear-view mirror



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

Board composition and diversity

The focus on board composition and diversity continued to gain steam in corporate governance circles during 2015. When it came to the two types of activists, it became a scenario of, "if the left hand didn't get you, the right hand might." First of all, corporate governance activists submitted a record number of proxy access shareholder proposals. Additionally, the hedge fund activists had their day and pushed for, and were successful in obtaining, board representation at a growing number of companies.

At its core, board composition is under pressure to evolve. In order to be well-positioned to oversee long-term value creation, directors know their boards need the right expertise and experience – including directors with diverse backgrounds. Directors also recognize they need to be more focused on CEO and director succession in order to make sustained growth a reality.

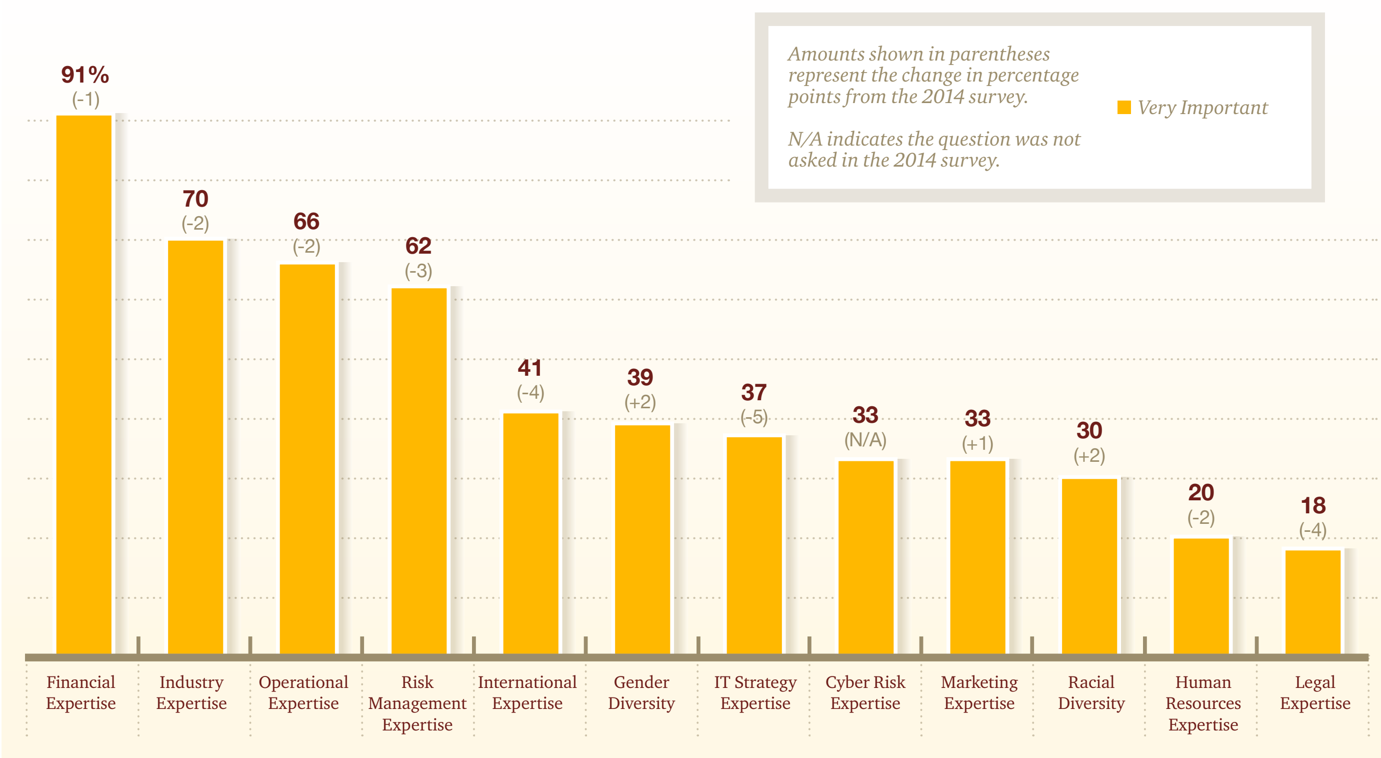
What director attributes are most important?

Consistent with results from last year, the most desirable director attributes continue to be financial expertise (91% describe it as very important), followed by industry expertise (70%), operational expertise (66%), and risk management expertise (62%). These areas are crucial to board service as they provide the foundations for overseeing the business. The percentage of directors who think board diversity is an important attribute increased; 39% now consider gender diversity very important compared to only 37% in 2014. And 30% now consider racial diversity very important – up from 28% last year.

Given the climate around cyber-breaches, it's not surprising that 87% of directors find board expertise in this area to be at least "somewhat" important. But it's surprising that directors rate IT strategy expertise as a higher priority than having a director with a cyber risk background. The importance of cybersecurity has certainly been recognized, but directors are strategically focused when it comes to IT. Directors are thinking down the road and know that the effective use of IT can be critical to long-term success.

Human resources and legal expertise continue to be less sought after, with only one-in-five directors describing these attributes as "very important".

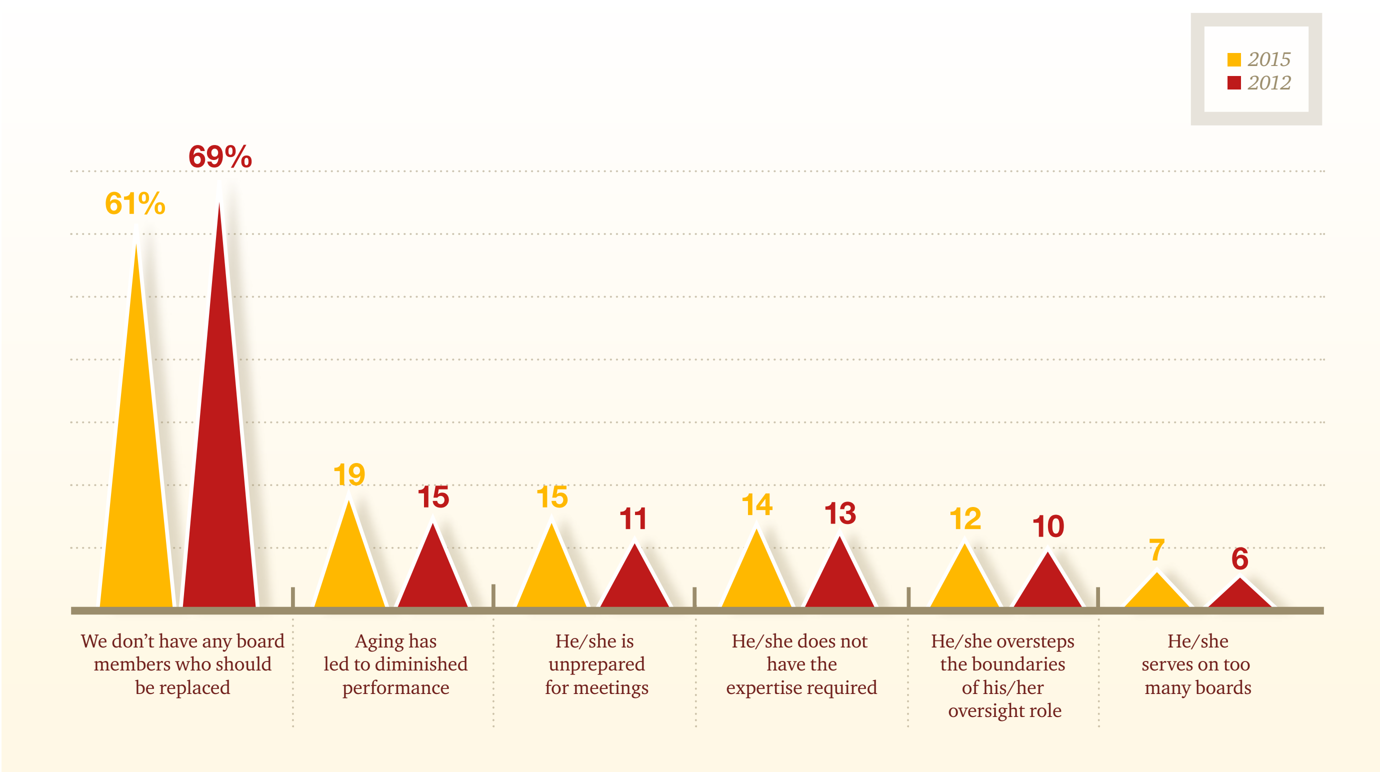
How would you describe the importance of having the following attributes on your board?



Greater director dissatisfaction with peer performance

The level of dissatisfaction directors express with their fellow directors has increased each of the last three years – signaling that a significant number of board members expect more from their peers. It may also indicate that the bar for acceptable board performance continues to rise. Nearly 40% of directors now say someone on their board should be replaced – a jump from 31% only three years ago. Directors continue to cite diminished performance due to aging, unpreparedness for meetings, and lack of expertise as the top reasons for their dissatisfaction with peer performance. Overall, director criticism of peers may indicate a recognition that changes to board composition are necessary to promote long-term value creation.

Do you believe that any of your board members should be replaced for the following reasons?



Deeper insights:

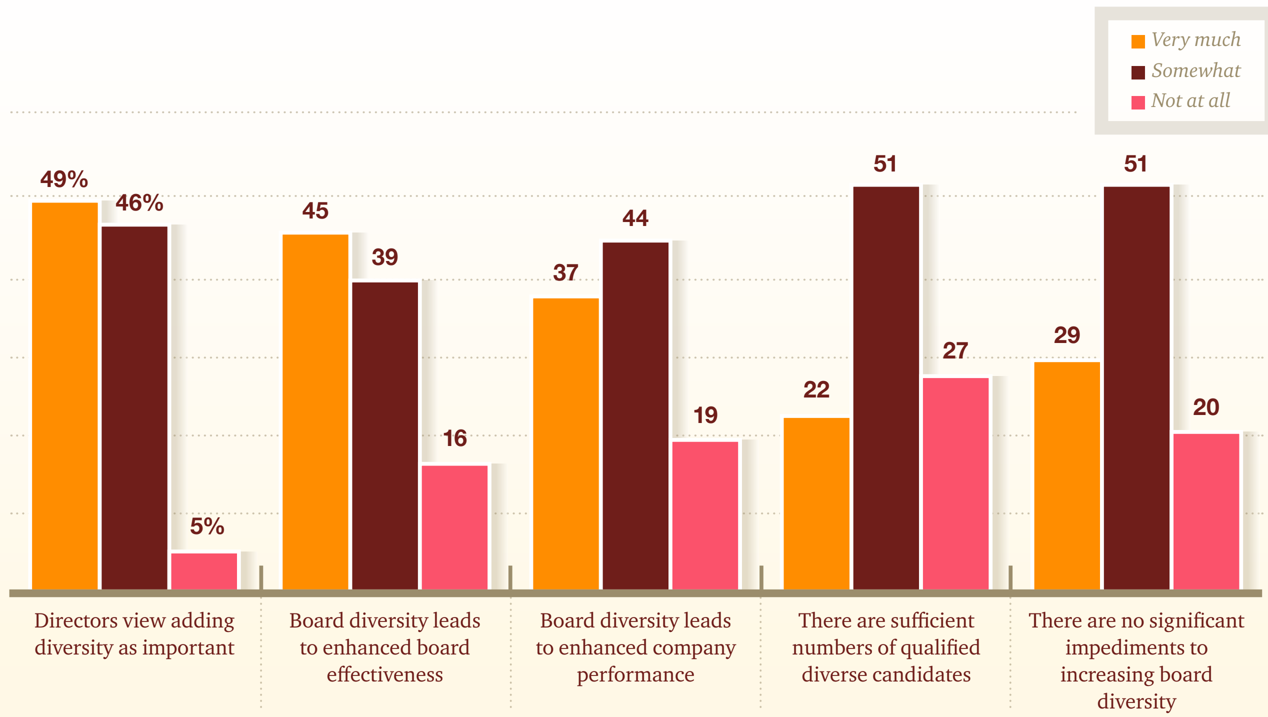
- ***Female directors are slightly more likely to believe a fellow director should be replaced;*** *42% of female directors believe someone on their board should be replaced, compared to 39% of male directors.*

Board diversity in the spotlight

Because boards are emphasizing governing for the long term, getting the right mix of directors is key, including achieving diversity. Global demographics continue to shift and directors realize their boards must have a broader array of perspectives to meet future challenges. Overall, 95% of directors view diversity as at least a "somewhat" important director attribute. However, more than 70% of directors at least "somewhat" believe there are impediments to increasing board diversity.

They cite a limited pool of diverse director candidates as a significant obstacle; less than one quarter very much believe there is a sufficient number of qualified diverse candidates. The vast majority of directors believe board diversity positively impacts both the board and the company; more than eight-in-ten believe diversity at least "somewhat" enhances board effectiveness and company performance, and more than one-third believe it very much does so.

To what extent do you believe the following regarding board diversity:



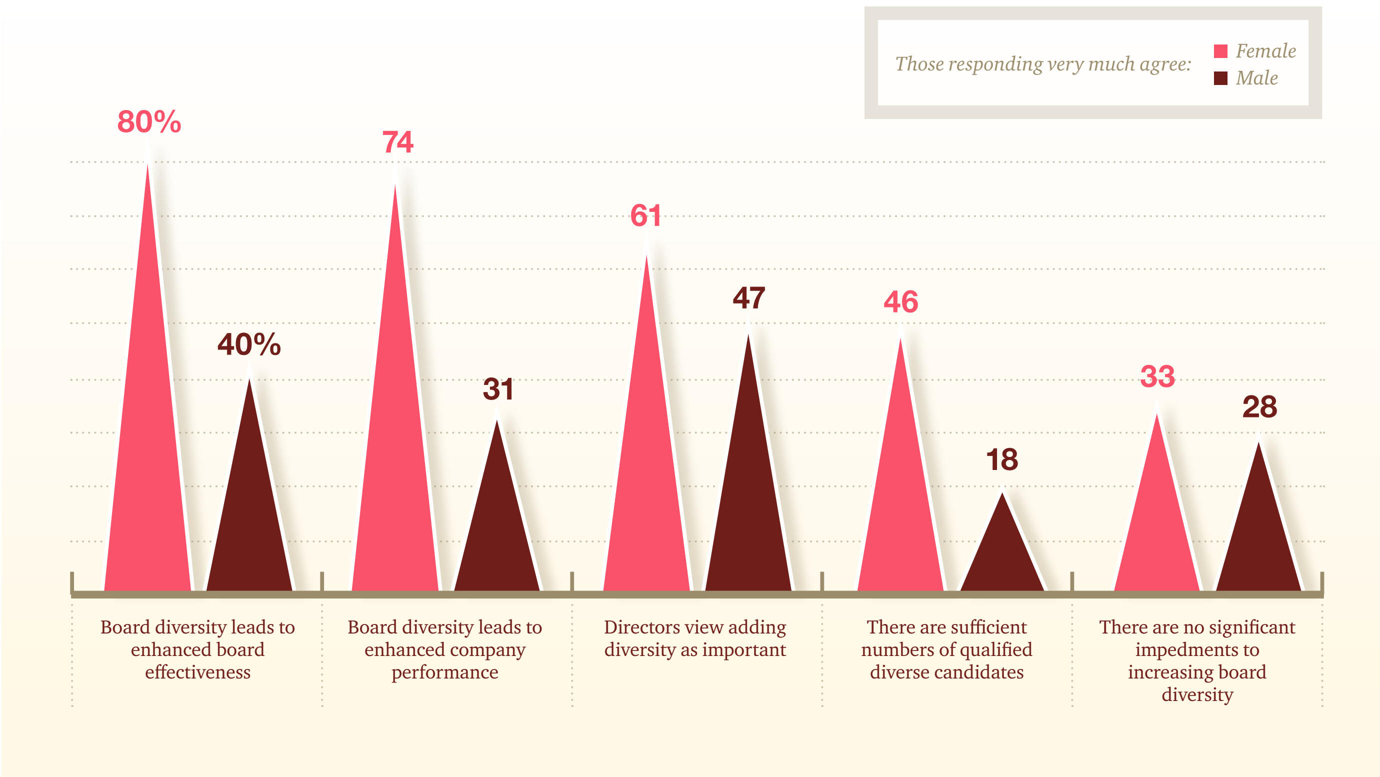
Deeper insights:

- ***Directors of the largest companies prioritize diversity more:*** *67% of mega-cap company directors think diversity is "very important" to board composition compared to only 31% of directors at micro-cap companies.*
- ***Conflicting views about the importance of diversity exist between newer and more-tenured directors:*** *62% of directors with less than one year of board service "very much" agree that having diversity on the board is important, compared to only 39% of directors who have tenure of greater than ten years.*

Male and female directors disagree about the importance of having gender and racial diversity on their boards. Female directors continue to be far more likely to consider board diversity important – with 63% of women describing gender diversity as a very important attribute compared to only 35% of male directors. Similarly, 46% of female directors describe racial diversity as very important compared to only 27% of their male counterparts.

Similar to the differences in importance each gender places on diversity, there are stark contrasts in male and female views on diversity's impact. Women are twice as likely to "very much" believe diversity leads to enhanced board effectiveness. Similarly, 74% of female directors "very much" agree that board diversity leads to enhanced company performance, compared to only 31% of males.

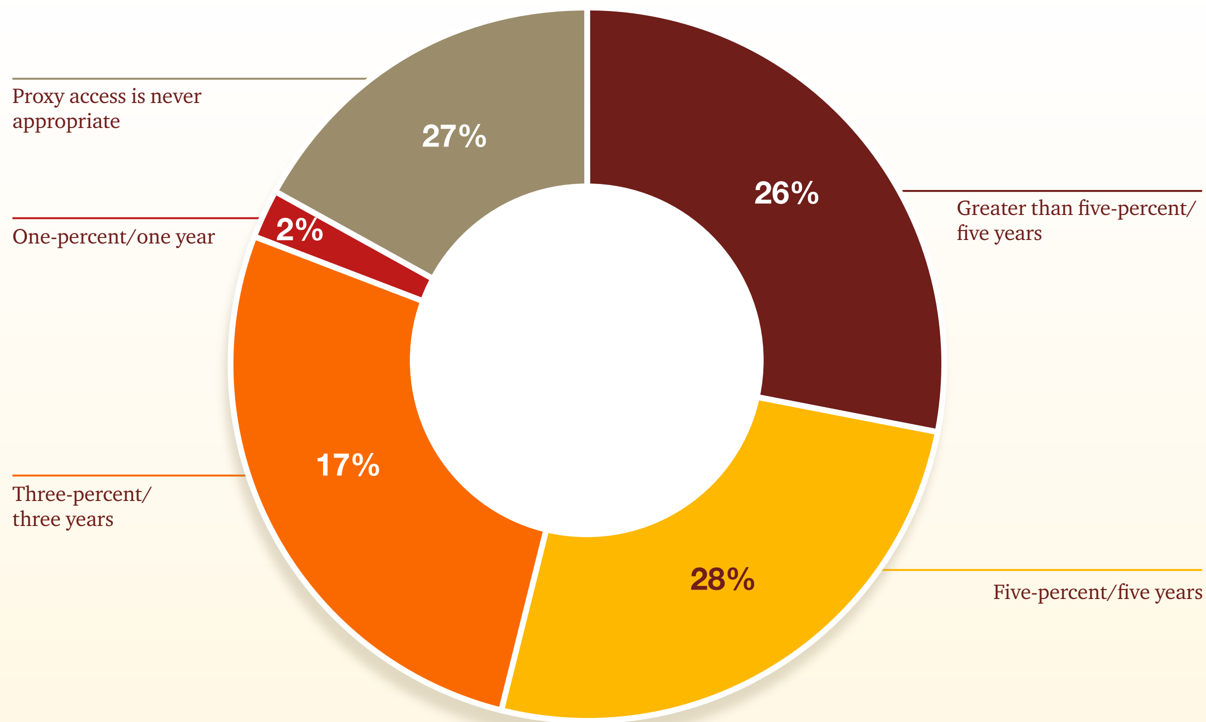
To what extent do you believe the following regarding board diversity (by gender):



The "right" thresholds for proxy access

Proxy access refers to the right of shareholders (with certain ownership stakes and holding shares over a certain period of time) to place a certain percentage of director nominees on a company's slate. It has been one of the most hotly contested governance issues of 2015, with more than 100 companies receiving shareholder proposals requesting adoption.[3] Proxy advisory firms favor a three-percent ownership position and a three-year holding period. But even though a significant majority of directors view granting proxy access to be appropriate, most believe it should require higher ownership thresholds and longer holding periods. Less than one-in-five directors believe the three percent ownership and three-year holding period are appropriate. Instead, more than half believe proxy access is appropriate at five-percent ownership for at least five years or more. Twenty-seven percent of directors believe proxy access is never appropriate.

At what ownership threshold do you generally believe it is appropriate to grant shareholders proxy access?



Deeper insights:

- ***Directors with greater tenure are far more likely to reject proxy access:** Directors with a tenure of greater than ten years are almost three times more likely to reject proxy access compared to directors with less than one year of tenure.*

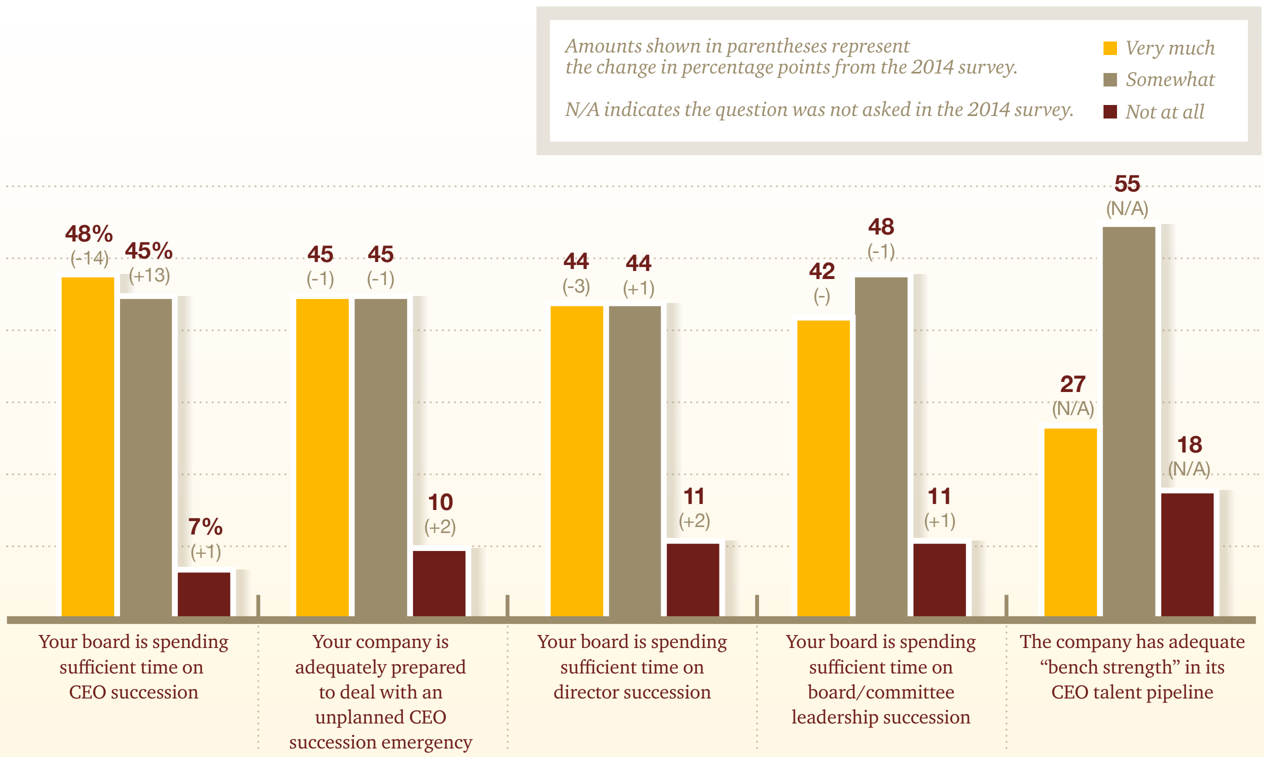
[3] PwC+Broadridge *ProxyPulse*, August 2015.

Less confidence about CEO and board succession

CEO and director succession are quintessential board composition issues. Having smooth transitions in these leadership roles is crucial to a company's long-term success. As such, it's imperative that boards focus on these areas. However, there was a noteworthy decline this year in the percentage of directors who believe their boards are spending sufficient time on CEO succession; only 48% "very much" believe this to be the case, down from 62% last year. A related concern is that more than half of directors only "somewhat" or "not at all" believe their company is adequately prepared to deal with an unplanned CEO succession emergency. And only about one quarter "very much" believe their company has adequate bench strength in its CEO talent pipeline. This may be why 52% of directors say they want to spend at least "some" additional board time on CEO succession going forward.

Board and committee leadership succession are two other areas in which directors showed concern; less than half "very much" believe their board is spending sufficient time fulfilling these responsibilities, and one-in-ten believe their board is "not at all" doing so. The concerns about CEO and director succession suggest today's directors are concerned about leadership transition and continuity.

To what extent do you agree with the following:



Deeper insights:

- ***Directors of the largest companies are more satisfied with the amount of time spent on CEO and director succession;*** *Directors of mega-cap companies are twice as likely to agree their boards spend sufficient time on CEO and director succession compared to directors of micro-cap companies.*

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To have a deeper conversation about how these findings may affect your business, please contact:

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