

10 Minutes on Post-Crisis Boardrooms*

What you need to know about emerging topics essential to your business. Brought to you by PricewaterhouseCoopers.

December 2009

What directors think: Anticipating what Washington will do next

Highlights:

- Directors across all sectors say regulators' influence on boardrooms rivals that of institutional investors.
- Directors are assessing whether the C-suite and board peers have the right talent to deal with the wide range of regulatory changes expected over the next year.
- As the economy moves toward recovery, boards are setting their sights on new growth opportunities, including those potentially stemming from initiatives underway in Washington.

A year after the financial meltdown, many companies have returned to relative stability. Few, however, have undergone a radical transformation. A recent PricewaterhouseCoopers and Corporate Board Member magazine survey shows that although capital spending and staff levels are down, business models and operations remain essentially unchanged.

Perhaps that is because companies and their boards are waiting for Congress and regulators to resolve key policy issues such as systemic risk, executive compensation, healthcare reform, and greenhouse gas regulation.

While some companies appear to be hedging their bets until new legislation and rules are passed, others are actively preparing to seize growth opportunities—and in some cases, are already pursuing them—ahead of Washington's decisions.

Many companies are unwilling to take a wait-and-see approach.

1. The majority of directors in the insurance, pharmaceutical, and healthcare products industries say their companies intend to carry out expansion plans, despite not knowing the outcome of the healthcare debate.
2. Directors in the energy and utility sectors are similarly sanguine, saying they intend to stay on track with expansion projects even though Congress is still working on a climate and energy package.
3. Ongoing legislative debate on financial regulatory reform hasn't kept banks, savings institutions, and other financial institutions from looking for growth opportunities.
4. Directors' heightened focus on both risk and shareholder concerns suggests that some boards have been paying greater attention to the risk-compensation relationship independent of new regulatory guidance in that area.

At a glance

All eyes are on Washington. Many directors are seeing where opportunities might emerge from upcoming regulation and reform, even though few expect a panacea.

Directors agree more regulation is inevitable...

- Nearly all the directors we surveyed think a considerable amount of new regulation will result from the economic crisis.
- Two-thirds think government limitations on executive pay at TARP recipients will have a spillover effect on other companies.
- Two-thirds think shareholders will have increasing influence (e.g., through passage of proxy access rules).

...but are mindful of the challenges

- Over half the directors surveyed think more regulation would not have prevented the crisis.
- Over half think it will be difficult for their companies to retain the best leaders if they cannot pay them market value.
- Nearly one-quarter think that if shareholder-nominated directors are elected, it will have a negative impact on the collegiality and functionality of the board; most other respondents say it's hard to predict.

Influencing the board

Directors in key industries say regulators rival institutional investors as the group that most influences boards

Key industry	Who has the most influence?	
	Regulators	Institutional investors
Bank/savings institutions	85%	5%
Insurance	41%	24%
Energy/utility	40%	30%
Consumer products	34%	30%
Healthcare products/ pharmaceutical	32%	43%
Other financial institutions	31%	45%

With a greater collective stake in the political debate than they've had in decades, directors are keenly observing developments in Washington. For some companies, the outcome of pending legislation on healthcare reform, greenhouse gas regulation, and financial regulatory reform could necessitate making operational changes, reconsidering core business strategies, and adjusting to increased regulator scrutiny. Indeed, directors say they're already feeling greater regulatory influence even as the precise shape of new rules and legislation continues to unfold.

Many boards are staying the course

Despite pending policies, many of the directors we surveyed don't intend to put growth plans on hold until new rules and legislation emerge. On the contrary, the majority of surveyed directors indicate that their companies will move forward with expansion and M&A activities. That includes over two-thirds of the banking industry directors, who say they won't delay planned expansion, as well as half the financial services directors, who say they're searching for good acquisitions. As for the directors

we surveyed in the healthcare products and pharmaceutical industry, 87 percent say their companies intend to stay on track with expansion projects.

Compensation remains in the spotlight

This fall, government has redoubled its efforts to address executive compensation. The SEC, the Federal Reserve Board, and the US Treasury have all recently announced new rules and principles that, among other things, aim to prevent pay packages from rewarding excessive risk-taking.

Although actual government limitations on executive compensation apply only to companies receiving federal assistance, two-thirds of directors we surveyed believe that those restrictions will color compensation committees' discussions in boardrooms generally, not just at TARP recipients. Such discussions may also be increasingly influenced by shareholders, who will have greater ability to pressure boards if say-on-pay and proxy-access legislation is passed.

Making sure the right talent is at the helm...

Directors continue to focus on unknown risks—and, in particular, on the ability of management teams to identify and react to those risks once they materialize. Directors are less concerned about the CEO's ability. But what about when the CEO steps down? Of the directors we surveyed, some are more closely evaluating whether members of the current supporting management team are qualified to take the top person's place.

Not your father's C-suite

Insufficient talent among the people directly supporting the CEO often points to inadequate succession planning. Done well, good succession planning grooms internal talent. Increasingly, however, boards are recognizing that the range of skills and in-depth knowledge necessary for effective corporate leadership is broader than in the past. It is unlikely that one person, or even a few, will have all the requisite competencies.

The traditional C-suite is therefore expanding at some companies. Positions such as chief regulatory affairs/public policy officer, chief risk officer, and sustainability leader—roles once

regarded by many companies as auxiliary rather than strategic—have begun to be elevated in stature, particularly as a result of the past year's developments.

As the makeup of the C-suite changes, so too will its dynamics; growing pains may ensue, as power shifts occur and possible turf battles are resolved. Members of the newly evolving C-suite will need to iron out these wrinkles quickly so that as a group they can effectively manage and capitalize on the deluge of changes coming out of Washington.

Dealing with such changes will be especially challenging in today's economy, which—much like pending legislation and regulation—remains fluid. Corporate leadership must nonetheless navigate these shifting currents. It's no wonder, then, that directors are taking a long, hard look at who's at the helm.

What directors are concerned about:	Percent concerned
Unknown risks	59%
Ability of the CEO to manage through current challenges	25%
Unsatisfactory management-succession plan	39%

...and in the boardroom

In assessing their risk resilience, directors say they...

Expect increased regulatory investigation/action	71%
Expect more shareholder litigation	65%
Feel their risk as a director has increased in the past 12 months	69%

Directors are also taking a hard look at who's sitting next to them in the boardroom. Fifty-six percent of those we surveyed think there's a shortage of qualified directors in today's environment.

New skill sets for a brave new world

Expertise in financial and technological matters is what boards have had the most difficulty finding in director candidates, according to the directors we surveyed.

Although new expertise isn't, in itself, necessarily hard to find—there are, for instance, plenty of individuals who have financial expertise—adding it to the board can be challenging. That's because many boards may want to stay a certain size. And so, bringing new expertise to the table requires either replacing a director or expanding the board's headcount.

That logistical consideration might also account, in part, for why surveyed directors say their boards aren't aggressively seeking government and public policy expertise. Such skills may also be in limited supply at the director-candidate level, since businesses have gone relatively unregulated in recent

decades. As new government regulations and reforms take hold, however, directors' skill sets may have to adapt.

Birdseye view: Gauging the risk-compensation relationship companywide

Most directors we surveyed say they struggle to determine an appropriate risk appetite for their companies. Compensation committees in particular have to gauge that appetite as they evaluate their compensation programs.

Key to that task is making sure the company's risk-and-reward model doesn't inadvertently create organization-wide risk—i.e., doesn't emphasize short-term performance at the expense of corporate sustainability. New and proposed guidance from the SEC, the Federal Reserve Board, and the US Treasury reflect this thinking. For its part, the SEC intends to have companies scrutinize the risk-compensation relationship beyond the top tier of leadership, where necessary. Going forward, therefore, directors may have to learn how to look at risk and compensation much more broadly across their companies than in the past.

Capitalizing on Washington's decisions

Directors in key industries say their companies are not postponing planned expansion:

Healthcare products/pharmaceutical	87%
Insurance	83%
Advanced technology	81%
Bank/savings institutions	77%
Other financial institutions	74%
Energy/utilities	66%

Though economic events are an obvious driver of director behavior right now, anticipated regulatory involvement may also be having a strong influence on what directors are thinking and doing about the future.

Eyeing growth opportunities

Across all industries, directors we surveyed say they regard capitalizing on growth opportunities as chief among their responsibilities.

Some of those opportunities are likely to emerge from efforts to reduce greenhouse gas emissions. One option currently being debated in Congress is a federal cap-and-trade system—financial companies are keen to explore the business opportunities to be had in a growing carbon market. Legislation for reducing carbon emissions may also bring with it incentives such as federal grants, loan guarantees, and tax breaks for venture capitalists and others who want to invest in clean-technology energy alternatives.

There are less obvious beneficiaries of contemplated regulation as well. One is the advanced technology industry. Sixty-seven percent of the directors we surveyed in that industry say they are searching for good acquisitions. High-tech companies will, for instance, be in a position to capitalize on healthcare reform if legislation ends up mandating computerized medical records. Such companies can also begin capitalizing on heavy carbon emitters' need for software that's capable of measuring and reporting emissions, per new Environmental Protection Agency requirements.

Directors' ongoing focus on growth and their optimistic view about expansion plans suggests boards intend to make the most out of decisions emerging from Capitol Hill and elsewhere in Washington.

Upcoming 10Minutes topics

Maximizing internal audit

In the aftermath of the financial crisis, companies are reevaluating their enterprise risk management and envisioning a broader role for internal audit. But that will require shifting the focus of internal audit, as well as shifting resources and mindset. In this 10Minutes, we suggest ways to overcome these challenges and realize important benefits in the process.

Business continuity

The best disaster-survival manual may be obsolete if it doesn't anticipate major disruptions to the supply chain or in outsourced operations. As a result, business continuity management (BCM) programs are being designed to continually assess—as well as counter—risks stemming from the interdependencies integral to running a business.

Executive compensation

After nearly two decades, the pay-for-performance model is being revisited, as regulators and Congress aim to better align corporate compensation structures with risk considerations and sustainable performance. 10Minutes looks at how proposed rulemaking and legislation are likely to change not only compensation programs, but also how companies define performance.

Creating more value from HR

The link between effectively deployed talent and business results has never been more apparent than in the past year. Strong leadership enabled many firms to perform better than their competitors. 10Minutes discusses ways that companies can improve their approach to recruiting and managing pivotal employees by better aligning HR models to the strategic goals of the business.

How PwC can help

To have a deeper discussion about post-crisis boardrooms, please contact:

Robert Moritz
US chairman and senior partner
PricewaterhouseCoopers LLP
Phone: 646-471-8486
Email: robert.moritz@us.pwc.com

John Barry
Corporate Governance leader
PricewaterhouseCoopers LLP
Phone: 973-236-5460
Email: john.j.barry@us.pwc.com

Catherine Bromilow
Corporate Governance partner
PricewaterhouseCoopers LLP
Phone: 973-236-4120
Email: catherine.bromilow@us.pwc.com

Tell us how you like 10Minutes and what topics you would like to hear more about. Just send an email to:
10Minutes@us.pwc.com



10% total recycled fiber

This publication is printed on Cougar recycled paper. It is a Forest Stewardship Council (FSC) certified stock using 10% post-consumer waste (PCW) fiber and manufactured in a way that supports the long-term health and sustainability of our forests.

© 2009 PricewaterhouseCoopers LLP. All rights reserved. "PricewaterhouseCoopers" refers to PricewaterhouseCoopers LLP, a Delaware limited liability partnership, or, as the context requires, the PricewaterhouseCoopers global network or other member firms of the network, each of which is a separate and independent legal entity. This document is for general information purposes only, and should not be used as a substitute for consultation with professional advisors. *connectedthinking and 10Minutes are both trademarks of PricewaterhouseCoopers LLP (US). NY-10-0354