

2004 SPECIAL SUPPLEMENT



WHAT  
DIRECTORS  
THINK

THE CORPORATE BOARD MEMBER/PRICEWATERHOUSECOOPERS STUDY

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## PUBLISHER'S LETTER

December 2004

Three years ago, few people knew much about Enron or what it did. WorldCom was nothing more than a big long-distance company. And the only people who knew Sarbanes and Oxley were their constituents.

All that has changed, along with what it takes to be a corporate director. Long gone are the days of having committee meetings the hour before the board meeting started. The days are also gone when it would be just as easy to have a board meeting on the first tee at the country club as in the boardroom. And the rubber stamps that boards used to use have gone the way of the buggy whip.

The dust hasn't settled yet, so directors aren't completely sure what it is they should or shouldn't be doing. But they do know this—what they were doing three years ago wasn't enough.

What Directors Think, a research report by *Corporate Board Member* and PricewaterhouseCoopers, surveyed more than 1,200 corporate directors about how they're coping with the unprecedented demands on their time and talent. It's required some out-of-the-box thinking on their part, and these directors were generous enough to share their thoughts with us.

We hope you'll find this supplement, a companion to the magazine you received in October, useful in providing you with additional information on how directors are stepping up to the plate to help achieve the goal we all share—restoring investors' faith in the capital markets. We would also like to thank those directors who participated in this survey, whose opinions made this study possible.



A handwritten signature in black ink, appearing to read 'TK Kerstetter'.

TK Kerstetter  
President  
*Corporate Board Member*



A handwritten signature in black ink, appearing to read 'Herb Schulken'.

Herbert C. Schulken, Jr.  
Partner and U.S. Leader for Corporate Governance  
PricewaterhouseCoopers LLP

# Profile of U.S. Corporate Boards

The profile of boards of directors from publicly traded U.S. companies published below is the most recent snapshot available from *Corporate Board Member's* comprehensive database of directors and officers serving on boards of publicly traded companies listed with the NASDAQ Stock Market, New York Stock Exchange, and American Stock Exchange<sup>1</sup>.

## Number of directors per board

As of yearend 2004, directors on U.S. corporate boards totaled 50,253 from 5,894 publicly traded companies. This represents an average of 8.5 directors per board, with boards from larger companies averaging a higher number of directors than those from smaller companies, as shown below.

(\$) Revenue Size	Companies	Directors	Average
>10B	322	4,146	12.9
1B-10B	1,126	11,403	10.1
500M-1B	610	5,447	8.9
100M-500M	1,472	11,934	8.1
50M-100M	644	4,980	7.7
10M-50M	1,123	8,250	7.3
<10M	597	4,093	6.9
Entire Database	5,894	50,253	8.5

## Number of directorships held

The highest number of directorships held by one individual is 11. The vast majority of directors, 33,510, hold only one board seat. The pyramid below shows the distribution of the number of directorships held by U.S. corporate directors.

# of Directorships	Directors
11	1
10	1
9	3
8	3
7	12
6	58
5	153
4	501
3	1,414
2	4,617
1	33,510

## Inside versus outside directors

U.S. corporate boards had 9,968 inside directors representing an average of 1.7 inside directors per company, and 40,290 outside

directors representing an average of 6.8 outside directors per company.

(\$) Revenue Size	Companies	Inside	Avg. Inside	Outside	Avg. Outside
>10B	322	1,021	3.2	3,125	9.7
1B-10B	1,126	2,022	1.8	9,381	8.3
500M-1B	610	959	1.6	4,493	7.4
100M-500M	1,472	2,333	1.6	9,601	6.5
50M-100M	644	1,000	1.5	3,980	6.2
10M-50M	1,123	1,730	1.5	6,520	5.8
<10M	597	903	1.5	3,190	5.4
Entire Database	5,894	9,968	1.7	40,290	6.8

## Inside versus outside chairmen

Out of a total of 5,551 chairmen on U.S. corporate boards, 3,076 (55.4%) are inside chairmen and 2,475 (44.6%) are outside chairmen. These ratios hold steady among revenue size categories, as shown below.

(\$) Revenue Size	Inside Chair	%	Outside Chair	%
>10B	179	57.6%	132	42.4%
1B-10B	651	59.0%	453	41.0%
500M-1B	361	60.8%	233	39.2%
100M-500M	776	55.6%	620	44.4%
50M-100M	330	55.3%	267	44.7%
10M-50M	505	49.8%	510	50.2%
<10M	274	51.3%	260	48.7%
Entire Database <sup>2</sup>	3,076	55.4%	2,475	44.6%

## Gender of directors

There are 3,816 female directors on U.S. corporate boards representing a 0.6 percentage of the total director population. Larger company boards reflect a slightly higher ratio of female to male directors than smaller company boards.

(\$) Revenue Size	Companies	Female Directors	Avg. per Company
>10B	322	496	1.5
1B-10B	1,126	1,202	1.1
500M-1B	610	418	0.7
100M-500M	1,472	718	0.5
50M-100M	644	310	0.5
10M-50M	1,123	478	0.4
<10M	597	194	0.3
Entire Database	5,894	3,816	0.6

<sup>1</sup> Excludes over-the-counter stock companies.

<sup>2</sup> At the time of this report, 343 companies did not report a chairman.

## U. S. Directors Ready to Get Back to Business

Over the past three years, governance reform related to the structure and composition of boards, standards for independence, and transparency of financial disclosure ushered in sweeping changes in corporate boardrooms across the United States and internationally. The 2004 *Corporate Board Member*/PricewaterhouseCoopers annual board of directors' survey, "What Directors Think," reveals that after focusing on the minutia of compliance and structure, corporate directors are eager to spend more time on the fundamentals of good business and increasing shareholder value.

### The scope of the board

One important aspect of returning to fundamentals is determining the appropriate scope of the board's business. This process involves developing consensus and prioritization on the wide range of issues with which the board must deal. It's widely regarded that directors must pay more attention to the practice of evaluating board scope if they are going to manage their workload effectively, says TK Kerstetter, president of *Corporate Board Member*. Most directors surveyed agreed: Ninety percent of reported they believe determining board scope is an important exercise in the post-corporate-reform era.

According to Herbert C. Schulken, Jr., partner and U.S. Leader for Corporate Governance for PricewaterhouseCoopers LLP, the days of passive boards taking instructions from CEOs are over. "Directors are hearing more about their responsibilities and their potential liability, and they are taking action. Boards know they need to do more than they did in the past, and this new dynamic is creating some friction between the board and management." Will we get to a new equilibrium? Schulken says yes, but there's likely to be "some pain along the way."

But make no mistake, he says, today the board is in charge. "They are the representatives of the shareholders, the owners of the business. At the same time, there's no reason that management's agenda and the board's agenda can't be aligned. The success of the business is the central issue."

Yet one of the important things to remember, Schulken points out, is that management is running the business on a day-to-day basis. "Management should know what needs to be brought to the board's attention—both the things that must be addressed immediately and the issues that can wait until the next board meeting," he says. At the same time, board members may come across an issue—perhaps at their day job or through another board position—that may have applicability to their company. "Inquiring

about such a matter and its effect on the company is part of the director's fiduciary duty, and it's just good governance."

### Board agendas

In a related finding, when asked to which items directors would like their boards to devote more or less time, big-picture issues were seen as the most critical: Strategic planning ranked highest on the board action list with 58% indicating a desire to devote more time to it. This was followed by the 45% who would like to spend more time on succession planning and the 41% who would like more time to meet managers from key parts of the company (see Figure 1). Conversely, only 8% indicated they'd like to spend more time on narrower topics such as stock strategies and compliance and regulatory issues.

FIGURE 1

Please indicate if you would like your board to devote more, the same, or less time to the following items:

	More	Same	Less
Strategic planning	58%	42%	*
Succession planning	45%	54%	1%
Meet mgrs from key parts of the co.	41%	58%	1%
Visiting company work sites	40%	57%	3%
Discussing the competition	36%	62%	2%
Risk management	31%	68%	1%
Discussing the industry	30%	68%	2%
Monitoring performance	18%	81%	1%
Compensation issues	17%	81%	2%
Governance guidelines	11%	80%	9%
Getting CEO updates	10%	89%	1%
Analyst updates	9%	77%	14%
Stock strategies	8%	79%	13%
Compliance and reg issues	8%	84%	8%

In essence, Kerstetter says, there is nothing more substantive from a board's point of view than determining the direction of the company and laying out the plan to accomplish its goals. "However," he says, "this process is often fraught with challenges: finding the right adviser, determining the level of board participation, and understanding the business fully."

Schulken agrees involving the board in developing this overarching strategy is fundamental. “Board members typically have a great deal of business experience. They are, or have been, executives at other companies. They’ve crafted their own strategic plans—with or without their boards. They have clearly learned a lot about what works and what doesn’t. For the directors to have this level of experience—and for management not to call on it—overlooks a ready and valuable asset that the company has at its disposal.” To make the best use of this resource, it is important to develop a dialogue outside the boardroom. However, Schulken continues, directors need to be comfortable taking thoughts to management and management needs to be receptive to ideas coming from the board.

### Compliance readiness

While there is clearly the desire on the part of board members to engage in long-term thinking, nevertheless during the past 12 months, a vast amount of time and resources have been spent on one particular item: complying with Sarbanes-Oxley’s Section 404.

Amid much speculation among business consultants and the media about whether corporate America will be ready to comply with Section 404 requirements, the What Directors Think respondents were clear: 82% of respondents believe their company is prepared for Section 404 (see Figure 2).

Meeting that goal, however, has taken a lot of effort. At yearend, there is a great deal of work going on relative to Section 404, both at the company level and by external auditors. Most directors, especially audit committee members, have been experiencing a flurry of activity related to their company’s state of readiness.

The significant effort required for first-year compliance has, therefore, shifted some directors’ and managements’ focus away

from addressing corporate strategy and performance. The challenge in future years will be to ensure Section 404 efforts don’t divert attention from growing shareholder value, while still maintaining a strict level of adherence to compliance.

“Getting the controls documented and assessed is not a one-time undertaking,” Schulken says. “It must be a continuous process.” As new processes come online, he explains, controls surrounding them need to be documented and evaluated. Similarly, controls over existing processes need to be reevaluated to ensure they continue to be effective.

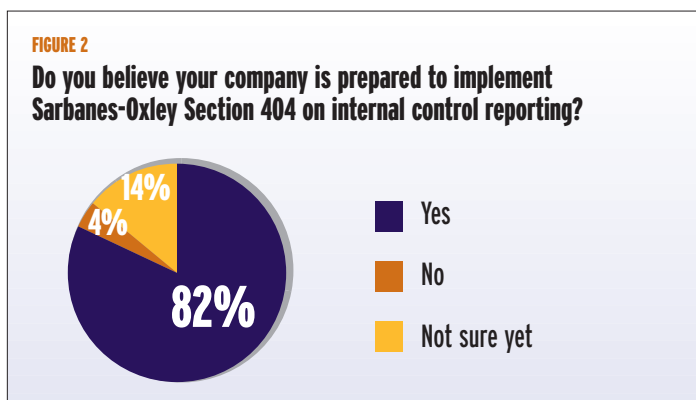
### Director compensation

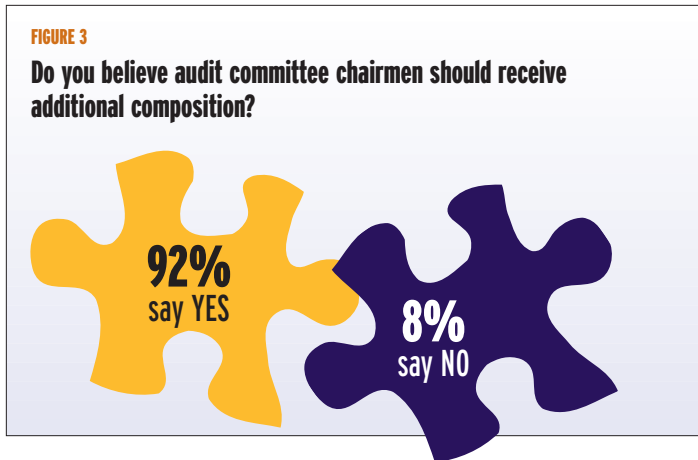
Another issue that is high on directors’ radar screens is compensation. According to the survey, the extreme upheaval felt by corporate boards during the last three years and the concern about increased workload and risk appears to have had some effect on directors’ compensation levels: The survey found that over the last 12 months, director compensation has increased for 60% of the respondents. Of those for whom there has been no increase, 60% believe that their compensation should be increased.

Respondents reported that they support bringing certain committees’ compensation more in line with the current demands on their time as well as the risk and responsibilities they shoulder. Ninety-two percent of responding directors believe the audit committee chairman should receive additional compensation (see Figure 3). Of those who support an increase, 61% believe such an increase should be 25% more than the directors’ pay; another 30% think it should be 50% of the directors’ pay.

“The responses to this question were particularly interesting,” Schulken says. “If the directors are going to receive an increase in their own compensation, they’re going to have to ask for it. Directors are probably feeling some pressure not to be seen as greedy, and yet, if anything, directors have been underpaid.” After all, he continues, when you consider the caliber of the people serving on boards and what they’re being asked to do—not to mention the personal and reputational liability they are subjecting themselves to—“directors are still one of the best bargains shareholders have today.”

In particular, Schulken points out that audit committees are clearly being asked to do more and their members today must be equipped with skills that haven’t been present on many boards. At the same time, there’s been a historical reluctance to pay certain directors more than other directors, forcing some boards





to begin looking for new ways to approach committee remuneration. “One differentiator in pay that boards seem comfortable with is letting the increased number of audit committee meetings provide the additional compensation for its members,” says Schulken.

### Effective evaluations

One of the board’s ongoing responsibilities is to periodically look inward and gauge how well members are working together and individually to accomplish the company’s strategic goals and to monitor organizational risk. Along those lines, the What Directors Think survey asked directors to estimate the effectiveness of their board in several key areas. For example, 45% of responding directors rated their compensation committee’s ability to manage CEO compensation as “effective;” another 36% rated this area as “very effective.” Ironically, Schulken says, these findings are seemingly at odds with the public’s opinion regarding executive pay.

“Everywhere you turn, you hear about runaway CEO compensation, yet the directors think they’re doing a good job of managing the process. That tells me one of two things: If these directors are right, then there’s really not a problem with executive compensation. It’s a public perception issue that needs to be better managed. However, if they’re wrong, then these directors are not going to be the ones to fix the problem,” says Schulken.

Directors also rated themselves highly in their ability to adopt a meaningful ethics policy, to stand up and challenge management when necessary, and in their audit committees’ ability to monitor accurate financial reporting.

### Conclusion

Corporate directors believe their role today is more challenging than ever before, and as such, it requires respect and deserves appropriate compensation. Despite the increased risks and responsibilities, however, directors have accepted the challenges that lie ahead and have reacted positively toward the new corporate environment in which standards of ethics and accountability have been raised. In the future, *Corporate Board Member* magazine and PricewaterhouseCoopers believe this outlook is likely to foster a healthier, more robust environment for U.S. businesses and stronger, more resilient, and more enlightened boards of directors.

## Governance and Reform

*Part I of our research findings covers the effect of corporate reform on the operations of the company and management; the effect that good governance has on the company, its management, and directors; and the changes surrounding audit committees and auditing services.*

### Effect of reform on management

At the close of 2004 it is not completely clear what overall effect—positive or negative—the vast number of reform measures promulgated by the Sarbanes-Oxley Act and the stock exchanges have had on U.S. corporate boards. Twenty percent of respondents to our 2004 survey believe Sarbanes-Oxley created an environment where managements are so distracted that company performance will be affected (compared to 14% last year); another 36% are not yet sure (see Figure 1). The feelings of this collective group may be attributed to looming deadlines related to Section 404 internal controls, to the many upheavals seen in board and committee composition, or to the intense shareholder scrutiny managements and boards have undergone since reform measures went into effect.

Nearly 30% of directors said they held more frequent board meetings due to the reform measures compared to 16% in 2003—perhaps indicating a higher need for hands-on oversight by the board during this watershed year. Despite the confidence of the 44% of respondents who believe their managements have been relatively unaffected by Sarbanes-Oxley, there is still an undercurrent of dissatisfaction with the legislation: 77% believe the Sarbanes-Oxley Act should be revisited by Congress to correct some of the act's unintended consequences (see Figure 2).

### Effect of good governance policies

There are many areas in which directors believe good corporate governance has a positive effect. Among our survey group, the following percentages indicate how many respondents agree that good corporate governance has a positive application on the following:

Makes it easier to recruit new directors	91%
The odds that, if named in litigation, you will be exonerated	85%
Improve your company's image	85%
The likelihood of being named in securities litigation	71%
The rate of premium or depth of coverage of your D&O insurance policy	62%
Positively affect your stock price	48%
How much your CEO is paid	47%
How well you are paid to be a director	30%

FIGURE 1

**Has the Sarbanes-Oxley Act created an environment where managements are so distracted that company performance will be affected?**

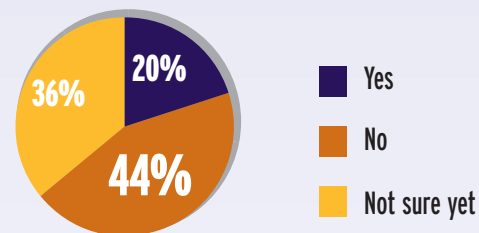


FIGURE 2

**Should the Sarbanes-Oxley Act be revisited by Congress to correct some of the unintended consequences?**

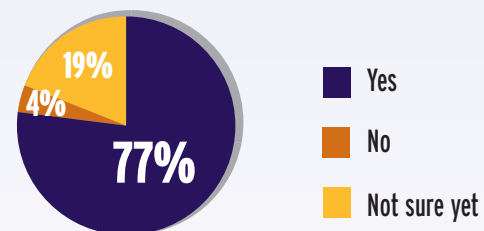
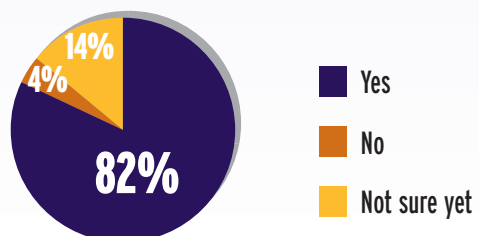


FIGURE 3

**Do you believe your company is prepared to implement Sarbanes-Oxley Section 404 on internal control reporting?**



## Section 404

An enormous ramp up both in time and resources was experienced by publicly traded companies in 2004 to comply with internal reporting requirements of Section 404. Within our survey group, 82% of respondents believe their company is prepared to implement Section 404 on internal control reporting (see Figure 3).

## Audit committees and auditing services

Showing a trend toward increasing confidence, 47% believe audit committees made up of outside directors can meet all the responsibilities of the new stock listing requirements and the Sarbanes-Oxley Act. These numbers are up from last year, when 40% of directors answered positively.

Slightly more than half of directors (51%) say they have allowed auditors to perform nonaudit services for their company (see Figure 4) and despite what is assumed to be a trend with this issue, our survey reported only 21% would support the recommendation to withhold votes for directors where audit committees have approved auditors to perform nonaudit services. A greater percentage (50%) would be in favor of withholding votes for directors who have family or business relationships with the company, suggesting that this area is perceived as a more serious matter than the former (see Figure 5).

Finally, seventy percent of respondents agree that the external auditor should assess the effectiveness of the audit committee's oversight of the internal control over financial reporting; 67% agree that the external auditor should assess the effectiveness of the audit committee's oversight of the external financial reporting process.

## Communication

Of note, there appears to be a positive indication that relationships between board members and the CEO have not suffered during these transition years of governance reform. In fact, in many cases it has improved. When asked whether CEO/board communication had changed since the introduction of corporate reform, 42% indicated their communication has improved and 55% say it has remained the same. Only 3% said their communication was more strained after reform was in place (see Figure 6).

FIGURE 4

Has your board allowed auditors to perform nonaudit services for your company?

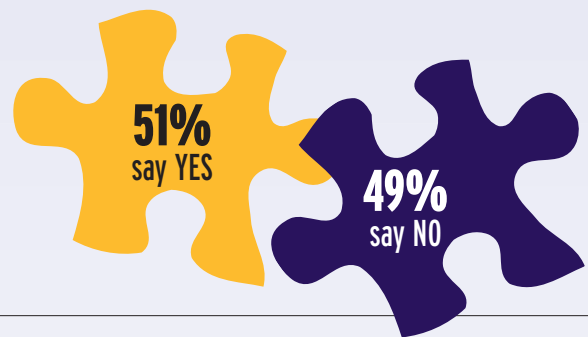


FIGURE 5

Percentage of directors who support the recommendation by institutional investors that shareholders withhold votes for directors where

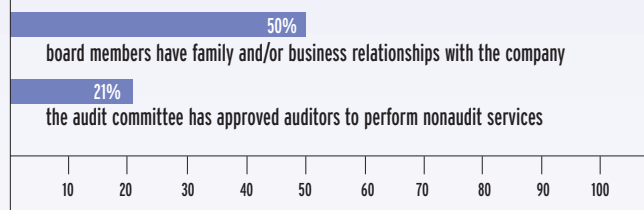
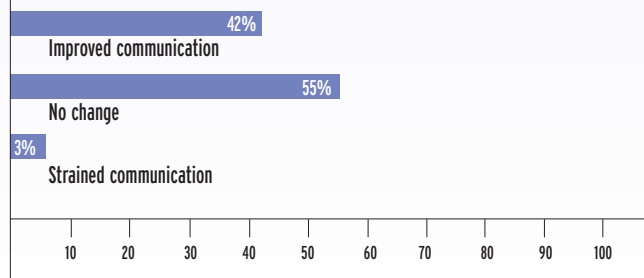


FIGURE 6

Has CEO/board communication changed since corporate reform was introduced?



## Board Structure and Scope

Part II focuses on strategic planning, board composition, and meeting structure.

### Board meetings and preparation

Recent governance reforms have not greatly affected the frequency of board meetings in U.S. publicly traded companies; 70% of respondents indicated the number of meetings per year has remained the same. Directors' informational needs are seemingly being met; only 4% say do not receive enough information to be prepared for their meetings. The majority of respondents' boards hold six meetings per year; 52% hold quarterly executive sessions during board meetings without the CEO (see Figure 1).

### CEOs on the board

The former CEO is no longer a board member on 72% of responding boards; 75% indicate they believe former CEOs should not serve on the board (see Figure 2). The positions of chairman and CEO are combined in the majority of the responding companies, with only 35% indicating they are divided into two separate positions. Forty-one percent say they believe the position of chairman/CEO should be divided, with the chairman being an outside director (see Figure 3). For those who have separate positions for chairman and CEO, 49% have an outside director holding the chairman position. Transversely, for those respondents whose chairman is also the CEO, 75% have appointed a lead director to preside at executive sessions and assist in setting board agendas.

### Limiting board seats

The limitation on the number of board seats that a director may hold is related to his or her role on the board (see Figure 4). Forty-three percent of CEOs have been limited to an average of two boards, 35% of audit committee members have been limited to an average of three boards, and 29% of outside directors have been limited to an average of three boards. Compared to our 2003 research, the desire to restrict both the CEO (33% in 2003) and the outside directors (16% in 2003) is up significantly, a trend expected to continue.

These limitations mean that the pool of traditional board candidates has become smaller and has resulted in boards expanding their search to include candidates such as CFOs and CIOs. Also, there are fewer individuals who once might have been considered "professional directors"—though retired executives serving on several boards today may still be considered in that category.

FIGURE 1

How often does your board hold executive sessions during board meetings without the CEO?

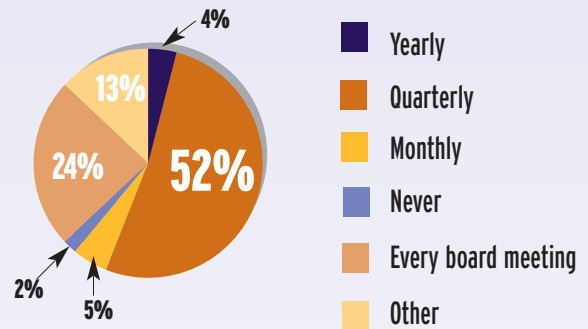


FIGURE 2

Should the former CEO sit on the board?

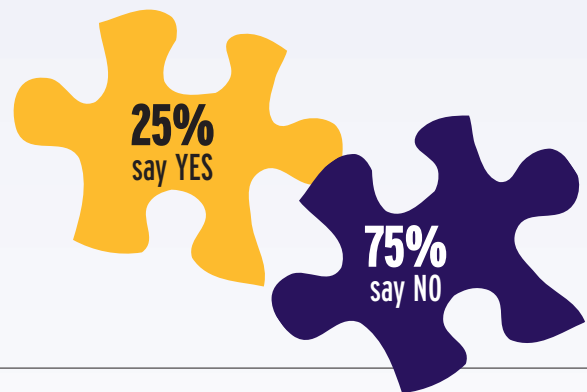
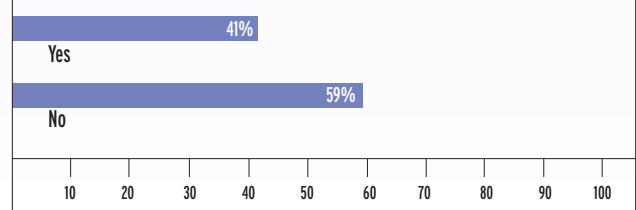


FIGURE 3

Should the positions of Chairman/CEO be divided?



## What boards want to do

Seventy-four percent of responding board members have spent time determining board scope; 90% believe it is an important exercise for directors in the post-corporate-reform era (see Figure 5).

Strategic planning is also high on the desired action list, with 58% of respondents indicating they want to devote more time to this exercise in the boardroom. Though this process is fraught with challenges, such as finding the right adviser, and determining the level of board participation, there is nothing more substantive from a board's viewpoint than determining the direction of the company.

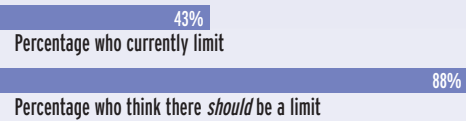
The following ranks the activities on which surveyed board members wish to place more, the same, or less priority:

	More	Same	Less
Strategic planning	58%	42%	*
Succession planning	45%	54%	1%
Meeting key managers	41%	58%	1%
Visiting company worksites	40%	57%	3%
Discussing the competition	36%	62%	2%
Risk management	31%	68%	1%
Discussing the industry	30%	68%	2%
Monitoring performance	18%	81%	1%
Compensation issues	17%	81%	2%
Governance guidelines	11%	80%	9%
Getting CEO updates	10%	89%	1%
Analyst updates	9%	77%	14%
Stock strategies	8%	79%	13%
Compliance and regulatory issues	8%	84%	8%

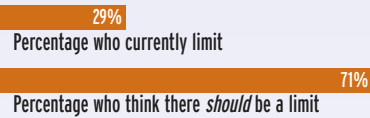
FIGURE 4

### Opinion on limiting the number of additional board seats for various directors.

#### CEO



#### Outside Directors



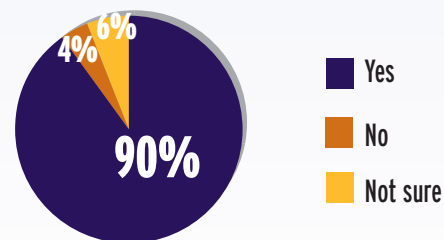
#### Audit Committee Members



10 20 30 40 50 60 70 80 90 100

FIGURE 5

### Do you think determining board scope is an important exercise for directors in the post-corporate-reform era?



## Compensation, Succession Planning, and Board Evaluations

Part III of the research discusses directors' compensation and benchmarks, the importance of succession planning, board efficacy, and the importance of board and director evaluations.

### Compensation

We surveyed directors about fairness of compensation and board practices related to compensation management. While 60% of directors surveyed had received increases over the last 12 months, of those 40% for whom no increase had occurred, 60% believe that compensation should be increased.

More solidarity is noted among those who think certain board roles are reasonably in need of additional remuneration. Ninety-two percent say audit committee chairmen should receive additional compensation, and 68% say lead directors should be given increased pay to compensate them for additional responsibilities in their roles (see Figure 1). In both cases, the majority of respondents believe about 25% of regular pay would be a fair increase (see Figure 2).

Reevaluating compensation benchmarks and ensuring compensation consultants report to the compensation committee instead of the CEO top the list of items on the compensation committee's agenda for the purpose of improving CEO pay policies, according to responding directors.

### Succession planning

Management succession is one of the most critical—and prickly—issues a board must deal with, especially when the outgoing CEO is involved in the process. Sixty-seven percent of respondents report they have a management succession committee or process in place (see Figure 3) and a little more than half of our respondents have undergone management succession in the last three years. Among those cases, about 33% of the decision power came from the retiring CEO, and about 66% rested in the hands of the board.

Because of the potential for many conflicting emotions that can muddy an expedient and smooth transition, directors believe they should have a well-thought-out succession plan in place. The majority (67%) of respondents currently has such a plan, yet many shared concerns about its efficacy: Only 18% estimate their board is “very effective” at succession planning.

FIGURE 1

**Percentage of directors who think the lead director or audit committee chairman should receive additional compensation:**

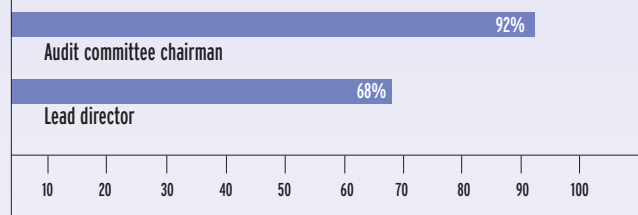
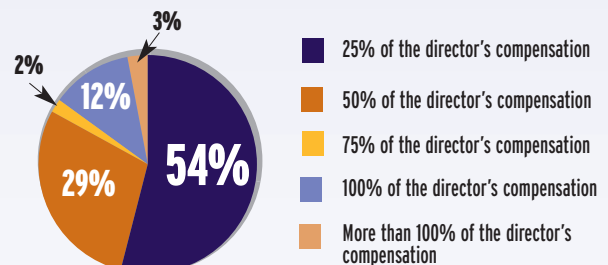
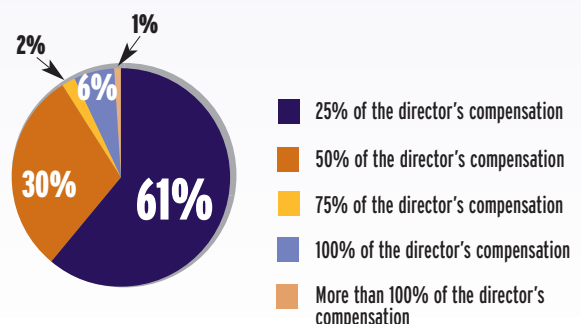


FIGURE 2

**Sixty-eight percent of respondents said additional compensation is appropriate for lead directors. How much additional compensation is appropriate?**



**Ninety-two percent of respondents said additional compensation is appropriate for audit committee chairmen. How much additional compensation is appropriate?**



## Board competency

The survey asked directors to rank the effectiveness of their board in seven areas. The results are listed below in order from most effective to least effective.

- The board’s ability to challenge management when appropriate
- The audit committee’s ability to monitor accurate financial reporting
- The board’s ability to adopt a meaningful ethics policy
- The compensation committee’s ability to properly manage CEO compensation
- The board’s ability to complete a management succession plan
- The board’s ability to create an agenda that best uses the board’s limited time
- The board’s ability to monitor a risk management plan to mitigate corporate risk

With regard to directors’ perceptions of their strengths and weaknesses, an area of concern is the board’s lack of confidence in their risk management ability. A board’s primary duty is evolving into managing risk across the enterprise; therefore, this area may be one in which outside assistance will be needed in the year ahead.

## Formal evaluations

The entire board’s performance is formally evaluated on a regular basis for 73% of responding boards (see Figure 4), a 23% increase over last year’s results. Additionally, 35% currently evaluate individual directors, and 79% believe that individual directors should be evaluated regularly, which is up 12% (see Figure 5). This is a growing trend and, though it is now part of NYSE listing requirements, it a practice that is still uncomfortable for many boards.

How effective are these evaluations? The majority of respondents who have undergone evaluations said they fall in the “effective” category, but far fewer rated them as “very effective.”

### Entire board

Very effective	11%
Effective	52%
Somewhat effective	35%
Ineffective	2%

### Individual directors

Very effective	14%
Effective	51%
Somewhat effective	30%
Ineffective	5%

FIGURE 3

Does the board have a management succession committee or process?

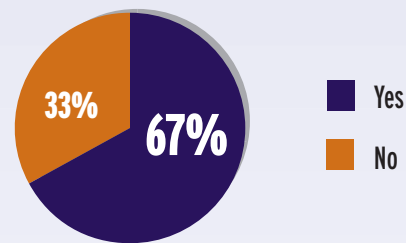


FIGURE 4

Percentage of respondents who formally evaluate the entire board and/or individual director performance on a regular basis.

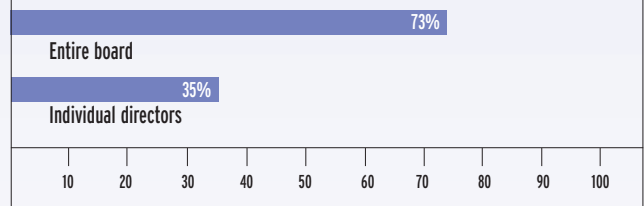
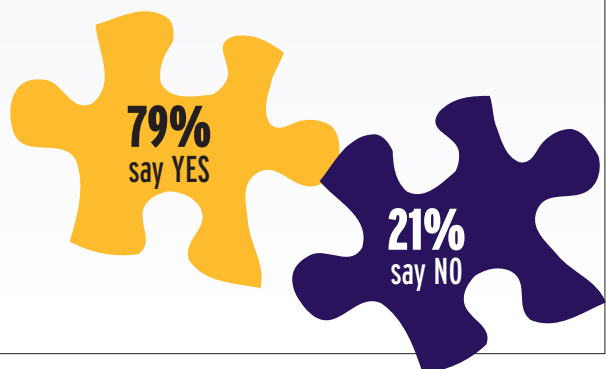


FIGURE 5

Should individual directors be evaluated regularly as to their performance?



## Board Culture and Risk

Part IV covers directors' perceptions about their internal culture, their appetite for risk, their need for liability protection, and the increased use of outside advisers.

### The importance of culture

Creating a viable, successful, and unique corporate culture is a proven component for increasing shareholder value. Board culture may be viewed as a microcosm of corporate culture—it expresses the collective mindset for how the board should conduct its business and for standards of accountability and ethics. Historically, board culture has been subservient to management culture; today, successful boards aim to achieve equality between the two to provide a fair and objective balance of power and the most positive governance results.

Respondents believe a company's culture can greatly affect ethics, risk taking, and the bottom-line performance of the company. Respondents also believe that a board can impact or alter a company's culture, with 79% answering affirmatively to that statement (see Figure 1).

Culture also plays a role in the ongoing health and viability of the board itself. A large majority (91%) of respondents believe good corporate governance makes it easier to recruit new directors. Interestingly, only 30% believe culture affects how well you are paid as a director.

### Appetite for risk

Board culture has a significant influence on the amount of risk a board is willing to assume. In addition, the majority of respondents believe trust in management has a strong influence on a board's appetite for risk. The results below show how trust in management influences a number of elements (with "1" indicating a great influence and "10" indicating no influence).

Mean/Median/Mode

Appetite for risk	2 / 2 / 1
Board scope (topics reviewed at meetings)	3 / 3 / 3
Length and agenda of meetings	4 / 3 / 3
Board involvement in operations	3 / 3 / 3
Time spent on ethics issues	3 / 3 / 2

FIGURE 1

Can a board impact or alter a company's culture?

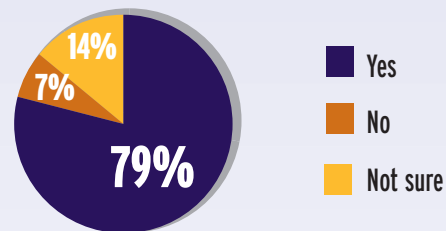


FIGURE 2

In the last 12 months, do you feel your risk as a director has

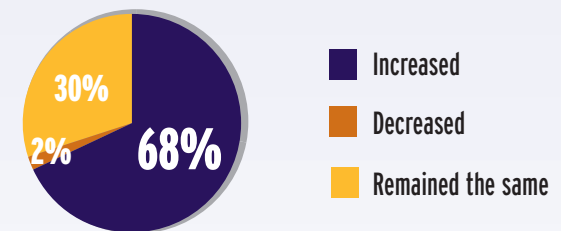
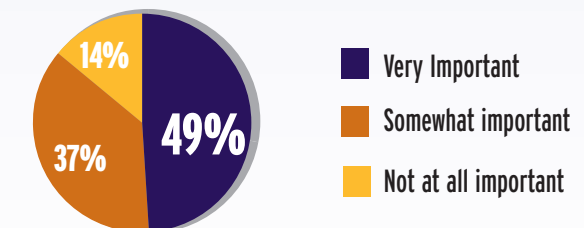


FIGURE 3

How important was D&O coverage in your decision to serve on your current board?



## Director liability and insurance

In the wake of major corporate scandals, additional governmental oversight and regulations, and overarching investor scrutiny, there is little doubt that directors perceive that their liability has greatly increased. The survey demonstrates that in the last 12 months, risk perception has increased for 68% of the respondents; only 2% say it has decreased (see Figure 2).

Operating within such an environment has made the need for adequate insurance protection more profound than ever before. It is not surprising that 49% of responding board members said D&O coverage was very important in their decision to serve on their current board (see Figure 3). Despite the recent proliferation of individual directors' coverage offered by several major carriers, however, only 6% have purchased individual coverage and only 21% would consider getting it (see Figure 4).

## The need for advisers

With boards feeling the brunt of many new requirements and an increased emphasis on their personal accountability, the need for outside adviser assistance is more acute. According to the survey, 47% of responding directors and 48% of audit committees have sought the aid of a governance expert/adviser (see Figure 5). Though 64% expect their companies' use of outside advisers to remain the same, 21% expect their usage of governance experts/advisers to increase (see Figure 6).

FIGURE 4

Would you consider getting yourself individual D&O coverage as a director?

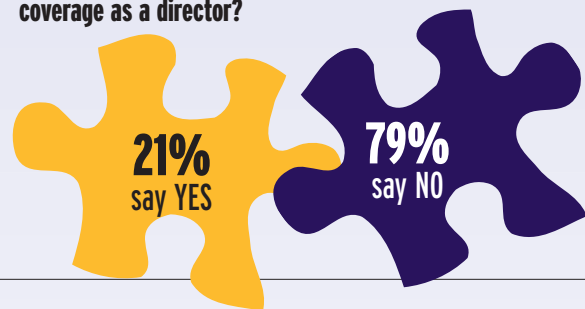


FIGURE 5

Has your board and/or audit committee sought the aid of a governance expert or adviser to help your board fulfill the new governance requirements?

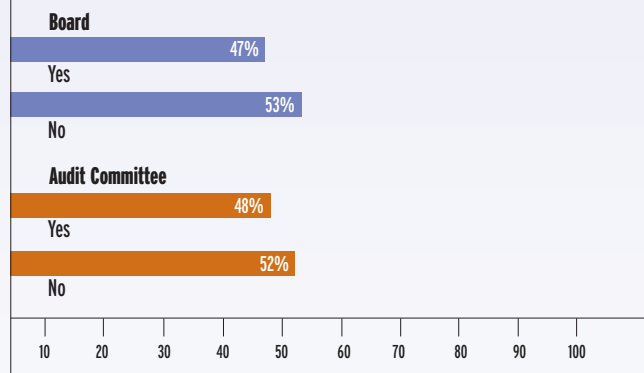
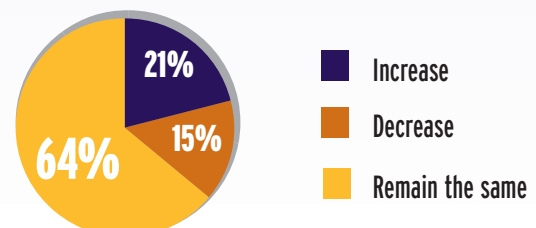


FIGURE 6

Do you expect the use of these governance experts or advisers to



## Insights on European Boards

In September 2004, *Corporate Board Member Europe* published the results of its European board study called Board Insights 2004: What Europe's Board Directors Think. This research study of 319 directors from 14 countries shows 63% of European directors believe EU Corporate Governance Reform provides genuine improvements in protection for investors. Moreover, in general, board members have demonstrated their acceptance of best practices recommended by documents such as the UK Combined Code, The German Corporate Governance Code, The Bouton Report, and EU Corporate Governance Reform.

### Perceptions of risk

Though opinions vary widely by country on the impact of governance reform—with directors from the UK feeling a heightened sense of risk and those in Germany feeling the least impact thus far—the majority of directors surveyed believe their personal liability has increased over the past 18 months. Out of the total directors surveyed, 63% thought legal risk had increased, 54% that financial risk had increased, and 46% that their reputational risk had increased.

### Directors require education

Despite understanding the need for reform, the research found a discrepancy between directors' acceptance of risk and their preparedness to manage the additional responsibilities inherent in their fiduciary role. This may be partly due to a lack of formal instruction: Though reform measures have been implemented in every country surveyed since 2001, directors report receiving little in the way of education covering those reforms during the same period. Only 58% report receiving any education or training related to their role as a board member; of those who did, 41% say training took place more than two years ago. This pattern is likely to change over time as investors become more aware of the correlation between best practices and corporate efficiency and begin promoting education in order to attain best practices.

### Best practices

Investors' heightened concerns about independence and ethics have led to the institution of a number of reform practices in Europe, some garnering more support as measured by responses from country groups. To gauge the overall effect such reforms are having, directors were polled about the implementation status for the following practices:

Practice	Currently in place
Formal policy for auditor independence	89%
Preparedness for international accounting standards	88%
Formal code of ethics	82%
Policy for use of an audit firm for non-audit/consultancy work	66%
Meetings for non-executive directors only	56%
Mandatory rotation of external auditors	40%

### Board compensation and succession planning

In addition to the need for training, the survey identified several other areas that deserve greater attention. Less than half of board members surveyed (47%) say they have a good understanding of formal management succession plans; only 45% say they understand the plan for top managers. Even more telling, 32% reported they did not know if their company had a formal succession plan for their chief executive.

# Methodology

During May and June 2004, *Corporate Board Member* magazine conducted the annual What Directors Think study.

## Sampling

Ten thousand studies were sent by mail to the directors of the top 2000 publicly traded companies. A 12.8% response rate was achieved with 1279 questionnaires returned. The questionnaire consisted of two basic types of questions: those addressing the policies and practices of the board and those addressing the characteristics and opinions of the individual director.

## Analyzing the results

The questionnaire held two basic types of questions: questions addressing the policies and practices of the board and questions addressing the characteristics and opinions of the individual director. To achieve nonbiased data when calculating the results for the board related questions, each respondent's board was identified using a director ID number.

Each board was only allowed to be represented once in the data pool causing deletion of any board already represented. This brought the total number of respondents used to calculate the board-related questions down to 843. These questions are shown in italics. The full number of responses were used to calculate the results for the questions dealing with individual director opinions and actions.

Cross-tabulations are only performed on appropriate questions and are not performed on questions where the variable cannot be affected by the fixed element the cross-tabulation is based upon.

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