

# WHAT DIRECTORS THINK

The 2006 *Corporate Board Member/PricewaterhouseCoopers* Survey





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### Profile of U.S. Corporate Boards

# INTRODUCTION



Historically, directors have looked to the CEO as the company's visionary and leader of the board, but today's corporate climate requires independence and a renewed focus on best practices and fiduciary duties. Taking ownership of the board meeting agenda is one way directors can maintain an appropriate balance between management and the board. Beyond that, directors need to speak up and ask for information that they may not be getting on important issues like customer satisfaction, employee morale, and CEO performance measures. Additionally, boards need to take strides to build good management succession policies to ensure a smooth transition in the event of an unexpected loss of the CEO.

This year, *Corporate Board Member* has once again teamed up with PricewaterhouseCoopers LLP to bring you the What Directors Think research report: a study drawn from a 2006 survey of more than 1,300 corporate directors who answered nearly 70 questions on how they and their boards are meeting the challenges and demands of their jobs.

We hope you find this supplement, a companion to the *Corporate Board Member* magazine published in October, useful in providing you with additional information on how directors are handling the responsibilities and commitments of corporate governance—an item that has occupied increasingly more of their time in the past several years. In addition, we would like to thank the board members who participated in our survey, whose opinions made this study possible.



**TK Kerstetter**  
President  
*Corporate Board Member*



**Catherine L. Bromilow**  
Partner and U.S. Leader for  
Corporate Governance  
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## Time for U.S. Directors to Take Charge

Securing a company's continued success requires perseverance and the ability to adapt long-term corporate strategy in an environment where reform has become standard operating procedure. And while U.S. directors have spent considerable time addressing changes in legal requirements and preparing their companies to meet the challenges of a new environment of ethics and risk, overall they've been hesitant to take charge in areas that might make shareholders nervous—and also in some areas where shareholders and observers have expressed concern.

### CEO Succession

Succession planning can be a touchy subject, especially if a board is happy with its current chief executive and would like to see him or her remain in the position for some time; however, CEOs are not permanent fixtures, so a good succession plan is essential, even without a retirement looming on the horizon. Nearly half (43%\*) of the 1,330 directors who responded to this year's survey said they were dissatisfied with their company's succession plan—and 23% of those said their CEO was uncomfortable with the topic of succession. A full 20% said their company didn't have a succession plan.

Boards need to reassess their approach when it comes to succession planning. A last-minute search for a CEO not only costs more money, but also eliminates the possibility of having someone waiting in the wings, ready and able to step in should the need arise. Having that successor ready is essential to the continued success of a company; after all, no matter what, business must continue.

"Directors need to recognize that a succession plan is not a 'nice thing to have,' but is truly critical. This is especially true given the tremendous rise in CEO and senior management turnover we've witnessed over the past few years," says Catherine L. Bromilow, PricewaterhouseCoopers LLP partner and leader of its corporate governance group.

### Board Leadership

About half (51%) of participating directors said they prefer a board led by the chair/CEO, so it is no surprise that directors are not pushing for more power. And while investors want independent boards, 90% of respondents said they are satisfied with their control over the agenda.

"The survey results related to the board being comfortable with the chair/CEO providing board leadership are not a big surprise, but do suggest that many boards may not be as independent as shareholders might hope," says TK Kerstetter, president of

*Corporate Board Member.* "While CEO guidance will always be important, boards have to establish leadership through the lead or presiding director, especially when the chair is also the CEO, so that during executive sessions of the board and at other critical times, a prudent structure is in place to fulfill their fiduciary responsibilities."

### Compensation

Eighty-eight percent of directors surveyed said full disclosure of senior management compensation in the proxy was a positive step for publicly listed companies, and only 30% were concerned about meeting the new SEC disclosure rules. Director confidence, however, is perhaps misplaced. Only 47% of the boards represented currently use tally sheets to calculate CEO pay packages, and a small but significant number of directors said they did not know what the CEO would collect upon leaving the position because of termination (20%), retirement (22%), or a change in control (19%).

Sixty-six percent of responding directors said U.S. company boards are having trouble controlling the size of CEO compensation. Another 34% said stockholders and institutional investors will most likely be the force that slows growth in CEO pay, while only 1% said they thought Congress would have to get involved.

"Directors might be underestimating the likelihood of Congress getting involved if CEO pay abuses continue to be displayed to the public on the front pages of many well read newspapers and other publications," Kerstetter says. "Current rumblings about having shareholders approve compensation packages would be worrisome enough for many companies, much less having hard regulations about what CEOs can be paid. The sad part, as usual, is that while abuses might still be the exception, all public companies will be painted by the same broad brush."

"Directors are going to be in for some surprises when they see the numbers come together, as companies draft the new disclosures," Bromilow says. "We think that particularly the amounts of deferred compensation—including various forms of post-employment benefits—will raise some eyebrows in boardrooms."

### Other Highlights

*Directors identify worst-case scenarios.* Headlines of the past several years have placed a lot of focus on situations that directors don't want to be in. We asked directors, hypothetically speaking, to identify the worst situation in which their board could find itself. Having officers investigated for insider trading was at the top of the list. Directors also rated highly the sudden loss of a CEO without a succession plan in place—not surprising given the

significant number of boards reporting a lack of succession planning. Directors considered an unexpected financial or operational crisis as the third worst-case scenario, followed distantly by an unanticipated hostile takeover bid and a \$10 million bonus for the CEO that was unjustified by profits.

“The crises that directors rated as the worst all represent significant compliance and operational problems,” Bromilow says. “And they point to the need for a highly ethical culture, with management living the values, and an effective enterprise risk management process, including robust crisis plans.”

*Pensions plans to be eliminated.* Despite the negative press that might ensue, 71% of respondents said they thought most companies would alter or eliminate pension plans to improve future earnings.

*Institutional investors influence boards.* When asked which group influenced their board the most, 51% of respondents chose institutional investors above analysts, ISS and rating agencies, the plaintiffs’ bar, and activist hedge funds. This finding may indicate why 81% said they were not concerned about the impact of hedge funds on their companies.

*Support growing for virtual meetings.* Participants in this year’s study reported devoting an average of 21 hours per month to board issues—a substantial increase from the average of 14 hours reported five years ago. And while boards seem reluctant to embrace technology as the remedy for their overburdened schedules, 47% said they would feel comfortable holding a board meeting in a secure Internet environment—up from 36% in 2002.

*Boards evaluate themselves and their CEOs.* Eighty-six percent of represented boards undergo a formal, full-board performance evaluation on a regular basis, and nearly 60% have taken action or have created an implementation program as a result of these evaluations. Conversely, just as 14% of boards aren’t evaluating their own performance, the same number (14%) do not perform an annual review of their CEO. Twenty-two percent of directors reported dissatisfaction with the quality of their board’s CEO review.

“The fact that so many boards identified constructive action from evaluating their own performance shows the value of these exercises,” says Bromilow, “but it’s difficult to understand how those boards that aren’t reviewing their CEOs are reaching fair conclusions about CEO compensation.”

*Directors support board education.* The results indicate there is a lot of support for board education—83% of those surveyed said they thought board members should attend director education seminars. In response to a related question, 52% said board education should combine both outside seminars and private, in-boardroom instruction.

*Directors are still concerned about risk.* A little over half (52%) of responding directors said they thought their risk had stayed the same over the past year, but 44% said they felt their risk had increased. “Although there were no high-profile court cases in the 12 months before our survey, we get the sense that the constant focus on boards is prompting directors to feel a certain degree of general unease about their risk,” Bromilow says. Eighty-one percent of directors have reviewed their D&O policy in the past 12 months.

*Directors are not getting data on some important issues.* Respondents identified issues related to poor customer satisfaction and low employee morale as red flags signaling that a director should step up his or her involvement on the board; however, the study showed that in the past two years, less than half of the represented boards had received data related to those issues.

“Directors are right on target to identify weak employee values and poor customer satisfaction as important red flags to future company performance,” says Kerstetter, “but the statistics show that many don’t get the information they need to manage two of their important constituencies. This is an area where many boards need to step up and press for some level of reporting, either directly or as part of a company’s strategic plan analysis.”

## Conclusion: Directors Must Take Charge

Boards need to step up their oversight, particularly in succession planning. At the heart of the matter of correcting the balance of power is the fact that, so far, boards are not taking control of their agendas in a way that dovetails with their critical role and fiduciary responsibility to constituents.

\* For the purposes of this report, percentages were rounded to the nearest whole number.

## Succession and Board Leadership

FIGURE 1

Are you satisfied with the planning of your company's CEO succession?

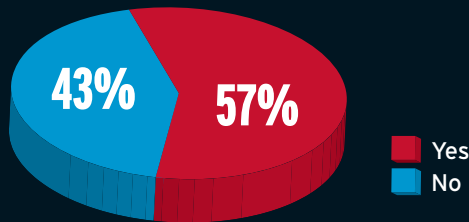


FIGURE 2

Directors who said they are unhappy with their company's CEO succession planning tell us what is behind their dissatisfaction:

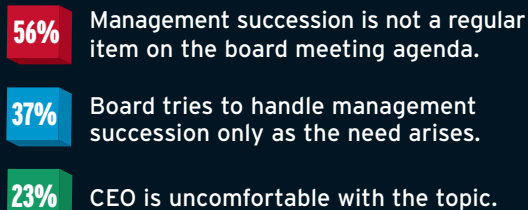


FIGURE 3

From whom does board leadership emanate?



Inside every boardroom there are leaders driving the company to its next destination. But who exactly is behind the wheel? Who holds the keys to the board and committee meeting agendas? It is that ultimate leader—the person other leaders look to—who is the one in the company's driver's seat. And while changing drivers midrace might be the exciting stuff of Hollywood fiction, directors need to make sure their boards have a succession plan in place before they find themselves (and their businesses) stalled in the middle of the road, mired down in a search for a new CEO.

### Succession

If there is one thing boards had better get right, it's having the right CEO. Yet, according to the results of the 2006 *Corporate Board Member/PricewaterhouseCoopers LLP What Directors Think* study, boards continue to struggle with succession planning. A CEO manages the company and takes it where it needs to go, but no executive sticks around forever—and sometimes a CEO's departure is abrupt and unexpected. Boards need a plan to manage both an anticipated and unanticipated CEO replacement.

When a CEO leaves, directors know it is bench strength—the future CEO waiting in the wings—that keeps the company on track. Yet, 20% of the directors we surveyed said their company has no succession process in place. And nearly half (43%) are still dissatisfied with their companies' plans for management succession (*Figure 1*). Of those, 56% said management succession is not a regular item on the board meeting agenda, 37% told us their board tries to handle management succession only as the need arises, and 23% said their CEO is uncomfortable with the topic of succession (*Figure 2*). However, most (77%) reported that their CEO supports the board's CEO succession process.

### Leadership

When asked, 50% of respondents said their board leadership emanates from a CEO who is also chair (*Figure 3*). Add to that another 11% who said they take their cues from a nonchair CEO, and it is apparent CEOs are in the driver's seat at a majority of companies. Still, 23% of directors surveyed said their boards are led by a nonexecutive chair, and 11% by a lead director. When asked who they would prefer as board leader, respondents were almost equally split—49% said an outside chair or lead director, while 51% preferred the CEO.

At just over half (58%) of the represented companies, the chair and CEO positions are combined, while the remaining 42% have separate seats for the chair and CEO. And at first glance, directors appear to be comfortable with the status quo. Fifty-nine percent of those surveyed said the positions should be combined, while 41% said they should be separated. However, of those respondents whose chair and CEO positions are divided, only 67% said an independent director should hold the chair position. Meanwhile nearly a quarter (23%) of those who indicated the positions are combined at their company said the chair should be an independent director.

### Who Controls the Meeting Agenda?

The person who holds the keys to the agenda wields a hefty amount of control. Nearly half (48%) of responding directors said final responsibility for approving their board's agenda rests on a CEO who is also chair (*Figure 4*). Another 26% said a nonexecutive

chair is responsible for the agenda, while 12% said it is their lead director, and 10% said their CEO (who is not also chair) handles the item lineup.

A vast majority (90%) of responding directors said they are satisfied with the amount of control they have over their board meeting agendas. Eight percent said they would like more control, and 2% said they prefer no involvement. However, despite the high number expressing satisfaction with their level of input over the agenda, respondents said they would like to see more time devoted to discussing the competition (60%), strategic planning (56%), discussing the industry (48%), meeting managers from key parts of the company (43%), succession planning (43%), and visiting company work sites (38%), while 33% would like to see less time devoted to Section 404 analysis (Table 1). These findings indicate that directors should exercise greater control over their agendas and steer discussions to create more balance between management and the board members who serve as shareholder representatives.

**TABLE 1**  
Directors would like to devote more, less, or the same amount of time to the following items:

	More	Same	Less
Discussing the competition	60%	39%	1%
Strategic planning	56%	44%	0%
Discussing the industry	48%	51%	1%
Succession planning	43%	56%	1%
Meeting managers from key parts of the company	43%	56%	1%
Visiting company work sites	38%	58%	4%
Compensation issues	26%	72%	2%
Risk management	23%	72%	5%
Reviewing M&A in their industry	22%	74%	4%
Director liability issues	16%	77%	7%
Monitoring performance	16%	82%	2%
Analyst updates	13%	82%	5%
CEO updates	12%	87%	1%
Compliance and regulatory issues	9%	76%	15%
Governance guidelines	5%	78%	17%
Section 404 analysis	3%	64%	33%

## Committee Agendas

When it comes to committee meetings, 71% of directors said the committee chairs hold the wheel (Figure 5). Still, 10% report that their CEO is responsible for establishing this important road map to committee meeting discussion. Other individuals responsible for committee meeting agendas are the general counsel or the corporate secretary (7%), the CFO (5%), or a nonexecutive chair (5%).

**FIGURE 4**

### Who has final responsibility for approving your board meeting agenda?



**FIGURE 5**

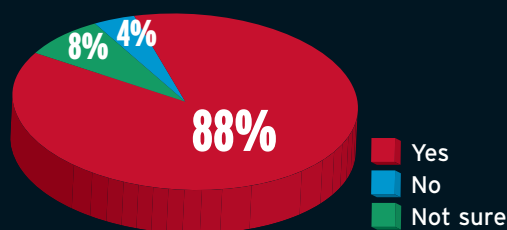
### Who is primarily responsible for establishing committee-meeting agendas?



## Compensation

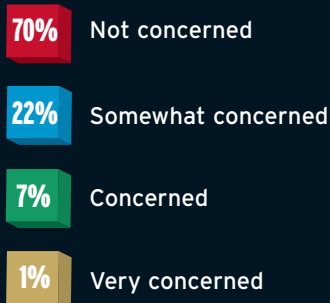
**FIGURE 6**

**Do you feel that providing full disclosure of senior management compensation in the proxy is a positive step for publicly listed companies?**



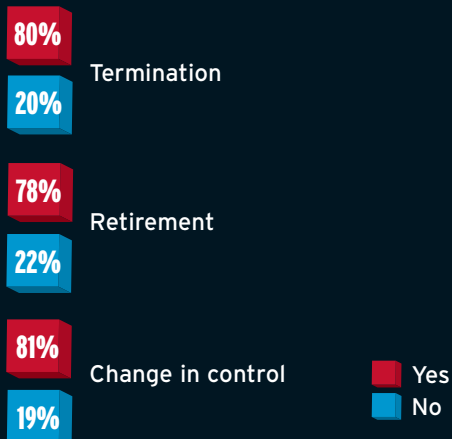
**FIGURE 7**

**How concerned are you about having to provide greater disclosure about senior management compensation under the forthcoming SEC rules?**



**FIGURE 8**

**Do you know much your CEO would collect in the following scenarios?**



The new SEC disclosure rules, issued in August 2006, have put a magnifying lens on executive and director compensation. At the heart of the new rules is the requirement that companies provide clearer and more complete information on compensation packages. The 2006 What Directors Think study delved into the issue to find out how directors really feel about the increased scrutiny and what effect it might have on future practices.

### New SEC Disclosure Standards

Directors don't seem to mind that shareholders will be able to keep a closer eye on compensation. Most of those surveyed (88%) agree that providing full disclosure of senior management compensation in the proxy is a positive step for publicly listed companies (Figure 6). Directors also aren't letting the prospect of greater exposure of compensation elements push them outside their comfort zones. Almost three-quarters of our survey respondents (70%) said they are not concerned about the new disclosure rules (Figure 7). Another 22% said they are somewhat concerned, while only 8% said they are concerned or very concerned about the new disclosure requirements.

Yet, director confidence is perhaps misplaced. Only 47% of the boards represented use tally sheets to calculate CEO pay packages. Approximately one in five directors said they did not know what the CEO would collect upon leaving the position because of termination (20%), retirement (22%), or a change in control (19%) (Figure 8).

### Controlling CEO Pay—Someone Has to Do It

Enormous CEO pay packages have made quite a spectacle in news headlines in the past several years. In his March 2006 speech before the Council of Institutional Investors, SEC Chairman Christopher Cox said there is a reason people complain about management salaries in the tens of millions, but not about similar salaries for athletes, actors, and movie producers—"we're implicitly more confident that the salaries of quarterbacks, movie stars, and race car drivers are determined by the market."

But when it comes to CEO pay, how do we know how much is too much? In the past year, experts have talked a lot about redesigning performance metrics to more closely link CEO salaries and bonuses to overall company success—true pay for performance. Two-thirds (66%) of responding directors believe U.S. company boards are having trouble controlling the size of CEO compensation (Figure 9).

If boards don't take control of CEO pay, it's only a matter of time before someone steps in—in fact, that is already happening. Some investors have initiated proxy fights using the issue of CEO pay packages to rally support. Perhaps this is why about one-third of participating directors (34%) believe that stockholders and institutional investors is the group most likely to slow the growth of CEO pay at a majority of companies (Figure 10).

Some industry watchers believe executive pay reform won't take root without congressional intervention. Boards members, however, don't appear to agree, or perhaps our results reflect wishful thinking rooted in a general belief that legislated reform may not be the best step for business. Only 1% of responding directors said they believed

congressional intervention will be necessary to curtail the rapid growth of CEO compensation. Forty-one percent of responding directors said boards will be the most likely source of new CEO pay limits. A small number of respondents (10%) said they do not believe that companies have a problem of rapid CEO compensation growth.

### Board and Committee Compensation

In the 12 months prior to the survey, 57% of represented directors received a pay increase. Overall, nearly three-quarters (73%) believe their compensation for serving as a director is adequate.

**TABLE 2**

**For years, directors have been saying that certain board positions should receive additional pay, but this year's lower numbers likely show that boards have already begun to increase compensation for those with additional board duties.**

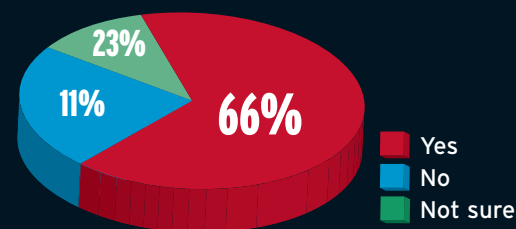
Position	2002	2003	2004	2005	2006
Audit committee chair	54%	81%	92%	86%	66%
Lead director	*	*	68%	61%	40%
Compensation committee chair	*	*	*	53%	42%
Governance/nominating committee chair	*	*	*	38%	23%

\* Statistic not measured this year.

When asked whether certain board positions warranted additional compensation, fewer directors responded “yes” in this year’s survey compared with last year’s—perhaps because some chairs received pay increases last year. This year, 66% said the audit committee chair should receive additional compensation—down from 86% last year. Forty-two percent said the compensation committee chair should receive additional pay, followed by the lead director (40%), and the governance/nominating committee chair (23%) (Table 2). Rather than indicating that fewer directors agree that additional pay is warranted, these numbers likely reflect the fact that many boards have already addressed the issue of increasing committee chair pay and have established a comfortable new benchmark.

**FIGURE 9**

**In general, do you believe U.S. company boards are having trouble controlling the size of CEO compensation?**



**FIGURE 10**

**Which of the following is most likely to curtail the rapid growth of CEO compensation in many of today's companies?**



## Ethics and Governance

**FIGURE 11**

### Which of the following characterizes the worst position in which a board could find itself?

- 32%** Several company officers are being investigated for insider trading.
- 27%** The company suddenly loses its CEO without a succession plan in place.
- 25%** An unexpected financial or operational crisis has occurred without a company crisis plan in place.
- 12%** There is a hostile takeover bid that the company and the board have not anticipated and are not prepared to address.
- 4%** Your compensation plan just rewarded the CEO a \$10 million dollar bonus even though the stock price is lower for the second year in a row.

**FIGURE 12**

### Which of the following groups do you believe influence your board the most?

- 51%** Institutional investors
- 26%** Analysts
- 15%** ISS and rating agencies
- 4%** Plaintiffs' bar
- 3%** Activist hedge funds

Developing a sterling code of ethics continues to be essential for companies across the United States. Because board members make decisions on important and challenging issues, shareholders are demanding that the board explain its choices and are taking steps to ensure that directors act as their representatives in all decisions affecting the company's success.

### Worst-Case Scenarios

Directors don't need searing headlines like those generated by confidentiality investigations, or high-profile, board-related court cases, to remind them that there are some situations no one wants to be in.

In the 2006 What Directors Think study, we asked directors to tell us which of several situations characterize the worst position in which a board could find itself (*Figure 11*). A third (32%) of respondents indicated that their worst-case scenario would be having several company officers investigated for insider trading. Twenty-seven percent said it would be the sudden loss of a CEO without a succession plan in place. Twenty-five percent said that an unexpected financial or operational crisis (without a company crisis plan in place) would be most devastating. Only 12% thought a hostile takeover bid that the company and the board did not anticipate and were not prepared to address would be the worst situation. A mere 4% chose the situation where stock prices decline for two consecutive years, but the CEO has just been rewarded with a \$10 million bonus.

### Balance of Power

Institutional investors have made their presence known to today's boards. And whether or not you believe—as some analysts do—that shareholder-motivated reforms are a good thing, when asked who most influences their boards, 51% percent of directors responding to our survey said institutional investors—considerably more than those who chose analysts (26%), ISS and rating agencies (15%), the plaintiffs' bar (4%), and activist hedge funds (3%) (*Figure 12*). Perhaps this explains why most directors surveyed (81%) were not at all concerned or only somewhat concerned about the impact of hedge funds on their companies (*Table 3*). Twenty-nine percent were concerned and 46% were somewhat concerned about the impact of hedge funds on the capital markets.

**TABLE 3**  
**How concerned are you about the effect of hedge funds on:**

	Your Company	Capital Markets
Very concerned	5%	14%
Concerned	14%	29%
Somewhat concerned	40%	46%
Not at all concerned	41%	11%

## Executive Sessions

Board independence is an important issue. Most directors surveyed (91%) said they find executive sessions useful, but 22% said they weren't sure their CEO understands the value of such sessions (*Figure 13*). Seven percent said that executive sessions are not valuable to the board, and 1% said that such sessions have strained their board's relationship with the CEO.

## Explaining Tough Ethical Decisions

There is no doubt directors are sometimes forced to make tough ethical decisions—such as the choice between increasing shareholder profits and supporting retired employees. Both groups are constituents to whom the director owes a fiduciary responsibility, and a decision either way will most certainly create fallout on one side or the other. Yet the bottom line tends to outweigh employee concerns in most situations. Several companies have already begun to cut benefits for retired employees, sometimes granting a generous CEO pay package in the same period. Adding weight to this trend, 71% of directors in this year's study predicted that most companies will alter or eliminate pension plans to improve future earnings (*Figure 14*).

## Quality of Earnings

On a positive note, most responding directors (98%) are comfortable with their company's quality of earnings—the degree of conservatism versus aggressiveness in accounting policies, accounting judgments, and accounting estimates (*Figure 15*).

FIGURE 13

**Which of the following best describes the value of your board's executive sessions, made up of independent directors?**

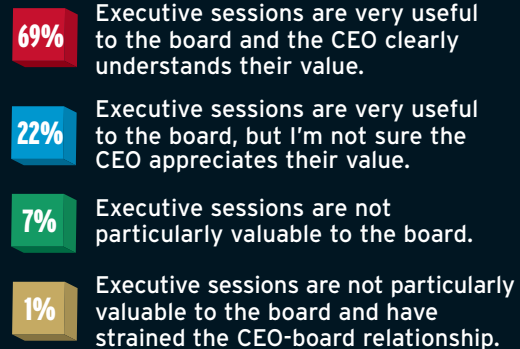


FIGURE 14

**Do you think most companies will eliminate pension plans to improve future earnings?**

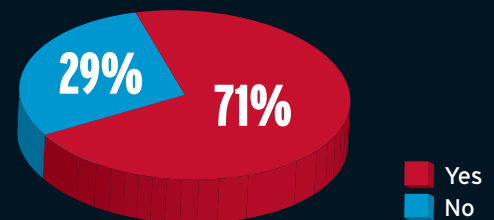
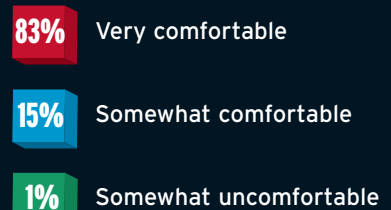


FIGURE 15

**How comfortable are you with your company's quality of earnings? (i.e., the degree of conservatism vs. aggressiveness in the accounting policies and accounting judgments/estimates)**



## Board Meetings

FIGURE 16

### Board business on the Internet?

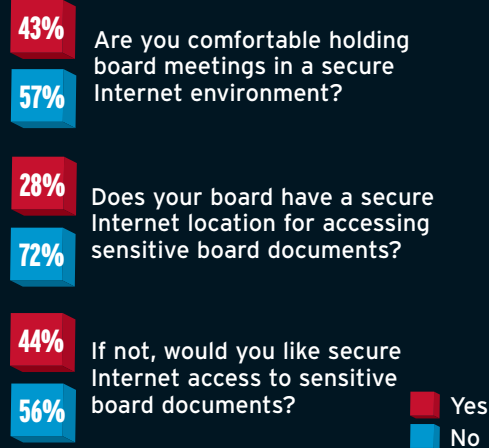


FIGURE 17

### Hours spent on board matters:



Directors are pressed for time. It has been a pervasive theme in the ongoing discussion of director issues—from meeting preparation to the actual length of board meetings—everything takes more time than it did just a few years ago. To get a better sense of this trend, the 2006 What Directors Think study asked directors to quantify their time commitments and give us a snapshot of this year’s corporate board meeting.

### Virtual Meetings?

The vast, interconnected web of the Internet has become a common component of everyday life, receding to the background as most people take for granted the ease in which they correspond, send instant messages, bank, shop, and virtually live online. With all of this comes a sense of the Internet as a safe and secure environment, but directors are skeptical—and rightfully so—especially when data security breaches at financial institutions and government departments regularly make the news.

Even so, support for virtual meetings is growing. According to the survey, directors are split on the issue of holding board meetings in a secure Internet environment. Forty-three percent said they would feel comfortable with a virtual meeting (*Figure 16*)—this is up from 36% in our 2002 study. More than half (57%) responded in the negative. Perhaps this is because boards are not very familiar with secure data environments—only 28% of those surveyed have a secure Internet location where they can access sensitive board materials. Of the 72% who said they do not have a point of secure data access, only 44% said they would like to have access to such a location.

### Time Commitments

Four years ago, board members reported spending an average of 14 hours a month on board issues (*Figure 17*). Last year, that number climbed to 22 hours per month—a difference of 8 hours. This year, the average time commitment eased back to 21 hours per month.

The survey also asked directors how long meetings of their full board typically last. The results were essentially a bell curve, with 3% meeting for two hours or less, 30% meeting from three to four hours, 42% meeting from five to six hours, 16% meeting from seven to eight hours, 3% meeting from nine to 10 hours, and 6% meeting for 10 hours or more (*Figure 18*).

### Committee Service

Serving on a committee is a major time commitment. Of the responding directors, 38% said they serve on governance/nominating committees (17% as chairs), 34% on compensation committees (19% as chairs), and 41% on audit committees (19% as chairs). While most compensation and governance/nominating committees represented in our survey meet about four to five times a year on average, those on the high end of the scale meet anywhere from 15 to 20 times a year. Audit committees meet more frequently than the other committees—eight times a year on average—with some committees meeting up to 35 times a year. Presumably, the outliers were addressing some challenging issues.

In terms of meeting time, governance or nominating committee meetings tend to be the shortest, and audit committee meetings tend to last the longest—three to four hours a session being the most popular response (Table 4). According to our survey, most committees (98%) report their efforts to the board and have the board ratify actions.

**TABLE 4**  
How long do committee meetings last?

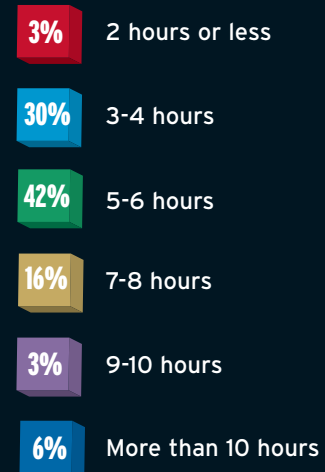
	Audit	Compensation	Governance/ Nominating
2 hours or less	19%	53%	86%
3-4 hours	62%	42%	14%
5-6 hours	16%	3%	0%
All day	2%	1%	0%
More than one day	1%	1%	0%

### International Expansions

Global expansion is a major subject of board meeting conversation. Over half (52%) of the represented boards have discussed the emerging Chinese market as part of their agendas (Figure 19). These results are not surprising given that 26% of responding companies compete with Chinese companies, 28% outsource to China, 12% invest significantly in Chinese companies, and 32% sell to Chinese markets (Figure 20). In the 12 months prior to the survey, 11% of responding directors traveled to Hong Kong, 19% to Shanghai or Beijing, and 11% to other cities in China. Additionally, survey results show boards are discussing other emerging international markets like those in India (35%) and Brazil (21%).

**FIGURE 18**

### Typically, how long are your full board meetings?



**FIGURE 19**

### Which of the following emerging markets have you discussed as part of your board meeting agenda?



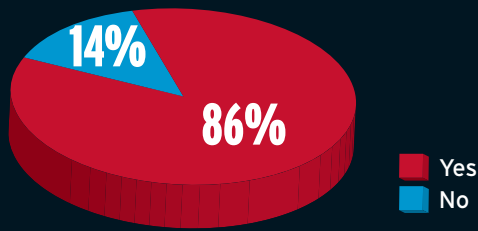
**FIGURE 20**

### Business with China

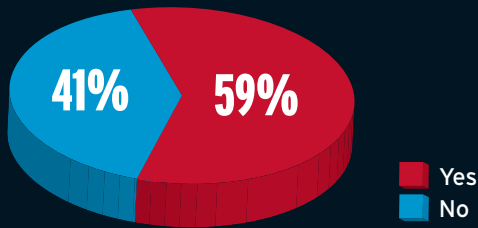


## Performance and Evaluations

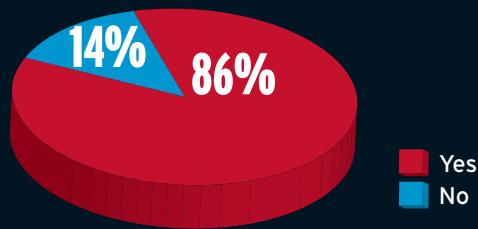
**FIGURE 21**  
Is the entire board's performance formally evaluated on a regular basis?



**FIGURE 22**  
Was there any action taken or implementation plan created as a result of the board evaluation?



**FIGURE 23**  
Does the board perform a thorough annual review of the CEO's performance?



A periodic review of CEO and board effectiveness is an excellent way for a board to take stock of its progress toward important goals and targets. Whether the evaluation is an internal process or is run by an outside facilitator, taking a good, long look in the mirror is an important way for a board to see how well its members work together, relate to major stakeholders, deliberate on important decisions, arm themselves with information, fulfill various responsibilities under the law, and lay the foundation for the company's continued success.

### Self-Evaluation

The most telling image is the one the board paints of itself. This year's What Directors Think study gave directors a checklist and asked them to rate their boards' effectiveness on several important dimensions (Table 5).

**TABLE 5**  
How do directors rate their boards' effectiveness on the following measures?

	Very Effective	Effective	Neutral	Ineffective
Board's ability to stand up and challenge management when appropriate	50%	38%	11%	1%
Audit committee's ability to monitor financial reporting	53%	42%	5%	0%
Compensation committee's ability to properly oversee CEO compensation	37%	46%	15%	2%
Board's ability to monitor a risk management plan to mitigate corporate exposures	12%	47%	37%	4%
Board's ability to establish its own leadership	27%	47%	21%	5%
Board's ability to create an agenda that best uses the board's limited time	18%	51%	27%	4%
Board's ability to adopt a meaningful ethics policy	47%	42%	10%	1%

### Boards Make Use of Evaluations

Most participating boards (86%) conduct a formal performance evaluation of the entire board on a regular basis (Figure 21). Internal general counsel facilitates the evaluation process for over half (58%) of represented boards. Other represented boards use an internal officer (14%), an outside attorney (15%), or a third-party adviser (14%) to facilitate the evaluation process. But how useful is an in-depth review of the board and management? Nearly 60% of participating boards report taking action or creating an implementation program as a result of these evaluations (Figure 22).

## Sizing Up the CEO

CEO compensation has been one of this year's hot buttons, but 14% of participating boards do not conduct thorough annual reviews of CEO performance (a comparable number to last year's 15%) (Figure 23), and 22% of directors reported that their boards are only somewhat effective or are poor in their execution of the development and delivery of the CEO's performance review. The flip side of these numbers shows that a vast majority (86%) of represented boards perform CEO reviews, and 78% believe they effectively administer the process through development and delivery.

Boards differ on whose job it is to discuss the CEO's performance review with him or her. Responding directors indicated that the chair of the compensation committee is the most likely person (47%) to talk to the CEO about his or her performance evaluation, followed by the lead director (38%), the board chair (21%), the entire board (14%), and the chair of the nominating committee (6%) (Figure 24). CEO evaluation is considered a best practice and should be a priority on every board.

## Board Education

Whether it is in the boardroom or a lecture hall, board education is a great way for directors to further their professional development and find out what issues other boards are facing that they, too, might soon face. The majority of respondents (83%) said they believe board members should attend director education seminars (Figure 25). When asked whether it was more beneficial to attend director training outside the boardroom, where there is an opportunity to meet other directors, or to bring board education into the boardroom to deal with sensitive issues, a majority of the directors surveyed (52%) preferred a combination of the two types of training (Figure 26). Only 9% said director education is not necessary.

## Director Term Limits

Overall, the directors surveyed are satisfied with their fellow board members; however, 25% said there is someone on their board who should be replaced. Over half (59%) of the represented boards have discussed director term limits yet there is no groundswell of support for implementing them. Nearly three-quarters of all participating directors (70%) said they were not in favor of implementing term limits.

FIGURE 24

### Who discusses the CEO's performance evaluation with the CEO?

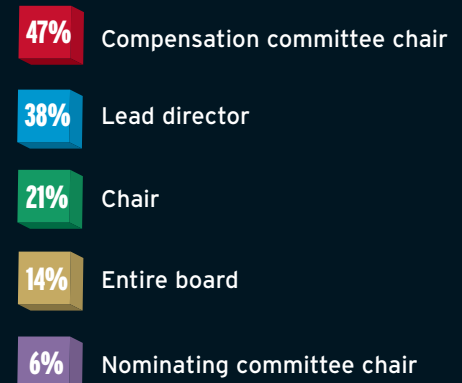


FIGURE 25

### Do you believe board members should attend director education seminars?

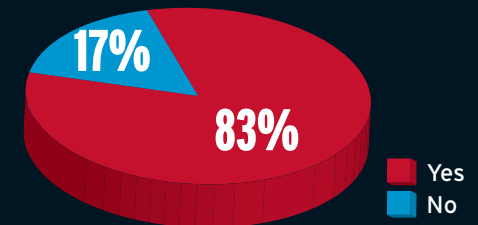
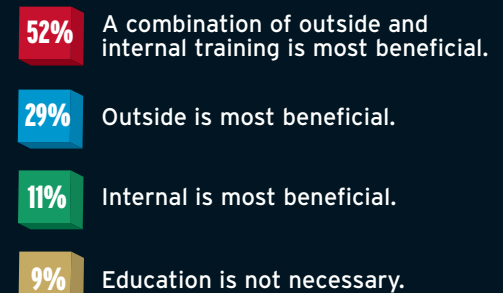


FIGURE 26

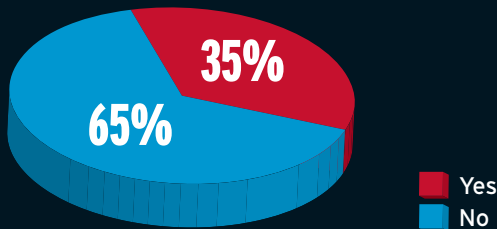
### Is it more beneficial to attend director training outside the boardroom where you can meet other directors, or to bring board education into the boardroom to deal with sensitive issues?



## Risk and Liability

**FIGURE 27**

**Are you knowledgeable and up-to-date on the Department of Justice sentencing guidelines?**



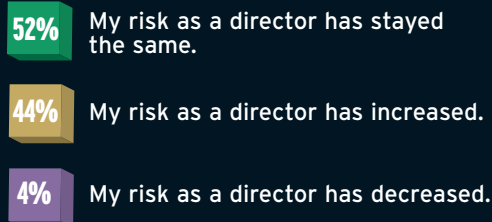
**FIGURE 28**

**Have you received the following types of information in the last two years?**



**FIGURE 29**

**In the last 12 months, how has your risk as a director changed?**



Even directors with the highest ethical standards can feel as if they are walking a tightrope, with an active plaintiffs’ bar and federal prosecutors watching their every move. Extensive personal and financial hardship hits any person who is the target of legal action, regardless of whether he or she is ultimately exonerated. Admittedly, the cases that have made news in the past several years have involved accusations of extreme director misbehavior. And although only 35% of responding directors are current on the Department of Justice sentencing guidelines (Figure 27), the constant media coverage has forced directors (even those with the most pristine of consciences) to look at their televisions and newspapers and ask themselves, and their legal advisers, “Could that be me?”

### Identifying Risky Situations

Directors need to know when it’s time to step up their involvement on the board. In the 2006 What Directors Think study, we asked directors to rate several potential red flags (Table 6). The list reads like a corporate nightmare, and there was no item that directors considered negligible. Yet, our survey shows that many boards are left hanging without enough information to identify potential problems before they become urgent situations. Fifty-seven percent of the boards represented in this year’s survey have not received general or specific customer satisfaction research in the past two years (Figure 28). Fifty-two percent have not reviewed information on employee values or satisfaction. And 17% have not considered peer group financial business data. The survey results show a positive correlation between company revenue size and the percentage of directors reporting receipt of these three types of information—meaning that companies on the lower end of the revenue scale are less likely to provide directors with these important measures of corporate well-being.

**TABLE 6**

**How important is each of the following red flags in signaling a director to step up his or her board involvement?** (responses listed in order of importance)

Company must restate earnings
Adverse Section 404 opinion
Management misses strategic performance goals
Research shows poor customer satisfaction track record
Research reflects poor employee morale
Company target of employee lawsuits
Stock price is declining
Low ISS governance quotient rating
Quarterly financial results miss analysts’ whisper numbers

## Directors Estimate Risk

We asked respondents whether they perceived a change in their risk as directors. Only 4% of directors reported that they believed their risk had decreased in the past 12 months, while 52% said they thought their risk had stayed the same (*Figure 29*). Forty-four percent perceived a greater risk over the past 12 months. There is no one event to account for these numbers—early 2006, when the survey was conducted, lacked the type of high-profile, headline-grabbing, director liability cases seen a year earlier—but the topic has continued to receive a lot of attention and has remained at the forefront of people’s minds.

## D&O Insurance

D&O insurance is a safety net for good directors who exercise diligence but must worry about unexpected exposure to risk. And while most directors surveyed don’t believe their risk changed in the past year, 81% have reviewed their D&O policy and coverage in the past 12 months, and another 14% have reviewed their policy in the past two years (*Figure 30*). Most directors said they are satisfied with their understanding of their liability coverage—45% said they are completely satisfied and 50% said they are somewhat satisfied (*Figure 31*).

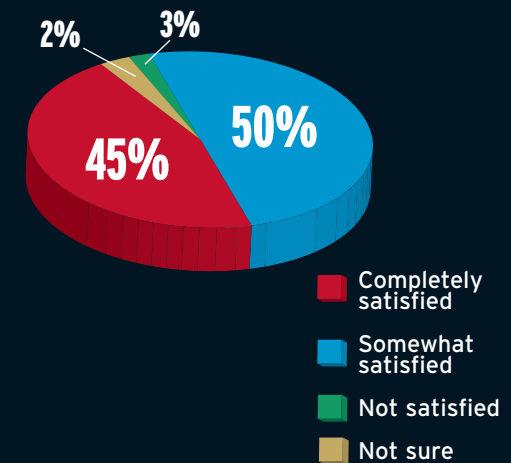
**FIGURE 30**

**When was the last time you reviewed your D&O insurance policy and coverage?**



**FIGURE 31**

**How satisfied are you with your understanding of your liability coverage at your company?**





# 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 companies listed with the NASDAQ Stock Market, New York Stock Exchange, and American Stock Exchange.

## Number of Directors Per Board

At the end of 2006, directors on U.S. corporate boards totaled 49,783 from 5,825 publicly traded companies. This represents an average of 8.6 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	365	4,575	12.5
1B-10B	1,228	12,229	10.0
500M-1B	608	5,277	8.7
100M-500M	1,430	11,490	8.0
50M-100M	621	4,744	7.6
10M-50M	940	7,012	7.5
<10M	633	4,456	7.0
Entire Database	5,825	49,783	8.6

## Number of Directorships Held

The highest number of directorships held by one individual is nine. The vast majority of directors, 33,110, hold only one board seat. The table below shows the distribution of the number of directorships held by U.S. corporate directors.

No. of Directorships	Directors
9	2
8	2
7	6
6	46
5	153
4	468
3	1,406
2	4,734
1	33,110

## Inside Versus Outside Directors\*

U.S. corporate boards had 9,238 inside directors representing an average of 1.59 inside directors per company, and 40,545 outside directors, representing an average of 6.96 outside directors per company.

(\$) Revenue Size	Co's.	Inside	Avg. Inside	Outside	Avg. Outside
>10B	365	958	2.6	3,617	9.9
1B-10B	1,228	2,057	1.7	10,172	8.3
500M-1B	608	862	1.4	4,415	7.3
100M-500M	1,430	2,102	1.5	9,388	6.6
50M-100M	621	941	1.5	3,802	6.1
10M-50M	940	1,382	1.5	5,630	6.0
<10M	633	936	1.5	3,521	5.6
Entire Database	5,825	9,238	1.59	40,545	6.96

## Inside Versus Outside Chairs\*\*

Out of a total of 5,460 chairs on U.S. corporate boards, 2,748 (50.3%) are inside chairs and 2,712 (49.7%) are outside chairs. These ratios hold steady among revenue size categories, as shown below.

(\$) Revenue Size	Inside Chair	%	Outside Chair	%
>10B	196	54.6%	163	45.4%
1B-10B	655	54.6%	545	45.4%
500M-1B	308	52.8%	275	47.2%
100M-500M	671	49.5%	685	50.5%
50M-100M	281	49.7%	284	50.3%
10M-50M	384	45.1%	468	54.9%
<10M	253	46.4%	292	53.6%
Entire Database**	2,748	50.3%	2,712	49.7%

## Gender of Directors

There are 4,043 seats on U.S. boards occupied by women, averaging 0.7 per company. Larger company boards have a significantly higher representation of women compared with smaller companies.

(\$) Revenue Size	Companies	Female Directors	Average per Co.
>10B	365	591	1.6
1B-10B	1,228	1,318	1.1
500M-1B	608	437	0.7
100M-500M	1,430	746	0.5
50M-100M	621	281	0.5
10M-50M	940	433	0.5
<10M	633	237	0.4
Entire Database	5,825	4,043	0.7

\*Retired directors are considered outside.

\*\* At the time of this report, 365 companies did not report a chair.

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