

Current issues for boards of directors



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A new NYSE rule restricts how brokers can vote uninstructed customer shares, which could have implications for shareholder vote results.

What CEOs are thinking about

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The role a director plays in M&A

Directors should work with management in assessing whether a deal brings value to the company and shareholders.

New limits on broker voting

On January 25, the New York Stock Exchange (NYSE) announced a change that further restricts how brokers can vote uninstructed customer shares. It means brokers may no longer use their discretion to vote uninstructed customer shares on governance proposals that are supported by management—matters that had formerly been considered “routine” by the NYSE. Going forward, brokers are now required to have specific client instructions.

The change is effective immediately.

The NYSE said the change is due to recent congressional and public policy trends critical of discretionary broker voting of uninstructed shares. In 2009, the NYSE amended Rule 452 to prohibit broker discretionary voting in uncontested director elections, and the Dodd-Frank Act prohibited brokers from uninstructed voting on executive compensation issues. The new policy applies to all NYSE member brokers, not just NYSE-listed companies.

Rule 452 governs when brokers may vote customer shares without instructions. Historically, brokers were allowed to use their discretion to cast votes on routine matters on behalf of shareholders who did not return their proxy cards within 10 days before the shareholder meeting. Company-supported governance proposals were considered routine, and brokers most often voted with company management.

Some examples of governance proposals that are no longer considered routine:

- declassifying a company’s board of directors
- majority voting on the election of directors
- eliminating supermajority voting provisions in a company’s governing documents
- providing for the use of written consent (in lieu of a meeting)
- providing the right to call a special meeting
- certain types of anti-takeover provision overrides

Brokers may continue to vote uninstructed customer shares to ratify auditors. Companies will be able to use these votes to establish a quorum for shareholder meetings.

What this means

This policy change could help activist investors more easily advance their own proposals, and it could increase the influence of proxy advisory firms’ recommendations against company-backed governance proposals, as broker votes usually support management.

What's on CEOs' minds?

“You need to have the best people organized and motivated the right way if you're going to be successful,”

David Cote, Chairman and CEO, Honeywell

US CEOs are cautiously focused on growth this year, but they are less confident than they were a year ago, according to PwC's *15th Annual Global CEO Survey*. With more than 160 US CEOs participating in the survey, their responses offer a broad perspective of how they are planning for the future.

Finding new business opportunities

Global economic volatility, the European sovereign debt crisis, natural disasters, and political unrest shook US CEO confidence last year. More than half of US CEOs (56%) said their businesses were financially impacted by the sovereign debt crisis in Europe. Forty percent cited an impact from the earthquake and tsunami in Japan, and 22% cited the political upheaval in the Middle East.

Depressed growth and rising fiscal debts and deficits in many developed nations continue to cause concern. But many CEOs are adjusting to the prospect of a slower US recovery by adapting their business strategies to take advantage of new opportunities arising in new markets—39% of US CEOs plan to complete a cross-border deal in 2012, up from 25% last year.

Many business leaders are also looking beyond the US and Europe for potential expansion. China is now considered the most important country for business growth prospects, and Brazil and India rank ahead of Western Europe's major economies as important markets for growth. About 75% of US businesses with operations in emerging markets expect businesses in those regions to expand, compared to only 42% of those with operations in Western Europe.

US companies still don't have a huge presence in emerging markets, with only one-third having significant operations in Asia or Latin America.

Fewer still have key operations in Africa or the Middle East, yet companies with key operations outside North America and Europe are the most optimistic about growth.

One potential hurdle for growth is finding talent, despite high unemployment around the globe. While 60% of US CEOs plan to hire this year, many expect to have difficulty recruiting and retaining the right mix of employees. Talent constraints are costing companies lost market and innovation opportunities. As a result, 84% of CEOs are making investments to try to improve the recruitment and retention of good employees.

Customer demand is changing

More than three-quarters of US CEOs (77%) are revising their business strategies in response to changing customer demand, up from 63% a year ago.

Beyond the US, CEOs recognize that customers in individual markets have specific needs, and they are focused on tailoring their products and services accordingly. For example, 40% of US CEOs with operations in India are modifying their products and services to accommodate these consumers, while 32% are developing products and services specifically for the local market.

There is also a major shift in global consumption, as the middle class expands exponentially in Asia and other parts of the world. In fact, Asia's share of global middle-class spending is expected to increase to nearly 60% by 2030 from 23% today, according to the Organisation for Economic Co-operation and Development.

M&A: The director's role

Mergers, acquisitions, and divestitures are often elements of a company's strategic business plan. These transactions can create increased value and efficiency, as well as increased risk.

Recent stock market gains on the heels of the financial crisis are creating a more favorable environment for M&A activity. Some companies hold a significant amount of cash, which could be used for an acquisition, while others have underperforming businesses that weigh on the financial statements. The apparent stock market recovery offers a signal to directors to pause and consider possible acquisition targets or exit strategies for poorly performing operations.

Directors play important oversight roles in transformational transactions, but the economic turbulence of the past few years has put their fiduciary duties in the spotlight. Directors should understand their duties—of care, loyalty, and good faith to the corporation and its shareholders—and challenge management to rationalize why the company wants to pursue a particular transaction:

- does it fit into the company's long-term business strategy or is it a reactive move to a sudden opportunity?
- when all of the negotiations are completed, will it still fulfill the company's objectives long-term?

The board and management should work together in the M&A process, whether the company is pursuing an acquisition or the sale of a business. Directors should challenge management's assumptions throughout the process and deliberate carefully about a potential transaction to determine whether it would bring value to the company and shareholders. Directors should also understand any regulatory approval process, and they should make sure the advisors to the transaction are truly objective.

Evaluating underperforming businesses

Despite the stock market nearing highs not seen since October 2007, some companies may still be feeling the weight of the crisis, with subsidiaries or businesses that are still underperforming.

An outright sale of a poorly performing operation is not the only option for a company. Other options may include initiating turnaround plans, specific asset sales, or out of court wind-downs including negotiated settlements with creditors.

Some boards create a special committee to work closely with management to further evaluate underperforming operations and better understand the financial and legal implications of potential exit strategies. The company's legal advisor and accounting firm may be able to provide the board with useful insights given their knowledge of the business.

Overseeing mergers and acquisitions

For companies looking to make an acquisition, the board and management should follow a "rules of engagement" framework to determine whether a deal makes sense. Management should outline the objectives for the transaction and any non-negotiable deal drivers.

The board should ask questions about the potential value of the deal and its price, and consider any significant inherent risks and management's track record for completing successful deals without overpaying.

In evaluating distressed M&A transactions, directors should also consider the execution risk, financing requirements, and time required to complete the transaction. After evaluating these factors, the board may decide to choose a different strategy that has a greater likelihood of success.

(For more on the board and transformational transactions, see PwC's *Board Effectiveness – What Works Best.*)

New limits on broker voting

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The change could potentially make it more difficult for companies to get shareholder approval of certain corporate governance proposals. For proposals that require a majority of outstanding votes for approval, the resulting broker non-votes will have the same effect as votes against the proposals.

It could also increase costs associated with getting shareholder approval for such proposals and could impact unspecified proposals, beyond the examples listed in the NYSE's memo.

What directors should do

Directors should consider and discuss with management:

- whether any company-backed governance proposals will be on the proxy, and if so, whether they will be subject to the new broker voting rules
- how to better engage with shareholders to get their support on such proposals, and whether to use a proxy solicitation firm to garner support
- how to communicate the implications of these changes to the company's retail shareholders, emphasizing the importance of returning their proxies
- whether the company uses or should consider using a stock monitoring service to stay abreast of the identity of its shareholder base

How PwC can help

To have a deeper discussion of how these subjects might affect your company or board, please contact:

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BoardroomDirect

Our Winter 2012 edition recaps shareholder proxy access, looks at other hot button issues for the proxy season, and discusses the risks and opportunities with social media and cloud computing.

Continuing the conversation: Directors speak

More than 100 directors met and shared their concerns on topics like the SEC whistleblower bounty program, CEO succession, executive compensation, and IT strategy and risk. This report highlights the themes of these discussions.

10Minutes on the boardroom agenda

New governance regulations, risks associated with emerging technologies and fraud, and the effects of the economic downturn have corporate directors focusing on ways to increase their effectiveness in the boardroom. Executive compensation, risk management, and succession planning are three areas of focus for directors.

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